

## Introduction

The MPM of the BOJ unexpectedly decided to widen the target range of 10Y JGB yield from  $\pm 25$ bp to  $\pm 50$ bp at its December meeting. Governor Kuroda explained that it was intended to improve the functions of JGB market, while the market seemed to suspect its implications.

## Assessment of economy

Policy statement reiterated the constructive view of the domestic economy. It explained that exports has been supported by relief of supply constraints, and consumption continued to recover moderately by increasing service expenditures. Moreover, level of corporate profits remained elevated, while business sentiment has been stabilized.

Governor Kuroda confirmed the positive outlook, in spite of elevated level of import prices and slower growth of overseas economies. In reply to a question, he showed confidence in continuous expansion of production as firms have been dealing with pent-up demands.

## Assessment of prices

Policy statement maintained the cautious view of the prices. While it admitted further acceleration of CPI inflation in coming months, it remained skeptical to its sustainability.

Governor Kuroda explained that current upward pressures on energy, food and durable goods prices have largely been due to transfer of rising input costs by firms. He expected these factors would diminish later next year, and CPI inflation rate in next fiscal year would be lower than 2%.

During the Q&A session, Governor Kuroda confirmed a virtuous circle between wages and prices would be possible in coming year on back of favorable conditions including corporate profits and inflation expectation. Nevertheless, he insisted that such a circle needs to be sustainable in order to achieve the inflation target.

## Policy decision

The MPM unexpectedly decided to widen the target range of 10Y JGB yield from  $\pm 25$ bp to  $\pm 50$ bp unanimously. Policy statement explained that it was intended to improve the functions of JGB market, thereby promoting smooth formation of the yield curve.

Governor Kuroda explained that impacts on JGB market by higher volatilities in overseas financial markets have become more evident recently. He also admitted that the functions of JGB market have deteriorated further, in terms of arbitrage across the maturity and between the cash and the futures. He expected that widening the target yield could improve the function of JGB market, leading to smooth transmission of intended policy effect.

All in all, Governor Kuroda emphasized that this policy action was not intended to modify the YCC or the overall stance of monetary easing.

Press reporters may not have shared the understanding, however. First of all, a number of reporters asked whether it was effectively a rise in policy rate. In fact, after the announcement of the policy decision, 10Y JGB yield jumped to 0.46% from 0.25%.

Governor Kuroda reiterated the intension to improve the function of JGB market, with reference to the maintenance of both policy rates of the YCC at -0.1% and 0% respectively.

Moreover, several reporters raised the issue of timing of policy decision. Specifically, they criticized Governor Kuroda, as he claimed in September that expansion of the target yield from  $\pm 0.25\%$  would have negative impacts on economic activities.

Governor Kuroda explained that expected improvement of the functions of JGB market would rather enhance the accommodative effect of monetary easing by way of smooth transmission of its impacts.

Domestic market participants seemed to be skeptic about the appropriateness of timing from different perspectives.

While the upward pressures on JGB yield from overseas markets have been evident in recent months, they are expected to be relieved in coming months due to concerns about slower overseas economic growth and changing expectations of monetary policy. Interestingly, Governor Kuroda effectively agreed with this line of thought, when he denied the possibility of another widening of the target range in the near future.

## Implications of the policy decision

Readers may like to note that Governor Kuroda referred to the “automotive” enhancement of monetary easing in terms of real policy rate due to rising inflation expectation.

Considering such favorable evolution, a candidate rationale of the policy decision would be the improvement of balance of trade offs. Specifically, the BOJ could now afford to pay more attention to side-effects of the YCC once the accommodative effects have become reinforced.

While such line of argument would be more appealing to the markets, it could have technical difficulties when asked about how large the real policy rate was reduced and how large its economic impacts would be expected.

Readers should also note that several major financial press reported over the last weekend that Kishida administration may have intension to modify the policy communique between the government and the BOJ. It was agreed in 2013 as the fundamental idea of “three arrows” of Abenomics.

The focus of attention is whether to add some flexibility for inflation target by the BOJ, as the current communique requires the BOJ to achieve the target “as soon as possible”.

In this context, domestic market participants may have a good reason to suspect that the policy decision today may be a first step for policy normalization, in spite of strong denial by Governor Kuroda.

**Author: Tetsuya Inoue**  
**Senior Researcher**  
**Financial Markets and Digital Business Research Department**  
**Nomura Research Institute**

This note is intended solely for informational purposes and should not be construed as investment advice. The author does not guarantee the accuracy or completeness of the information contained. Opinions in this note are those of the author and do not represent the views of Nomura Research Institute or Financial Technology and Market Research Department. This note is exclusively for the personal use of those receiving it directly from the author.