MARKET COMMENTARY

The BoJ defended its monetary policy stance

Authors: Christoph Siepmann, Florian Späte

January 18, 2023

- **This morning, the Bank of Japan defied large speculative market pressure by keeping its Yield-Curve-Control (YCC) policy unchanged, as expected. On top, it enlarged its tools slightly by adding variable-rate loans to financial institutions of up to 10 years duration on top of fixed-rate operations.**
- **Markets responded strongly as 10y Japan Government Bond (JGB) yields temporarily dropped back to a low of 0.36% while the yen depreciated against the US-dollar and Japanese stocks improved. By the time of writing, 10y JGB yields have risen to about 0.43%, and the yen re-appreciated.**
- **Looking ahead, the BoJ's resolve will likely calm markets for a while and refocus them more on fundamentals. However, expectations will shift to Kuroda's successor to be presented to the Japanese Parliament on February 10. We expect the new Governor to successively give up the YCC policy. Market turbulences could resurface ahead of his/her first monetary policy meeting on April 27/28.**

After the BoJ surprisingly expanded the trading range for 10y JGBs to +/- 50 bps in mid-December, markets speculated that the BoJ could give up the entire or parts of its YCC policy already today. Accordingly, speculation increased massively in the run-up to today's decision, forcing the BoJ to intervene by an amount of about 6% of Japan's GDP as the cap of 0.5% on 10-year JGB yields had been increasingly questioned. However, the BoJ defied expectations of giving in at this point, stressing again that it will purchase the necessary amount of JGBs "without setting an upper limit" to defend its policy. In addition, it added variable-rate loans to its toolbox by extending the duration of its funds-supplying operations to financial institutions.

Although most analysts (incl. us) had considered a (complete) departure from the YCC less likely, the movements on the financial markets today show that financial market participants were at least partially positioned for an adjustment. The yield on the 10-year JGB first fell to 0.36%, the yen depreciated to 131.6 USD/JPY and the Nikkei rose (against the market trend) by 2.5%. In the meantime, the situation has calmed down somewhat, the 10-year yield has risen to 0.43% and the yen has made up for all losses. While Bund yields initially hardly reacted, 10-year US yields fell 8 bps immediately after the BoJ decision.

Looking ahead, the bank reiterated its "standard" guidance that it will continue its policy as long as it is necessary to reach its 2% inflation target in a stable manner. It updated its macroeconomic fundamentals in the quarterly report, raising its core consumer inflation forecast for the current fiscal year (FY) ending in March to 3.0% (from 2.9% before), but maintained the inflation forecast for FY 2023 at 1.6%, while increasing the FY 2024 projection to 1.8%, from 1.6% in last October. In sum, the BoJ was giving no fundamental reason for a policy shift, implicitly seeing inflation dissipate again after a (likely) December peak of around 4% yoy. The BoJ also lowered growth projections amid weaker global growth which could weigh negatively on exports.

While today's decision has bought the BoJ some time, the yield curve has not normalised as intended by the central bank, but the kink has become even bigger since the December meeting. Accordingly, we do not rule out the possibility of fresh attacks in the coming weeks, forcing the BoJ to defend its policy. However, markets will probably focus more on the new Governor (replacing

Kuroda) and his/her review of the BoJ's achievements over the last ten years. Until his/her first monetary policy meeting, important fresh data (extent of wage increases, inflation development) will be available. As discussed in detail in a recent Focal Point, we expect the new Governor to successively give up the YCC policy. Thus, market turbulences could resurface ahead of April monetary policy decision, but the BoJ today's resolve also may have reminded markets that pure speculative pressure might not be enough to change the BoJ's decision.