

“BOJ's communication strategy of policy normalization”

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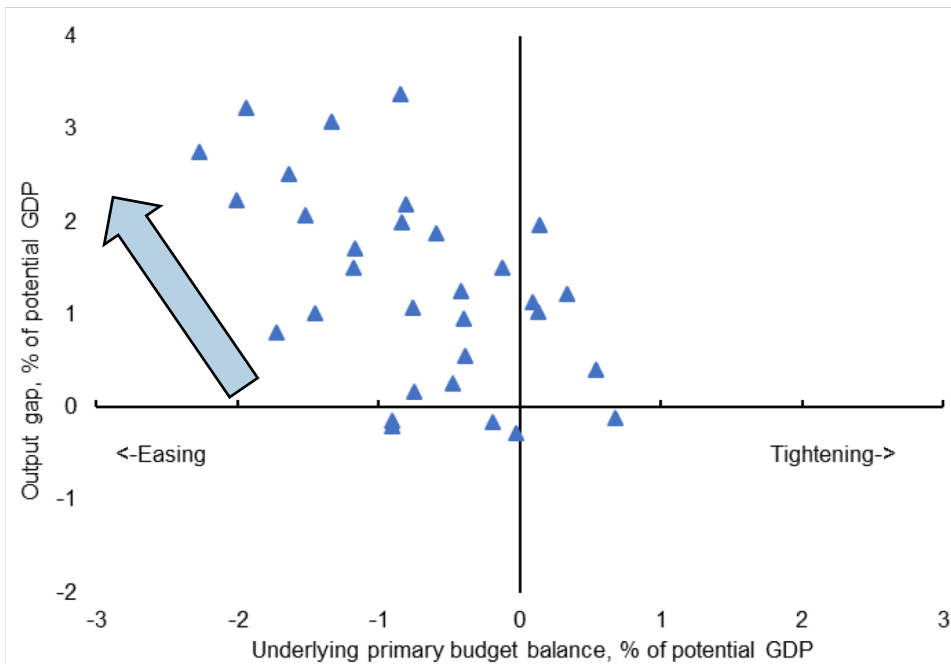


Executive Summary

1. BOJ's easing monetary policy is excessive. Its side effects started outweighing benefits in 2014. The inflation goal of 2% is inappropriate and unachievable.
2. Volatility of JGB market could be intensified eventually, if BOJ continues to purchase JGB. It could even undermine stability of global financial market.
3. To mitigate the side effects, BOJ has promoted de facto normalization policy or "stealth tapering" since 2016. The measure making YCC more flexible introduced in July 2018 was regarded as de facto normalization policy 2.0. Shortening average maturity of JGB could be the policy 3.0. Those policies are initiated by staffs of BOJ rather than the Governor.
4. The sharp yen appreciation and deterioration of economy could delay or suspend BOJ's normalization policies.

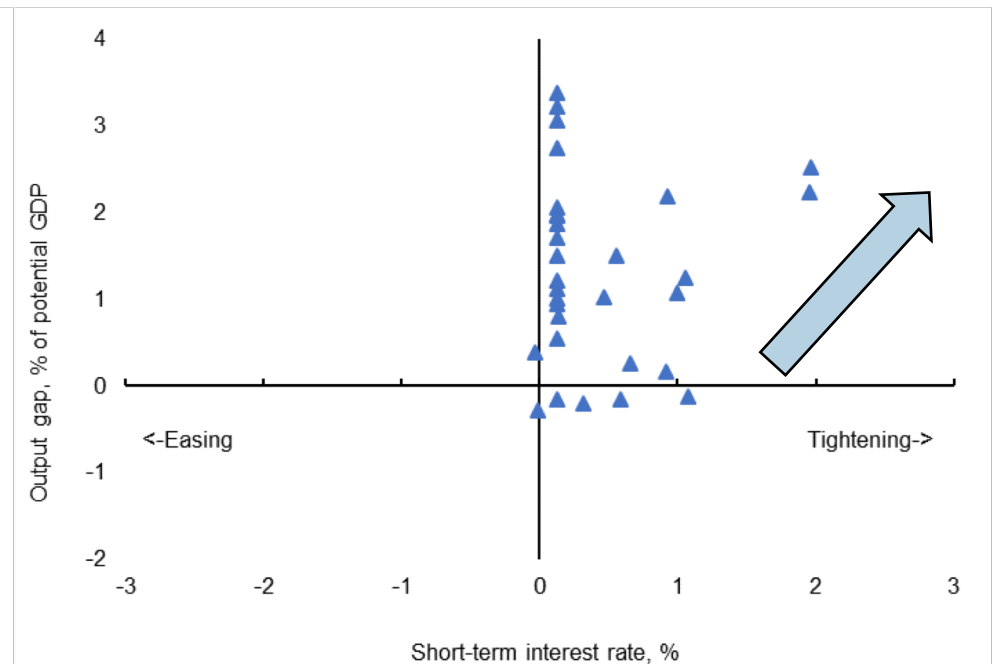
Normalization of monetary policies are accelerated by expansionary fiscal policies in the world

