

Flash Note 24/07/2018

Alex Fusté
[@AlexfusteAlex](#)
alex.fuste@andbank.com

BOJ's easing? Rumours and truths

The rumor (and market reaction)

- According to market information yesterday, the BOJ seemed leaned to debate policy changes in July to make its stimulus sustainable.
- The information came after some BOJ's members suggested the institution is in unusually active discussions before this month's policy decision, with interest-rate targets and stock-buying techniques on the table.
- Market participants quickly started to price in a BoJ's policy change, with yields jumping as much as 7 bps to 0.09%, the highest since February.

The evidence

- The fact is that internal debate currently focuses on ways to make stimulus more sustainable (not tapering the stimulus), as it will take some time for inflation to hit target of 2%.
- The BOJ even announced its first unlimited fixed-rate bond purchase operation since February after yields jumped on reports it will discuss possible changes to its ultra-loose monetary policy.
- The BOJ offered to buy 10-year JGBs at a fixed rate of 0.11%. The benchmark pared its advance after the operation was announced to 0.065%.

Difficult options for BoJ once reached this point

- Analysts are discussing the BOJ's difficult policy options amid the bind created by its prolonged ultra-easy monetary policy implemented to reach the elusive 2% inflation target.
- Within the adverse effects of a tapering policy we cannot ignore the following:
 1. A yen appreciation could take place if the BOJ adjusts interest rates, a move that would run counter to measures aimed at ending deflation
 2. Japanese equity market could drop sharply (given that the Asset Purchase Program, which has supported the market so much in recent years, would come to an end with tapering)
 3. This will inflict severe pain to GPIF (Government Pension Funds) as they have recently reached the 25% legal limit of exposure to the equity market.
- Citing people familiar with the BOJ's thinking, the central bank is likely to stick to the contours of its current policy at its next meeting despite

complaints from banks. While BOJ officials are studying some tweaks, such as more flexibility in its 0% target for 10-year JGB yields, none of the changes would add up to a fundamental policy shift.

Our assessment & outlook

- Japanese Equity market: Neutral-Positive (year end target for Nikkei at 23,100. Currently at 22,396)
- 10Year Japanese Government Bond: Negative (Year end target at 0.10%. Currently at 0.08%)
- JPY/USD: Neutral (year end target at 111.2, current 111.38)
- JPY/EUR: Neutral-Positive (year end target at 127.9, current 129.9)

Best