SuMi TRUST Monthly Commentary

September 2019

The Bank of Japan Monetary Policy Meeting (18th - 19th September 2019)
The Bank of Japan will hold its Monetary Policy Meeting in the middle of this month. In this report, we will share our outlook for BOJ, impact on the financial markets, impact of the higher consumption tax, as well as risk scenario.

1. We forecast the BOJ to keep policy unchanged

The Bank of Japan will hold its Monetary Policy Meeting from 18th to 19th September 2019. We at SuMi TAM forecast that there will be no change to policy. The reason for this is that the downside risks in the global economy and inflation are not enough to erode momentum towards the "price stability goal". We believe that unless the yen appreciates beyond 105 to the USD and approaches the 100 mark, the BOJ will not change its policy. Currently, the BOJ has no realistic effective policy options left. Whilst some believe that the BOJ will implement “a further cut in negative interest rates”, this is bound to have a negative impact on financial institutions and the financial system. Unless the positive side effects outweigh the negative effects, this is not a realistic option.

Although we do not see policy changes, we forecast that the BOJ will lower somewhat its economic outlook. The slowdown of the global economy due in part to the deterioration in Sino-US trade relations since early-August, and the lagging effects of China's economic stimulus measures are likely to be built into its outlook. Also, Governor Kuroda is likely to state in the post-policy meeting press conference that he would tolerate "a temporary dip in long-term interest rates". The BOJ will likely try to avoid "a further cut in negative interest rates" which will have side effects, and attempt to impress financial markets with a stronger stance on monetary easing.

2. Impact on the Financial Markets

Further intensification of the Sino-US trade dispute, President Trump openly calling for lower interest rates, and the financial markets beginning to discount forward events, the FOMC will likely be forced to lower rates in September by 0.25%. With the ECB Monthly Board Meeting (12th of September) and FOMC (17th - 18th of September) both likely to cut rates and taking place ahead of the BOJ meeting, some may view the BOJ's monetary policy as being hawkish. Therefore, we believe the yen will come under upward pressure as the US-Japan interest rate spread narrows. However, as lower US rates have largely been discounted, and as lower rates tend to improve market psychology, we believe that the yen will rise only gradually at best. Looking forward, we believe that there is strong support at 105 yen as a large amount of high coupon 10 year JGB’s will mature over the next 3 years and as Japanese investors have a strong appetite for foreign-denominated bonds.

As for the Japanese stock market, with the yen trending higher and the Sino-US trade dispute intensifying, we believe the upside is limited. And with the BOJ keeping policy unchanged amidst competitive easing by global central banks, many will feel that the BOJ has run out of bullets. Our downside target on the Nikkei 225 is 20,000 which equates to an average Price-to-Book ratio of 1.00. However, as we approach the year end, we believe global stock markets may bottom out on the back of easy global monetary and fiscal policies and attractive valuations.

3. Impact of the Higher Consumption Tax

The consumption tax rate will be raised from 8% to 10% on the 1st of October. With recent export and production figures pointing to sluggish external demand, there is concern that higher consumption taxes may lead to an economic slowdown. However, in a Financial Advisory Council meeting on the 29th of July, Prime Minister Abe stated that "if it becomes apparent that the economy is slowing down, we will launch macroeconomic measures flexibly without hesitation". Thus we expect the announcement of a large economic stimulus measure by the end of the year. Going forward, we believe that there is a strong possibility that the BOJ will act in concert with the government's large economic stimulus package with its own accommodative policy. One such measure by the BOJ may be the purchase of additional government bonds (JGBs) as the government issues bonds ahead of the large economic stimulus measure.

4. Risk Scenario: The BOJ could intervene at an early stage depending on the strength of the yen

Although we anticipate no action by the BOJ at its Monetary Policy Meeting in September, there is the increasing possibility that it may act depending on the level of the yen. Should the yen strengthen to 105 to the USD and head towards 100, the BOJ will inevitably take action. Possible measures would be "strengthening the forward guidance" or "additional ETF purchases" (from a JPY 6 trillion/annum pace to JPY 10 trillion/annum) which may serve to keep the yen strength in check.

Furthermore, in order to pursue "a further cut in negative interest rates" at some future stage, it may also need to consider measures to lower the burden on financial institutions whose earnings are likely to suffer as result. It is quite possible that "applying negative interest rates to the BOJ Loan Support Program" which the BOJ old boy network (that includes Mr Hayakawa of the Fujitsu Research Institute and Mr Iwata of the Nikkei Center) has been calling for, could be taken up for discussion. And with yield curve control reaching its limits, the September Monetary Policy Meeting could call for "(the second) Comprehensive Assessment" of the Monetary Easing, the first time since 2016, to alter the policy framework in earnest in the near future.

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