Forecast changes in OECD countries' fiscal policy (2017 vs 2019)



Note; Estimations by OECD
Source; Nomura, based on OECD, General Assessment of
The Macroeconomic Situation, 2018

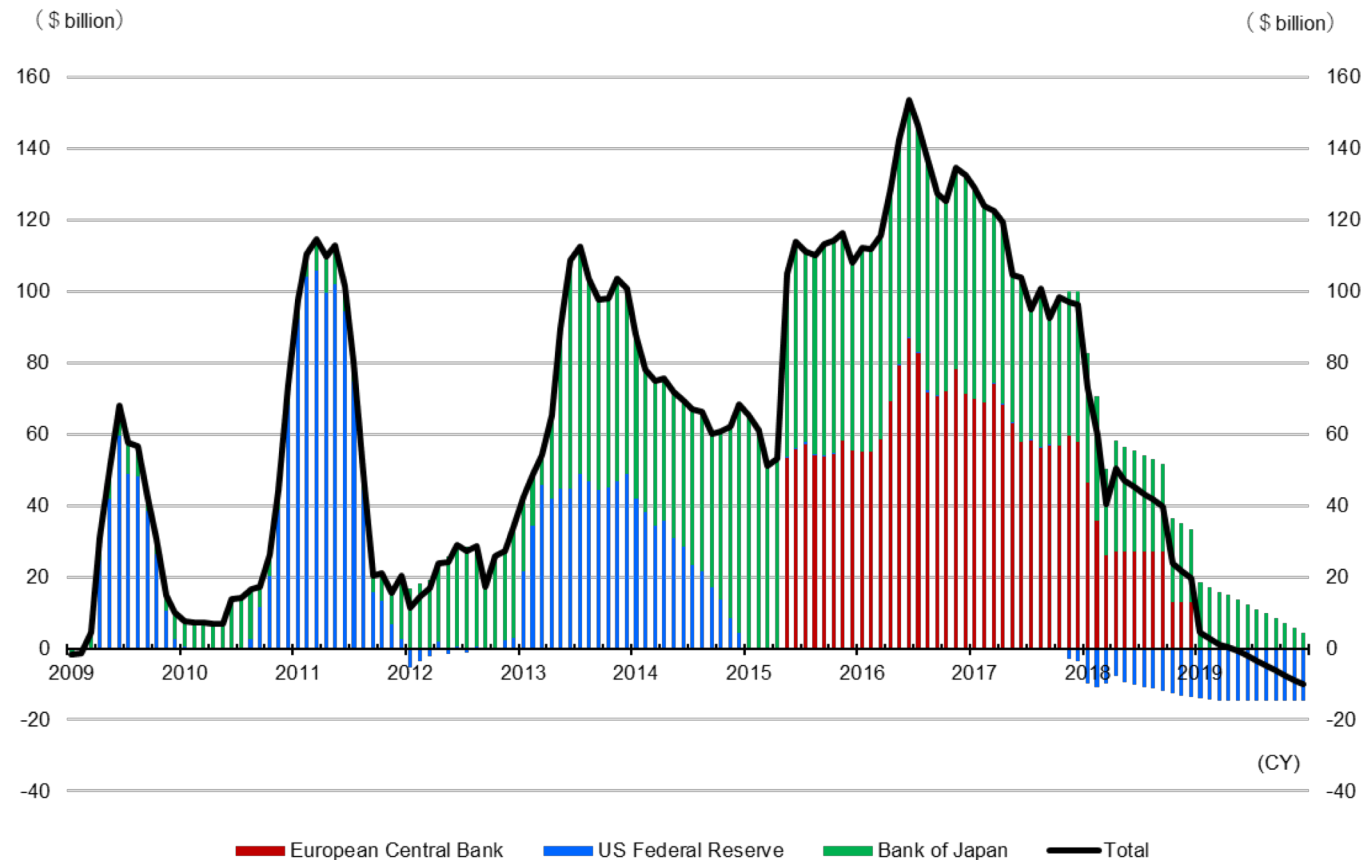
Forecast changes in OECD countries' policy interest rates (2017 vs 2019)



