

## BOJ's monetary policy and Japanese market response

- BOJ decided to increase purchase program of ETFs and to bolster smooth funding of USD for Japanese firms and financial institutions, while not extending its negative interest rate policy.
- In the wake of these policies, i) JPY appreciated against USD, ii) Japanese financial stocks rose and iii) Japanese Government Bond (JGB) price has fallen.
- Comprehensive assessment on effect of monetary policies set under Governor Kuroda's regime so far is scheduled at BOJ's next monetary policy meeting. Focus should be on any change in the monetary policy framework.

### BOJ decided to increase purchase program of ETFs and to bolster smooth funding of USD for Japanese firms and financial institutions, while not extending its negative interest rates policy.

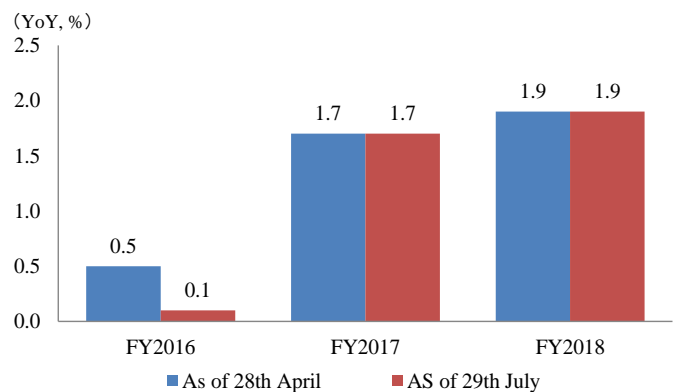
BOJ has unveiled additional measures to reinforce monetary easing stance at its Policy Meeting held on 28<sup>th</sup> and 29<sup>th</sup> July (Table 1). That involves i) increasing purchase of ETFs ( from JPY 3.3 trillion to JPY 6 trillion per year), ii) increase the size of BOJ's Special Rules for USD Lending Arrangement to Enhance the Fund-Provisioning Measures to Support Strengthening the Foundations for Economic Growth Conducted through Loan Support Program (from USD 12 billion to USD 24 billion) and iii) establish a new facility for lending securities to be pledged as collateral for the USD Fund-Supplying Operations. This time round, the central bank has decided not to take on extending i) monetary base, ii) purchase of long term JGBs and J-REITs, and iii) negative interest rates.

The "Outlook for Economic Activity and Prices", a report released on the same day, has still shown 2% inflation target would be achieved in 2017. However, BOJ seemed to have lowered its tone on the inflation target timeline as in the report they have added phrase as "the baseline scenario" while emphasizing "we have seen growing uncertainties surrounding overseas economies". Meanwhile, only FY2016 YoY growth of CPI excluding fresh foods was revised down (Chart 1).

"Table 1: Measures to Enhance Monetary Easings"

<b>i) Increase in purchase of ETFs</b>
BOJ will purchase ETFs so that their amount outstanding will increase at an annual pace of about JPY 6 trillion (current pace is about JPY 3.3 trillion).
<b>ii) Enhance the Fund-Provisioning Measures to Support Strengthening the Foundations for Economic Growth Conducted through Loan Support Program</b>
Increase the size of BOJ's lending program to USD24 billion (current size is USD 12 billion).
<b>iii) Establishing a new facility for lending securities to be pledged as collateral for the USD Funds-Supply Operations</b>
BOJ will establish a new facility in which it lends JGBs to financial institutions against their current account balances with the Bank.

"Chart 1: CPI Outlook of BOJ's Policy Board Members"



(Note) Outlook is median of those of BOJ's policy board members.

CPI is all items excluding fresh foods.

(Source) SMAM, based on BOJ's materials.

**In the wake of these policies, i) JPY appreciated against USD, ii) Japanese financial stocks rose and iii) Japanese Government Bond (JGB) price has fallen.**

Before the BOJ's announcement, USD/JPY rate in the currency exchange market had been traded at JPY 104 level against USD in a volatile manner. In the wake of the fresh policy, USD weakened against JPY and touched JPY 102.71 level, as market deemed BOJ's stance less aggressive than expected. Nikkei 225 index also moved in tandem with volatile USD/JPY exchange rate and plunged to the level of 16,100 at one time, but eventually closed at 16,569.27 (+ 92.43) for the day.

Shares in financial institutions saw a sharp rise as market participants favored BOJ's policies i) not to lower negative rates and ii) to ensure smooth funding in foreign currencies by Japanese firms, both of which were a tailwind for the sector performance. On the other hand, JGB prices declined sharply (yield to maturity rose) due to no further cut in negative interest rate and no expansion of quantitative easing in long term bonds. 10 year JGB yield which traded around  $-0.27\%$  level before BOJ's monetary policy announcement, narrowed to  $-0.16\%$ .

**Comprehensive assessment on effect of monetary policies set under Governor Kuroda's regime so far is scheduled at BOJ's next monetary policy meeting. Focus should be on any change in the monetary policy framework.**

Japanese government and BOJ have taken a coordinated action in a bid to shore up the economy through the fiscal stimulus and monetary easing, as economic measures led by the government is expected to obtain cabinet's approval on 2<sup>nd</sup> of August, 2016. We can expect certain positive impact to underpin Japanese economy from those measures. Meanwhile, BOJ plans to review what impact the monetary policies put in place so far have on the economy at the next monetary policy meeting. I will take a close look at any potential changes to be made in the policy framework on the review.

In terms of FX rate, USD is not likely to rise sharply against JPY, as moderate pace of US interest rate hike is expected. Moreover, USD/JPY rate is expected to be between JPY 98 to JPY 108 for some time, as JPY will not likely weaken on both monetary and fiscal policies this time. Current focus of the Japanese equity market is on corporate's business results where we have not seen many of companies with extremely poor performance so far. We should keep an eye on whether Nikkei 225 index can stabilize at around JPY 16,000 and be able to see positive news flows to push the market up again.

**\* Please note that this report is a translation of Japanese report written on 29th July, 2016.**

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