29 July 2016

# BoJ Review

## BoJ disappoints but keeps door open for more easing

- **The Bank of Japan (BoJ) is increasing its purchases of ETFs but has kept the policy interest rate and bond purchase programme unchanged at -0.1% and JPY80trn, respectively. The BoJ is keeping the door open for additional easing in September as it awaits the government's fiscal easing package.**
- **We do not see today's lack of action as a token that the BoJ is done but given that the BoJ refrained from cutting interest rates further into negative territory, we no longer expect it to cut interest rates further.**
- **Overall, the announcement is a disappointment and the BoJ's decision is negative for risk and global bond markets. However, the market reaction has been relatively modest given the significant disappointment: USD/JPY dropped 2.5 figures and initially dipped below 103. Markets are still speculating on a large fiscal stimulus package, which is likely to be announced next week.**
- **We expect USD/JPY to remain heavy in coming weeks, targeting 100 in 1M. Longer term, the outlook for USD/JPY very much depends on the size of the fiscal package and the BoJ's subsequent policy response at the next MPM on 21 September. We are currently reviewing our 3-12M USD/JPY forecast but in general we see less upside potential in the cross, as we no longer expect further negative interest rates.**

### Bank of Japan eases but disappoints

The BoJ this morning announced additional monetary easing measures. It announced that it will increase its purchases of ETFs (exchange-traded funds) to an annual pace of JPY6trn (previous pace of JPY3.3trn). At the same time, the BoJ decided to keep its policy interest rate and bond purchase programme unchanged at -0.1% and JPY80trn, respectively.

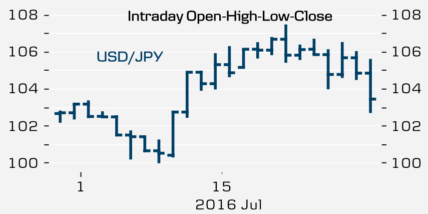
In addition to the increase in ETF purchases, the BoJ also decided to increase the size of the Bank's USD lending programme under which the Bank provides USD funding for a period of up to four years to support Japanese firms overseas activities through financial institutions.

Overall, the announcement is a disappointment as we and most other analysts had expected the BoJ to take bolder measures this time and the market was also priced for more easing.

However, in the statement, the BoJ said that it will conduct a comprehensive assessment of the developments in economic activity and prices under 'QQE' and 'QQE with negative interest rates' at the next monetary policy meeting (21 September). This could imply that that the BoJ will look to overhaul its QQE programme at the next meeting. At this point in time, the government's fiscal package is likely to have been announced and passed in the Diet.

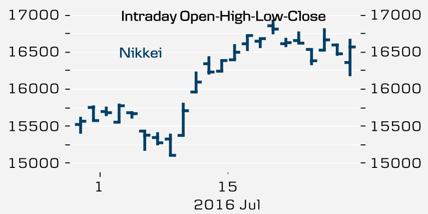
Given that the BoJ refrained from cutting interest rates further into negative territory today signals that the bar is high for additional rate cuts, in our view. Like the ECB, the BoJ may have second thoughts on negative rates and **we no longer expect it to cut interest rates further. However, the BoJ may be looking for other ways to push up inflation and we do not see today's lack of action as a token that the BoJ is done.** We believe it is awaiting the government's fiscal stimulus package before it wants to take further easing measures. Hence, we believe the door is open for more stimulus but the lower bound has been reached in terms of rate cuts.

USD/JPY lower......




Source: Bloomberg, Danske Bank Markets

.... but Nikkei higher after the announcement




Source: Bloomberg, Danske Bank Markets

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## Relatively modest market reaction despite big disappointment

USD/JPY dropped 2.5 figures and initially dipped below 103 after the announcement while Japanese equities initially rose on the announcement of additional ETF purchases. The fact that the BoJ did not cut interest rates further into negative is a positive for Japanese commercial banks. Yields on Japanese government bonds rose some 10-11bp across the 2-10Y segment and the 10Y30Y curve flattened 6bp with yields on 30Y government bonds rising 5bp.

The relatively modest reaction in USD/JPY despite the overall disappointment can probably be explained by the fact that Japanese equities are holding up and the market is still speculating on a large fiscal stimulus package, which is likely to be announced next week. Finally, the BoJ also implied that additional easing could come at its next meeting.

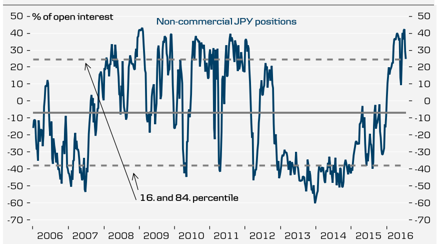
## We expect USD/JPY to fall to 100 in 1M

**We expect USD/JPY to remain heavy in coming weeks targeting 100 in 1M.** As such, the fiscal package announcement might be positive for risk but expectations are already high and we do not think that a soft promise of further easing in September will be enough to stop the yen from appreciating further in the short term. On the other hand, investors are already speculatively long JPY, according to IMM, and the risk of BoJ FX interventions in the event of significant JPY appreciation is likely to discourage investor from buying large scale JPY.

Longer term, the outlook for USD/JPY very much depends on the size of the fiscal package and the BoJ's subsequent policy response at the next monetary policy meeting on 21 September. **We are currently reviewing our 3-12M USD/JPY forecast but in general we see less upside potential fur the cross as we no longer expect further negative interest rates.**

Overall, the BoJ decision is negative for risk and global bond markets. Japanese investors have been heavy buyers of US treasuries and especially French bonds in the Eurozone over the past couple of years and we should expect a negative opening for bunds this morning.

**Investors are speculatively long JPY**




*Source: Commodity Futures Trading Commission, Macrobond Financial, Danske Bank Markets*

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