Note; Estimations by OECD
Source; Nomura, based on OECD, General Assessment of
The Macroeconomic Situation, 2018

Is only Japan significantly lagging in monetary normalization policy?

Government bond purchases (flow) by the world's three main central banks

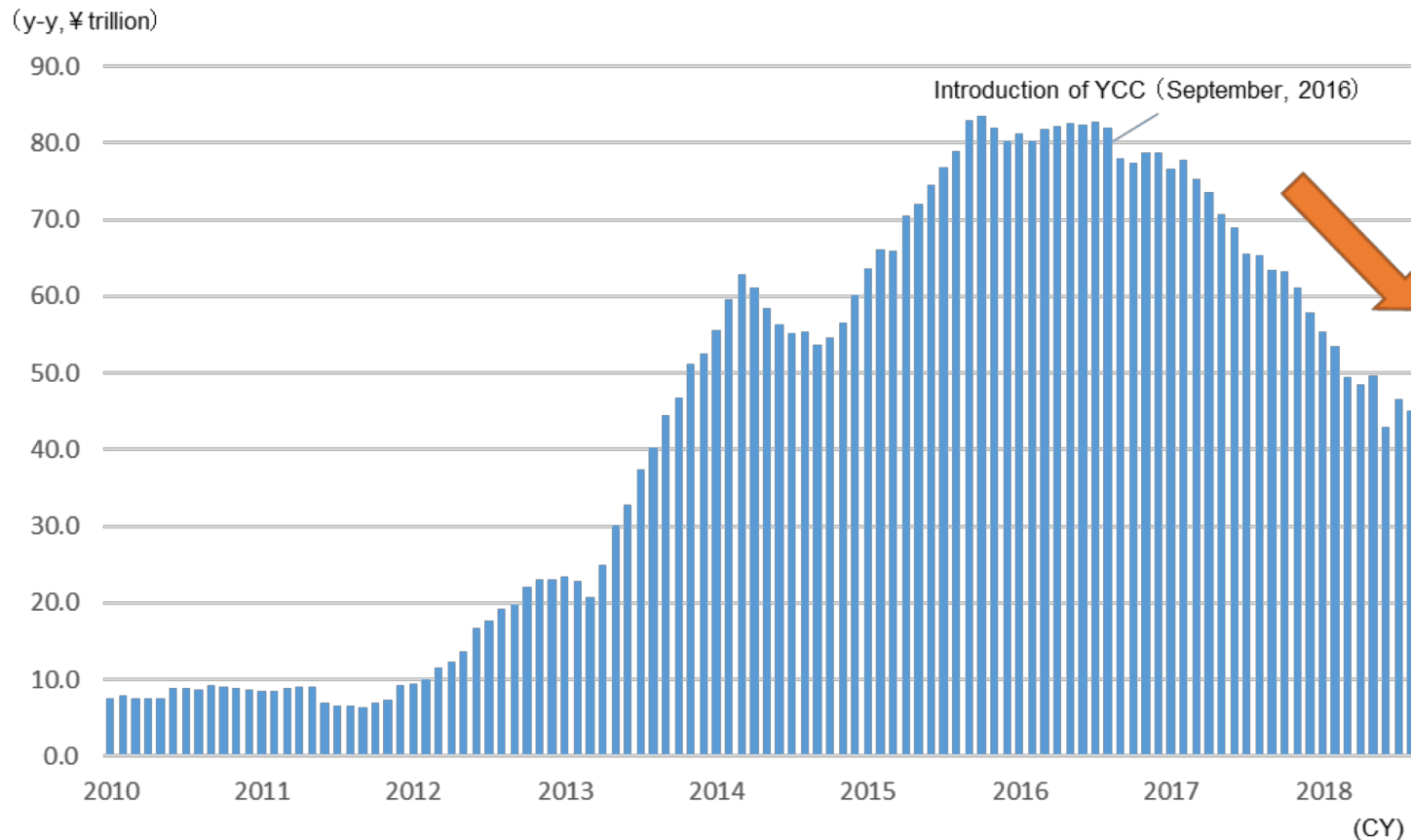


Note; The numbers after May, 2018 are forecasted by Nomura

Source; Nomura, based on OECD, General Assessment of The Macroeconomic Situation, 2018

De facto normalization policy, or “stealth tapering” is in progress

Change in BOJ's holdings of long-term JGBs



Source: Nomura based on BOJ statistics

“De facto normalization” vs “Official normalization”

Double standard of BOJ's monetary policy and communication

“De facto normalization policy”

the monetary policy which is not explicitly announced as normalization policy by BOJ but actually works as normalization policy...

e.g. reduction in purchase of JGB, making YCC flexible

“Official normalization policy”

the monetary policy which is officially announced as normalization policy by BOJ ...

e.g. increase in short- and long-term policy target rates, reduction in purchase of ETFs

