

# BANK OF JAPAN WATCH

26<sup>th</sup> Oct. 2011



## Forecast downgrade and further easing, with a twist

- **Policy Board to revise down GDP forecasts for FY2012**
- **Downward revision to CPI forecasts to show price stability not in sight**
- **Increase in asset purchases with lengthening of maturity likely next course of action**

The Bank of Japan's Policy Board is highly likely to cut its forecasts for GDP and inflation at its meeting tomorrow. Along with the fragility of financial markets and the strength of the yen, this should prompt a further ¥5 trillion expansion to the Bank's asset purchase scheme. The Bank is also likely to add a "twist" by increasing the duration of JGBs it purchases.

### Downgrading the forecasts

In the Bank's *Outlook for Economic Activity and Prices* to be published tomorrow, Board members will update their projections for GDP and core inflation (which excludes fresh food prices). The median forecast is traditionally regarded as the Bank's house view. The table below shows the results of the interim update published in July and our forecasts for comparison.

**TABLE: FORECASTS OF MAJORITY OF POLICY BOARD MEMBERS**  
(% Y/Y)

	Real GDP		CPI (Excl. Fresh Food)	
	Boj Jul 11 Forecast	Capital Economics	Boj Jul 11 Forecast	Capital Economics
FY 11-12	+0.2 to +0.6 (+0.4)	+0.1	+0.6 to +0.8 (+0.7) *	-0.3
FY 12-13	+2.5 to +3.0 (+2.9)	+1.9	+0.6 to +0.7 (+0.7)*	-0.7

Sources – BoJ, Capital Economics. Figures in brackets indicate the median forecast of Board members. FY = Fiscal Year April – March.  
\* The BoJ's forecasts for the CPI are on the 2005-base CPI, CE forecasts are on the 2010-base CPI.

The Bank is unlikely to change its GDP forecast for FY2011 significantly as it remains broadly in line with consensus (and only slightly above our own view of a 0.1% increase in GDP). Forecasts for FY2012, however, now look overly optimistic. The

slowdown in the global economy and the impact of the euro-zone sovereign debt crisis have weakened the prospects for Japanese exports and added to volatility in financial markets. Domestic demand is lacking forward momentum, and the boost from reconstruction spending will be partially offset by the higher taxes needed to pay for it. We would expect a downgrade to a range of 2.0% to 2.5% for FY2012.

The Board's updated inflation forecasts will reflect the change in the CPI weights in August that caused inflation to drop sharply. If we also factor in the lagged effect of the recent falls in commodity prices, Board member's forecasts are likely to be close to zero or negative for FY2011 and FY2012, indicating the economy is still some way from escaping deflation and justifying additional policy measures.

### Further easing, with a twist

Media reports confirm that the Board is likely to loosen monetary policy further tomorrow. We anticipate the Bank will increase the size of its asset purchase scheme by another ¥5 trillion from the current ¥50 trillion ceiling. The Board is also likely to lengthen the maturity of its JGB purchases beyond the current "two-years or less" to maturity, which should add to downward pressure on longer-dated yields. However, we don't expect this to materially affect the outlook for the yen, which we now think will strengthen further. See our *Japan Update* "Yen to strengthen to 60 against the dollar" published on 26<sup>th</sup> October.

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### BANK OF JAPAN BACKGROUND INFORMATION

Interest Rate Meetings	Policy Board meets every month, with additional meetings at the end of April and October to coincide with the publication of the twice-yearly "Outlook for Economic Activity and Prices". Meetings are usually two days, with the rate announcement at the end of the second day. There is a press conference after each meeting.	
Release of Minutes	Yes, minutes are published about a week after the next meeting (therefore typically about 5 weeks after the meeting concerned).	
Disclosure of Voting	Yes, at time of announcement.	
Inflation Target	The Bank of Japan's objective is to maintain "price stability". From December 2009 the Board has defined this as a year-on-year change in the CPI "in a positive range of 2% or lower" (which could be taken to mean 0.1% to 2%), with "the midpoints of most Policy Board member's understanding at around 1%". In October 2010 the Bank said it will maintain the virtually zero interest rate policy (VZIRP) "until it judges, on the basis of the understanding of medium- to long-term price stability, that price stability is in sight, on condition that no problem will be identified in examining risk factors, including the accumulation of financial imbalances."	
Policy Guidance	Press conferences and publication of "Monthly Report of Recent Economic and Financial Developments" after each regular meeting. Minutes for each meeting are then published following the next meeting. Growth and inflation forecasts published in twice-yearly "Outlook for Economic Activity and Prices" in April and October, with interim updates in January and July.	
Official Interest Rates	Policy is specified in terms of a target for the uncollateralised overnight call rate. This target is currently set at "around zero to 0.10%".	
Membership of Policy Board	Monetary policy decisions are made by a majority vote of the nine members of the Policy Board: the Governor, two Deputy Governors, and six other members.	
Governor	Mr. Masaaki Shirakawa (most recently an academic but previously a BoJ official)	
Deputy Governors	Mr. Kiyohiko G. Nishimura (previously an economics professor) Mr. Hirohide Yamaguchi (previously a senior BoJ official)	
The other six members of the Policy Board.	Mr. Seiji Nakamura (previously at MOL Ferry Co.) Mr. Hidetoshi Kamezaki (previously at Mitsubishi Corp.) Mr. Tadao Noda (previously at Mizuho finance group) Mr. Ryuzo Miyao (previously an academic) Mr. Yoshihisa Morimoto (previously at Tokyo Electric Power Co.) Ms. Sayuri Shirai (previously an IMF economist and academic)	
<b>Scheduled Meetings</b>	<b>Date</b>	<b>Outcome / Capital Economics Forecast</b>
* Publication of half-yearly "Outlook for Economic Activity and Prices"	28 Apr *	No change (Mr. Nishimura dissented in favour of another ¥5 trillion of QE)
	18 – 19 May	No change
	13 – 14 Jun	No change
** Interim update	11 – 12 Jul**	No change
	4 – 5 Aug	No change, QE target raised to ¥15 trillion
	6 – 7 Sep	No change
	6 – 7 Oct	No change
	27 Oct*	No change, ¥5 trillion expansion to QE
	15 – 16 Nov	No change
	20 – 21 Dec	No change (target rate ends 2011 at 0.10%)

Sources – Bank of Japan, Capital Economics