Mizuho Market Comment

22 July, 2024

Colin Asher
Senior Economist
colin.asher@mhcb.co.uk | +44 20 7012 5262

BoJ preview – BoJ caution on display

- **The main focus of the 31 July meeting will be the BoJ's plan to reduce its bond purchases**
- **We look for an initial ~¥1trn reduction and a gentle pace of subsequent reductions to ~¥3trn**
- **We expect Governor Ueda's caution to see a rate hike pushed into the autumn…**
- **…but still see USD/JPY lower in coming months, as the first Fed cut comes into view**

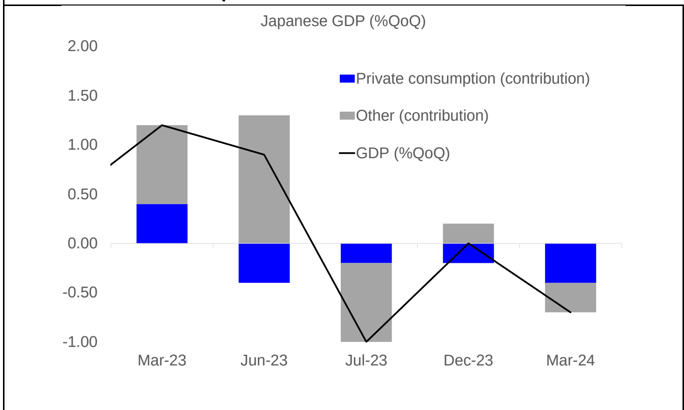
Bond buying plan the main focus
At its June 14 meeting the BoJ surprised investors by opting to consult on lowering its bond purchase rather than starting to lower them immediately. Those consultations have now taken place and the BoJ has published a summary. The BoJ undertook meetings with 1) banks, 2) securities companies and 3) buyside groups. The BoJ consulted on 4 topics which were 1a) the amount and b) speed of reductions; 2) what guidance the BoJ should give concerning reductions; 3) which maturities to target and 4) other related topics. The first meeting with banks seemed to produce the strongest calls for rapid and deep cuts to the Rinban operations. We suspect that large banks were keener than small banks for rapid reductions. Recall that as the Fed hiked it was the smaller banks, with weaker risk management that got into trouble. We suspect that the BoJ will be wary of moving rapidly for financial stability reasons. It will be keen to avoid a SVB-type event.

On what level of monthly buying to target the range that investors suggested was wide - from a total stop to a minimal reduction to ¥5trn/month. With regard to the end point, one approach is to look at bringing purchases back to their pre QQE level of around 4~5% of GDP. Nominal GDP has risen a lot since 2012. Using FY23 GDP gives a figure in the region of ¥2.5trn/month, which is only a little below expectations from the latest Quick bond market survey.

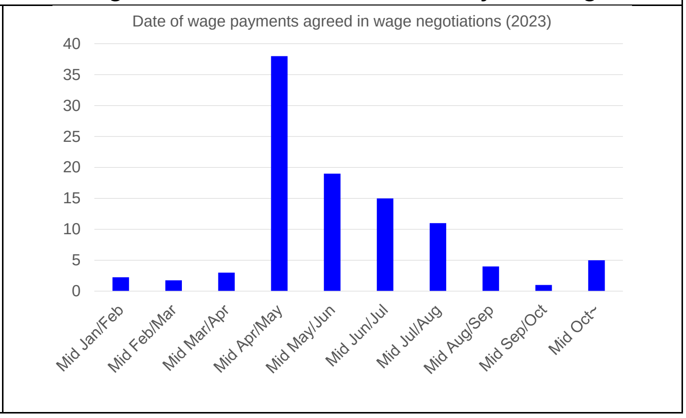
With regards to the pace, here too there was a range of views, with some looking for a rapid start and then a more gradual pace and some looking for a steady pace from the start. We suspect that the BoJ will start with an initial reduction in the region of ~¥1trn/month, in part to offset any potential disappointment that there will be no interest rate cut and because its highly likely that the market can withstand such a move. Given, the pressure on the yen, underdelivering is a risk. We then anticipate a steady quarterly reduction to take purchases down to ~¥3trn/month.

On what guidance the BoJ should give respondents views were mixed too. We suspect that the BoJ will continue to announce Rinban quarterly as a range to preserve some flexibility, with the mid-point of the range indicating lower purchases. The ranges may well be narrower than they are now. On maturity, the bulk of respondents seemed happy for the reductions to be mainly in the sub-10yr sector, which is what we expect, given that is where the BoJ has the bulk of its holdings.