Yen in real base undervalued by more than 20%

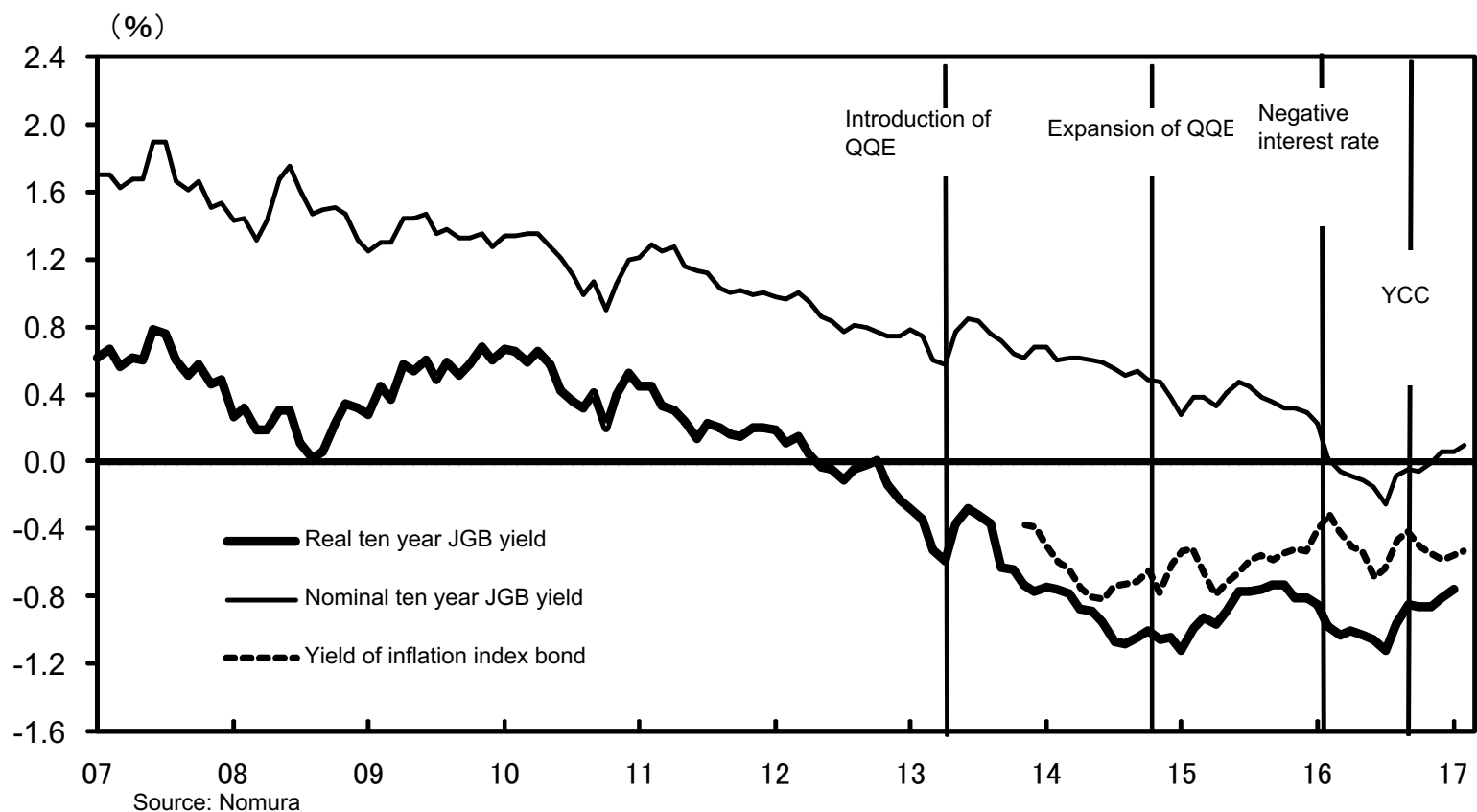
Real effective Yen value



Source: Nomura based on BOJ statistics

Introduction of the negative interest rate policy became the turning point of the BOJ's monetary policy

Monetary policy changes and real long-term yield



De facto normalization policy 2.0 -“stealth rate hike”

“Strengthening the Framework for Continuous Powerful Monetary Easing” (July 31, 2018)

