

ASIA HOT TOPICS

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BOJ PREVIEW: PREMATURE FOR A POLICY “REVERSAL”

Summary

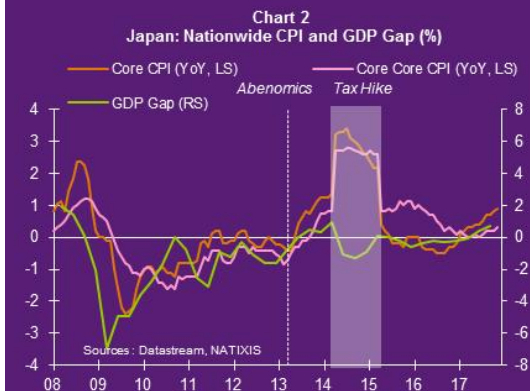
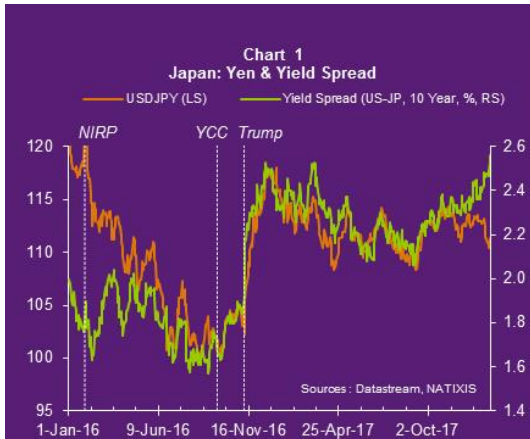
The BoJ is expected to remain on hold at the January meeting. The FX market has priced in a higher target rate on the 10 year JGB yield on the back of Governor Kuroda’s comments on the “reversal rate” and the recent reduction of the JGB purchase. However, it is still premature for the Bank to normalize, as inflation has been well below its 2% target. Therefore, the BoJ is expected to keep the status quo, by arguing that an accommodative monetary policy would support economic growth, which would in turn raise wages and inflation.


Although the yield spread between the Treasury and JGB markets widened, the Yen has surprisingly appreciated to USDJPY=110.8 (Chart 1). Following Governor Kuroda’s comments on the “reversal rate” in November, where a low interest rate could hurt the economy, the Bank of Japan (BoJ) recently reduced the amount of JGB purchase. With these developments, the market has priced in a normalization by the BoJ, which resulted into a stronger Yen.

However, it is still premature for the BoJ to suggest a normalization. Inflation pressure remains weak with the core CPI in November at +0.9%, below the 2% target (Chart 2). Furthermore, the core core CPI, which excludes both fresh food and energy prices from the overall level, was limited at +0.3% YoY in November. Any hint to normalize could strengthen the Yen further, increasing challenges of the BoJ to meet the inflation target.

Therefore, the BoJ is anticipated to keep the monetary policy on hold at the January meeting. The Bank is expected to argue that an accommodative monetary policy will support economic growth, which could in turn raise the core core CPI through higher wages. Once the Fed raises the policy rate further, the Yen is likely to depreciate again. At the same time, should the Yen depreciates rapidly on the back of a monetary policy differential, the BoJ is expected to reinterpret the 0% on the 10 year JGB yield as a floor rather than a target*.

*BoJ’s way out of the current impasse: use a 0% floor -rather than a target - for JGB yields



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