Private consumption has been weak…



…making the BoJ want more certainty on wages



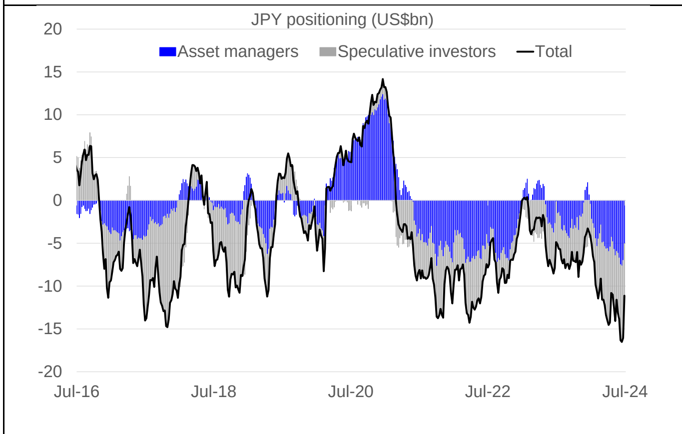
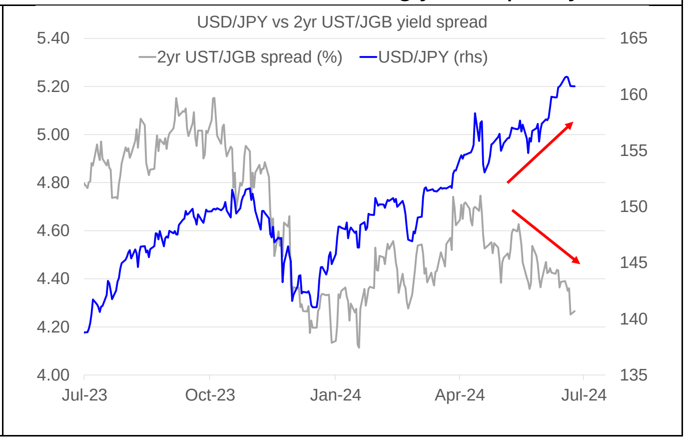
Source: Cabinet Office, MHLW

BoJ likely to avoid hiking at the same time as Rinban reduction

We suspect that the BoJ will pass on lifting the policy rate at the same time as they start reducing Rinban operations. The main reason is that Governor Ueda does not yet seem convinced that the economy is strong enough. GDP, especially consumption, has been weak. Consumption has contracted for 4 consecutive quarters and may have contracted again in Q2. By waiting, the Board will have a better view on the whether the spring wage negotiations have spread more broadly, as they so conspicuously failed to do last year. The May wage data were somewhat encouraging on this front but the June data will also be useful, given the tendency for spring wage hikes to be mainly reflected in the May ~ August wage data.

The BoJ Governor Ueda looks as if he is yet to be convinced that the 2% CPI target is achievable and he seems keen not to hike unless he thinks it can be achieved. The BoJ will be producing new forecasts at the 31 July meeting and the FY24 GDP forecast, which currently sits at 0.8% will be revised lower, thanks to the downward revision to Q1 GDP that puts a large negative base effect into FY24 GDP. It may be that the GDP forecast is below potential growth, which in theory limits upside pressure on prices. However, we do not expect that the CPI figures will be revised lower. If anything, near-term CPI figures may be higher thanks to the impact of a weak currency.

One of the reasons for expecting a rate hike at the 31 July meeting is the fear that failure to do so will stoke further yen weakness. Furthermore, recent comments for Taro Kono, a senior LDP politician, suggest that the government is keen for a hike. Similar comments were made by Toshimitsu Motegi, another LDP heavyweight, a few days later However, we see recent BoJ policy decisions as implying that it is more concerned about the JGB market than the FX market. Its concerns with the FX market are mainly from an inflation perspective - whether the weak yen impacts the price outlook. Governor Ueda has been cautious, especially in his rhetoric and especially on the economy. We believe he sees reducing Rinban operations as substituting for rate cuts, allowing Ueda to say to his political masters that he is taking action to stem yen weakness.

JPY shorts still elevated…	…even as JPY looks increasingly cheap vs yields
	

Source: Bloomberg

USD/JPY likely to push higher if BoJ skips a rate hike but upside seems limited

Assuming that our expectations are met, how do we think the market will react? We suspect that our views are close to the domestic consensus but that overseas investors will find the absence of a rate hike in July disappointing. This suggests that USD/JPY may head higher in the wake of the meeting.

That said, the fundamentals, most notably the prospects for higher Japanese policy rates and lower US policy rates, likely means a lower USD/JPY in time. In addition, Trump's recent FX comments suggest he will be a vector of volatility, specifically one with a weak USD bias. Higher volatility makes carry trades less attractive. Although the weekly CTFC data as of 16 July showed short JPY carry trades being trimmed quite sharply, short-JPY positions remain elevated. We continue to see gentle JPY strength emerging into year end and look for USD/JPY to sit around 145 on a 12-month horizon.