① Expansion of fluctuation range in 10-year yield ($0\% \pm 0.1\% \rightarrow 0\% \pm 0.2\%$)

➡ improving profit condition of banks by steeper yield curve

② Forward guidance for policy rates

(The Bank intends to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time, taking into account uncertainties regarding economic activity and prices including the effects of the consumption tax hike scheduled to take place in October 2019.*

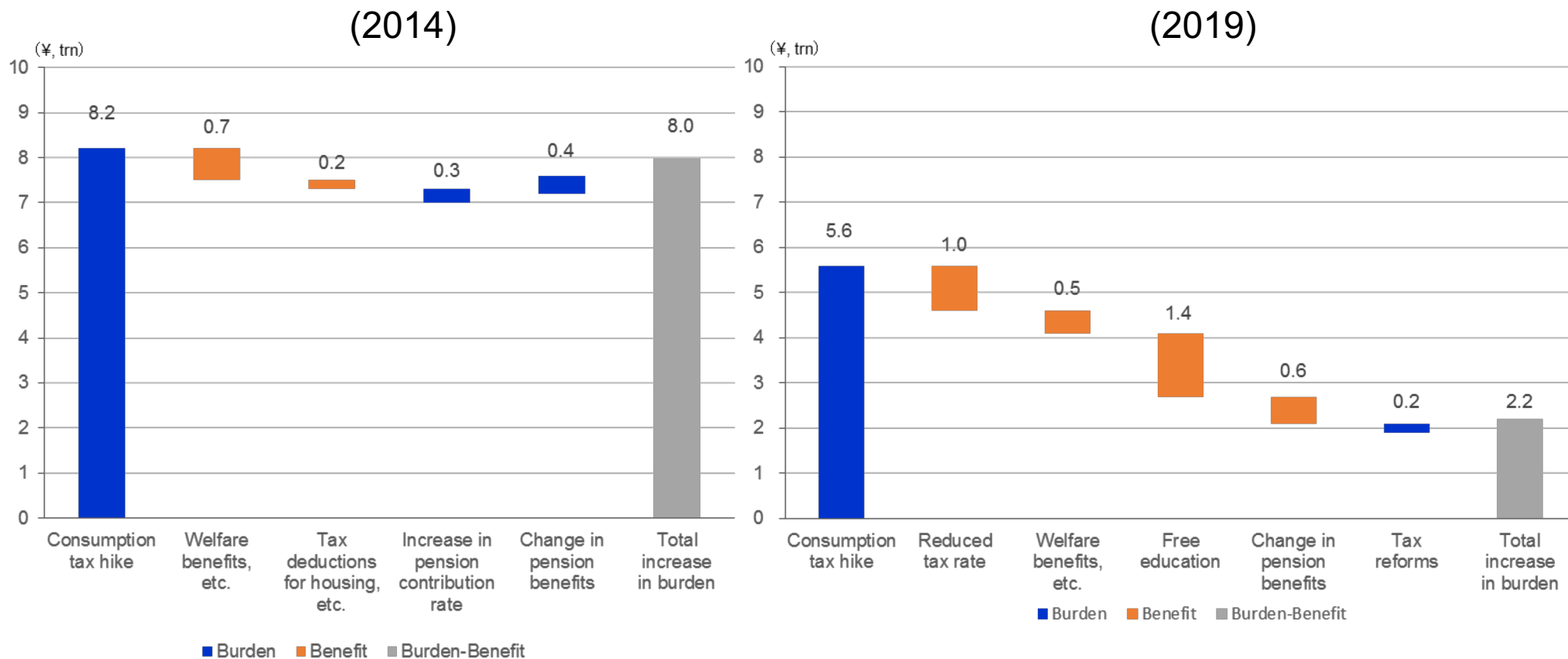
* “*for the time being*” in Japanese statement

