

BOJ's Assessment Results and Initial Market Reactions

- BOJ indicated its shift of monetary policy of controlling target to yield curve (“interest rates”), while maintaining commitment of monetary base expansion (“quantity”).
- Initial market reactions were (i) yield curve shifting upward, (ii) Japanese stock prices rising lead by financial sector and (iii) JPY weakening against USD.
- Market’s focus will be on whether steepening of yield curve can be sustained within the new monetary policy framework or not.

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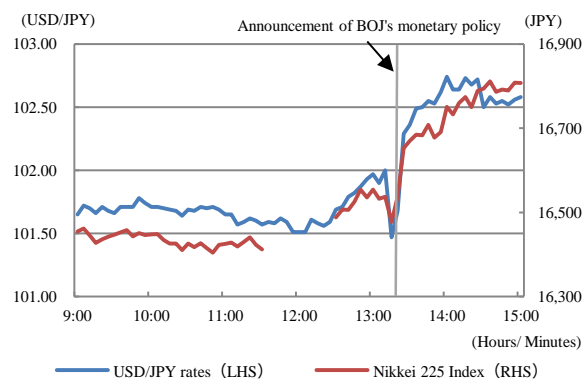
BOJ announced results of comprehensive assessment of its monetary policy on 21st September 2016, after Monetary Policy Meeting held on 20th and 21st September. This time, a new monetary policy framework of “Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control” was introduced, a little surprising for the markets. The new policy framework consists of two major components; (i) “yield curve control” and (ii) “inflation-overshooting commitment” (Table 1).

For component (i), BOJ intends to steepen yield curve by maintaining a negative interest rate of - 0.1% while purchasing JGBs in order to keep 10-year JGB yields at around 0%. This clearly indicated that BOJ’s controlling target will be “interest rates”. While component (ii) is the reinforcement of forward guidance (indication of the future course of monetary policy). BOJ will continue expanding the monetary base until YoY rate of increase in the observed CPI exceeds the price stability target of 2% and stays above the target in a stable manner. This is the message of BOJ indicating that “Quantity” will not be decreased.

"Table 1 : Summary of QQE with Yield Curve Control"

① Yield Curve Control	
Short-term interest rate:	Apply a negative interest rate of -0.1% to the Policy-Rate Balances in current account.
Long-term interest rate:	Purchase JGB so that 10-year JGB yield will remain around current level of 0%.
Purchase of JGB:	Purchase JGB more or less in line with current pace (JPY 80 trillion), while the guideline for average remaining maturity will be abolished.
New tools of market operations:	(i) Introduction of fixed-rate purchase operation, (ii) Extend fixed-rate funds-supply operation period up to 10 years from current 1 year.
② Inflation-overshooting commitment	
(i) Continue with "QQE with Yield Curve Control", to achieve the price stability target of 2% as long as it is necessary, for maintaining that target in a stable manner.	
(ii) Continue expanding the monetary base until the YoY rate of increase in the observed CPI exceeds the price stability target of 2% and stays above the target in a stable manner.	
(iii) The ratio of the monetary base to nominal GDP in Japan is expected to exceed 100% (about JPY 500 trillion) in slightly over one year.	

"Chart 1: USD/JPY rates and Nikkei 225 Index"



(Note) QQE stands for Quantitative and Qualitative Monetary Easing.
 (Source) SMAM, based on BOJ's materials and publicly available information.

(Note) Data period is from 9:00 to 15:00 of 21st September 2016.
 (Source) SMAM, based on Bloomberg L.P. data.

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Financial market responded quickly to the announcement of “QQE with Yield Curve Control” by BOJ. JGB’s yields across the curve rose as BOJ (i) held off on deepening negative interest rates and (ii) indicated to keep 10-year JGB yields at around 0%. Consequently, JGB’s yield curve shifted upward maintaining its steepened shape.

As an initial reaction, financial stocks rose sharply underpinning overall stock prices over the expectation on expansion of (i) investment revenue of institutional investors and (ii) margin of banks affected by the upward shift of yield curve. In addition, TOPIX rose more than that of Nikkei 225 Index on 21st September 2016, as BOJ announced purchase of JPY 2.7 trillion worth of TOPIX linked ETFs, out of total ETF annual purchase program. Meanwhile, USD/JPY rate which was traded around latter part of 101 in the morning, temporally strengthened to 102.79 passing 2 pm in the afternoon (Chart 1).

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As to “Quality”, the guideline for average remaining maturity of BOJ’s JGB purchases will be abolished, while annual pace of long-term JGB purchase remains at around JPY 80 trillion at least for the mean time. Meanwhile, policy of purchases of other assets such as ETFs and J-REITs remained unchanged. As for “Quantity”, policy to expand monetary base was maintained, however, BOJ has just indicated the ratio of the monetary base to nominal GDP in Japan to exceed 100 percent (about 500 trillion yen) in slightly over one year. The annual target amount of increase in monetary base of JPY 80 trillion was abolished.

This time, BOJ shifted its monetary policy to enduring one by extensively increasing flexibility on purchasing long-term JGBs, and focusing on interest rates as its controlling target. One of the focal points of market seems to be whether steepening of yield curve can be sustained within the new monetary policy framework or not. Meanwhile, BOJ indicated priority order of policy options in case of additional easing as follows; (i) yield curve control, (ii) increase in asset purchases and (iii) expansion of monetary base.

*** Please note that this report is a translation of Japanese report written on 21th September, 2016.**

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