July 29, 2016

TD Economics

International Commentary: Bank of Japan eases less than expected

- Yesterday the Bank of Japan (BoJ) decided to ease monetary policy by almost doubling its annual purchases of ETFs to 6 trillion yen from 3.3 trillion yen. In addition, the bank doubled its U.S. dollar lending program to overseas firms to $24 billion USD from $12 billion USD. Lastly, the BoJ established a new facility for lending securities to be pledged as collateral for U.S. dollar funds-supplying operations. These actions were viewed as underwhelming by the market, which had been expecting more substantial monetary accommodation, such as a reduction in its negative deposit rate by one-tenth of a percentage point to -0.2%. The yen strengthened to about 103 from 105 per USD (or 2.0% appreciation) on the news.

- Along with its update on monetary policy, the BoJ released revised forecasts for the Japanese economy that were somewhat firmer than April's outlook, motivated mainly by the decision to delay the rise in the consumption tax until October 2019. The median forecast for 2016 growth on a fiscal year basis (April 1 to March 31) was revised down to 1.0% from 1.2%, while growth in fiscal 2017 and 2018 was revised to 1.3% (previously: 0.1%) and 0.9% (previously: 1.0%), respectively. The outlook for year-on year inflation was revised down to 0.1% from 0.5% for fiscal 2016, while inflation forecasts for 2017 and 2018 were unchanged at 1.7% and 1.9%, respectively. Strengthening inflation over the forecast horizon is partly related to the expected pass-through from higher oil prices.

- Being the first meeting after the UK referendum, the BoJ cited developments in overseas economies as one of the main risks to the Japanese economy. In particular, the BoJ is closely monitoring the uncertain impacts on Japanese exports and financial markets from the aftermath of the UK vote to leave the EU. Additionally, the BoJ is monitoring what they deem highly uncertain future economic developments in its emerging market trading partners, including China.

- Earlier this week Prime Minister Shinzo Abe announced plans for an enhanced fiscal stimulus package amounting to 28 trillion yen – about 6% of Japan's economy. However, details are scarce on how much of this will actually be in the form of direct spending, and the timeline remains vague.

Key Implications

- While the modest expansion in ETF purchases disappointed markets, the BoJ signaled that there could be more monetary stimulus on the way. In the statement it referenced the need to undertake a full evaluation of their asset purchase programs and negative interest rate policies in order to assess their adequacy in terms of achieving the 2% inflation target. Given the highly uncertain external environment and plans for additional fiscal stimulus, the BoJ appears to have chosen to delay further monetary policy easing measures until the conclusion of the BoJ's next meeting on September 21st.

- While we remain of the view that the additional monetary stimulus announced in January should help the Bank of Japan move closer to its inflation target, temporary factors such as past declines in energy prices and exchange rate movements driven largely by external developments continue to make it difficult to assess underlying trend inflation (see our June quarterly economic update for our outlook on Japan). Moreover, plans for large fiscal stimulus that is accommodated by monetary policy should help bolster the efforts of Japanese authorities to boost aggregate demand sufficiently to help push inflation toward the BoJ's 2% target.

- However, the success of the BoJ in achieving its inflation target ultimately rests upon the ability of the "Three Arrows" economic policies of Prime Minister Shinzo Abe's government to boost domestic demand. We anticipate that household expenditures should be boosted by the continued tightening in labor markets, but this is likely to take some time to materialize given the continued slow pace of wage increases.

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