➡ message to the government not to hike policy rates before the consumption tax hike

③ Flexible purchase in amount of ETFs and J-RIETs

Economic effect of tax hike scheduled in 2019 is not large

Estimated income burden for Household by tax hikes

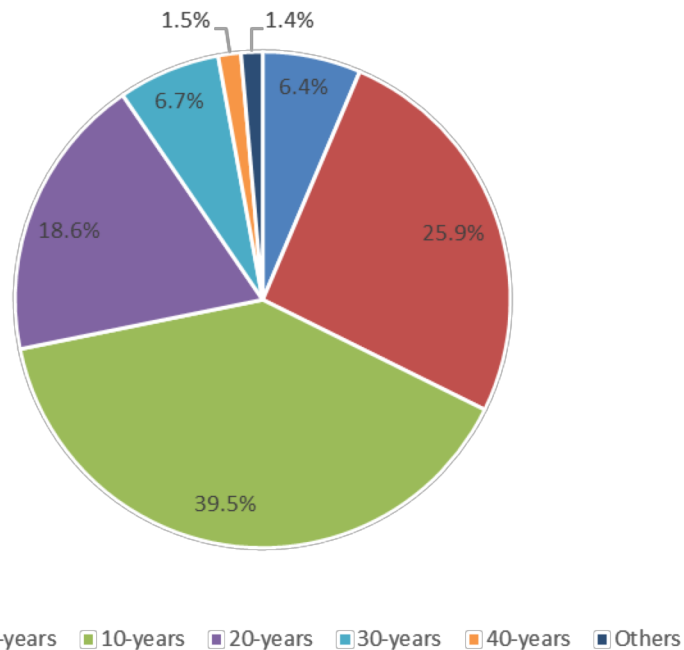


Source: Nomura based on BOJ statistics

Source: Nomura based on BOJ statistics

Is shortening average maturity of BOJ's holding JGBs “De facto normalization policy 3.0” ?

