BoJ Surprise

What Does Kuroda's Pivot Mean?

Executive Summary

- **In a surprise move, the Bank of Japan raised the range for the 10-year JGB rate to 0.5%, explaining that the aim is to address the distorted yield curve and improve market functioning.**

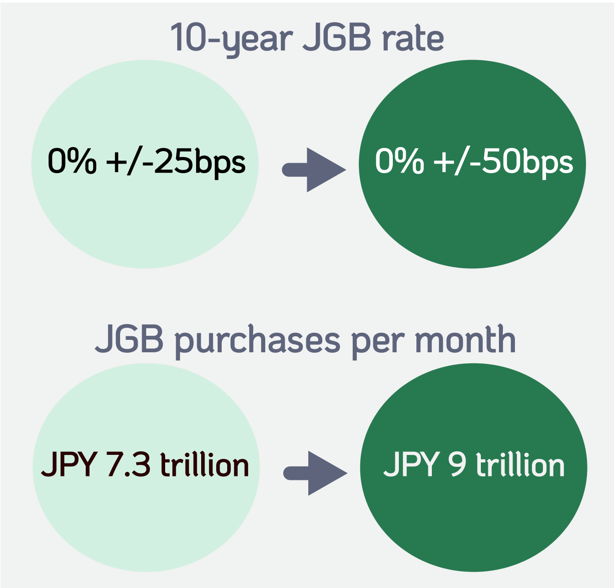
- **Governor Kuroda restated that he has no intention of hiking rates under current circumstances, and the existing scheme will be maintained for now with a slightly elevated yield curve.**

- **The move may, however, be considered an indication of the beginning of the end of the ultra-loose monetary policy era.**

- **Uncertainty over the possible timeframe of BoJ normalisation will impact equity markets in terms of valuations, as well as corporate profits amid currency fluctuations**

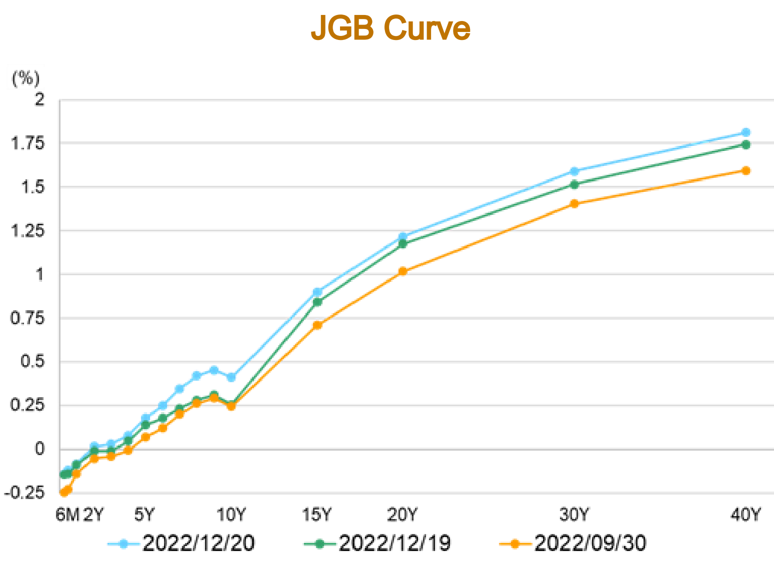
What did the BoJ announce?

The Bank of Japan took markets by surprise at its Monetary Policy Meeting on December 20th, **tweaking its target range for the 10-year JGB rate from 0% +/-25bps to +/-50bps.** The central bank states that the change is "in order to improve market functioning and encourage a smoother formation of the entire yield curve, while maintaining accommodative financial conditions," meaning the **aim is to address the side effects of its yield curve control (YCC) policy and resulting distortions in the JGB curve – not a response to rising prices and economic conditions.**



Governor Haruhiko Kuroda stressed that the **goal is to make YCC and easy monetary policy work better**, and should **not be taken as a signal of a shift towards a tighter stance.** He added that **tightening is not in sight at this point in time**, with **CPI growth projected to slow in fiscal 2023** to a level below the bank's target of 2%. The short-term interest rate is unchanged, at -0.1%.

The BoJ also announced an **increase in JGB purchases from JPY 7.3 trillion to JPY 9 trillion per month at various points along the yield curve**, with the twin goal of avoiding a sharp hike in rates and of suggesting a guidance level of the curve.



Source: Factset

What does the move signify?

> "...the goal is to make YCC and easy monetary policy work better, and should not be taken as a signal of a shift towards a tighter stance.

While it is **too early to conclude definitively that the BoJ's action is a first step towards tightening**, it does represent a change in messaging from Kuroda, who previously claimed that he had no intention of expanding the 25bps YCC range, as to do so would only serve to hurt the economy. **His new position, meanwhile, stresses that the new 50bps range will do no harm, and will instead improve market functioning.** The current scheme will be maintained for the time being with a new 0.5% cap on the 10-year rate. **The BoJ will not change monetary policy until certain specific conditions are achieved – notably wage increases and continued inflation – which is unlikely at least before the end of the governor's tenure in April 2023.**

Despite the central bank's comments, however, many market participants cannot help but suspect this is a move to revise the joint statement of 2013 by the BoJ and the Abe government. Modifying this pledge, which has served for close to a decade as a blueprint for fighting deflation, would lay the groundwork to drop YCC and negative interest rates in a post-Kuroda transition – effectively phasing out Abenomics. The government may have already started to lobby the BoJ to follow such a course. **All eyes will now be on the question of Kuroda's successor, wage hikes for FY 2023, and the timing of lifting the negative short-term rate.**

The bond market reacted with a surge in yields, while stocks fell and the yen climbed. A stronger currency will reduce input costs for Japanese companies, but hurt the profits and reduce expected upward revisions of exporters. Uncertainty over any further move by the monetary authority under a new governor may put pressure on equity market sentiment. **For the time being, we expect the market PER to stay around its current discounted level of 12x – below the long-term average – until the BoJ's stance becomes clearer and US rate hikes peak out.**