The structure of BOJ's holding JGBs by maturity



Note; As of August 20th, 2018

Source; Nomura, based on the BOJ's data

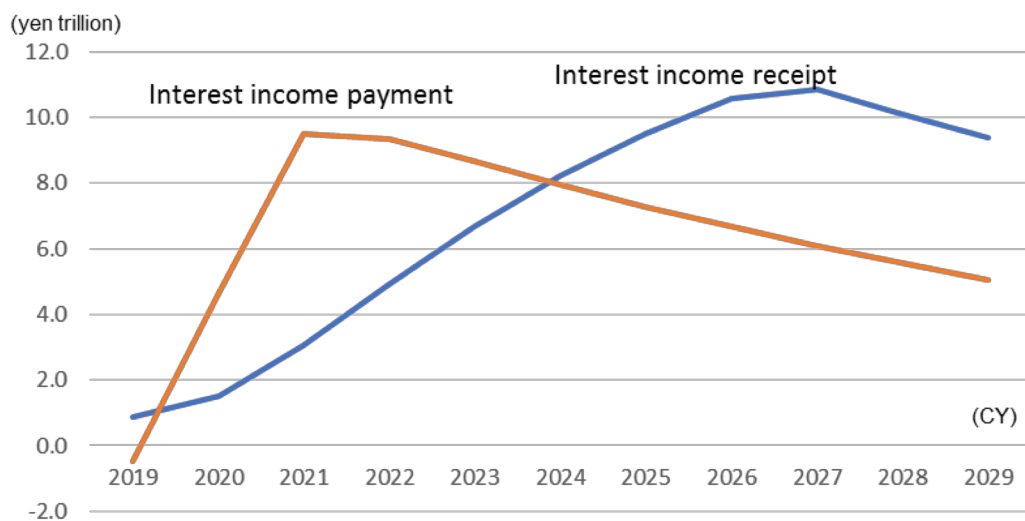
The average maturity of BOJ's holding JGBs has remained the same level as at around 7.5 years over the two years.

Shortening average maturity of BOJ's holding JGBs may help mitigating side effects of excessive easing monetary policy in three ways.

1. improving profits of banks by steeper yield curve
2. accelerating the pace in reduction of BOJ's holding JGBs in the future
3. reducing the risk of BOJ's balance sheet in case of IOER hike in the future

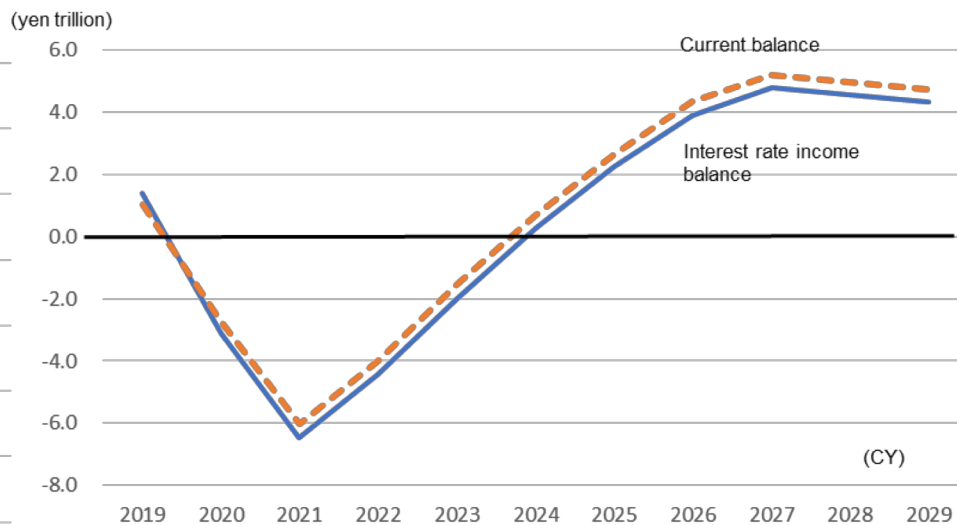
Risk of deficit and negative equity of BOJ at the exit

Simulation of BOJ's interest income at the exit



Source: Nomura

Simulation of BOJ's current balance at the exit



Source: Nomura

Abandoned 2% inflation goal ?

Price forecasts in July Outlook for Economic Activity and Prices Report of each year

	The current FY	The next FY	2 FYs ahead
July-13	0.6	1.3	1.9
July-14	1.3	1.9	2.1
July-15	0.6	1.3	1.9
July-16	0.1	1.7	1.9
July-17	1.1	1.5	1.8
July-18	1.2	1.5	1.6

Note; the medians of the Policy Board members' forecasts of CPI (all items less fresh food) excluding the effects of the consumption tax hike
Source; Nomura, based on the BOJ

NRI

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Dream up the future.