

# Preview: Bank of Japan

## Further easing likely, renewed intervention close

- In light of renewed appreciation pressure on JPY, we now believe Bank of Japan (BoJ) will announce some small easing steps in connection with tomorrow's monetary meeting. The force of the response will depend on the development in JPY in the wake of today's EU summit.
- Most likely BoJ will announce its own version of Fed's 'Operation Twist' by extending the maturities of its bond purchases, while leaving the overall size of its asset programme unchanged at JPY15trn. With only about 50% of its asset purchase programme limit utilized, it makes little sense to raise the limit at this stage.
- Should appreciation pressure intensify we believe Japan will eventually respond with intervention and the monetary easing measures will also be more forceful. At this stage an increase in the 6-month fund supplying operation or extending the maturities in the fund supplying operations look like the most likely steps.

### Small easing step expected tomorrow

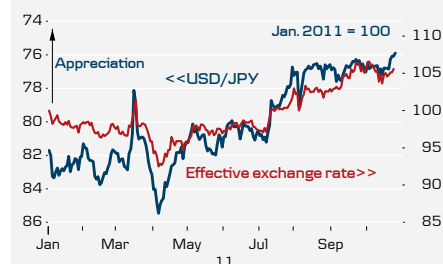
Bank of Japan will conclude its monetary meeting tomorrow morning (CET). In light of the renewed appreciation pressure on JPY and with USD/JPY currently testing new lows, we now expect BoJ to announce new small easing measures in connection with tomorrow's monetary meeting. BoJ will be able to respond to the development in financial markets in the wake of today's EU summit. The forcefulness of BoJ's response will probably depend on the development in the JPY exchange rate overnight. Should risk aversion increase and appreciation pressure intensify, renewed intervention in the FX market is imminent in our opinion and will most likely be followed by an expansion of BoJ's quantitative easing programme (QE).

As in Switzerland, monetary policy in Japan is increasingly driven by the exchange rate development. Since September last year announcements of additional QE have been made in connection with JPY appreciation and intervention in the FX market. There is a broad consensus among the government and the board members that the strong JPY is a major threat to the recovery although the Japanese economy has now largely recovered from the impact from the earthquake.

In Japan the leading interest is currently 0.1% so, as is the case in most other major developed markets, cutting interest rates is no longer an option. Hence BoJ's has to either expand or adjust its QE programme. Currently QE consists of an asset purchase programme (JPY15trn) and provision of liquidity for 3-month and 6-month maturities at 0.1% interest rate (JPY35trn).

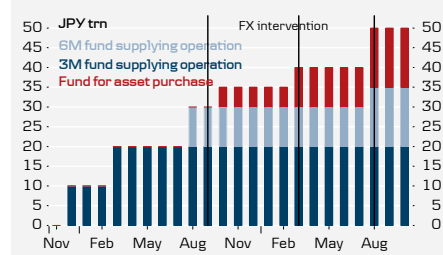
Tomorrow it will mainly be important for BoJ to show it is doing something. For that reason we only expect a modest easing unless JPY appreciates significantly overnight. We think BoJ will announce its own version of 'Operation Twist' by extending the maturities of its bond purchases. Currently BoJ is only allowed to purchase government and corporate bonds with maturities less than two years. .

### Renewed appreciation pressure could force BoJ to respond



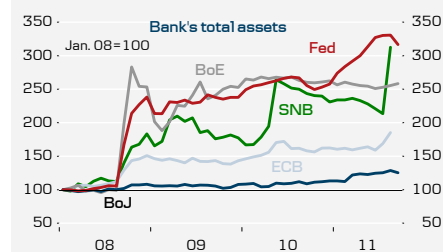
Source: Reuters Ecowin and Danske Markets

### QE announcements have been driven by exchange rate developments



Source: Bank of Japan & Danske Markets

### BoJ's QE picking up pace, but it is still trailing other central banks



Source: Reuters Ecowin and Danske Markets

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Currently BoJ has utilized less than 55% of its asset purchase limit and it makes little sense to increase the limit for asset purchases at this stage. Consequently, the most likely outcome is that BoJ increases its fixed rate supply operations programme. This programme is currently 92% utilized and it makes more sense to increase this part of the QE programme at this stage. If this programme is expanded, it will most likely be a JPY5trn increase in the 6-month funds supplying operation. This would be a stronger response than the aforementioned ‘Operation Twist’ - particularly if it is increased by more than JPY5trn or if the maturity is extended to more than 6 months.

### BoJ's will release revised macroeconomic forecasts

BoJ will tomorrow also release new macroeconomic forecasts (note that forecasts cover the fiscal year April-March). The most notable difference is that BoJ's inflation forecast is poised to be revised markedly lower, but this solely reflects the technical impact from the reweighting of the consumer basket used to calculate consumer prices. Reweighting has subtracted about 0.5pp from the year-on-year increase in consumer prices.

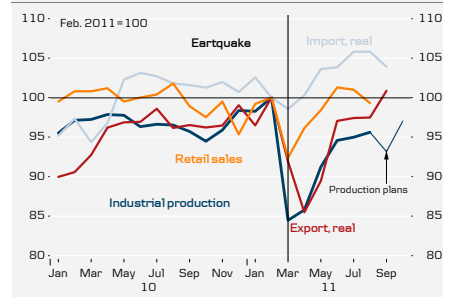
We do not expect major changes in BoJ's growth forecast, although a downward revision of FY 2012 is possible on the back of a weaker global outlook. On balance, recent economic data have been encouraging and the Japanese economy has now largely recovered from the impact from the earthquake and tsunami in March. Particularly data released earlier this week showed that exports were surprisingly strong in September and are now back to pre-earthquake levels. The strong export data suggest that GDP growth could be around 5% q/q AR in Q3. However, data for September to be released on Friday and early next week are likely to show that the recovery is poised to lose some steam. Even though the recovery is poised to lose considerably more steam in Q4, Japan will continue to perform relatively well compared to Europe and the US because of the impact from reconstruction.

### Bank of Japan's macroeconomic forecasts

%	GDP		CPI	
	BoJ*	Danske Bank	BoJ*	Danske Bank
FY 2011	0.4	0.5	0.7	-0.1
FY 2012	2.9	2.5	0.7	0.2

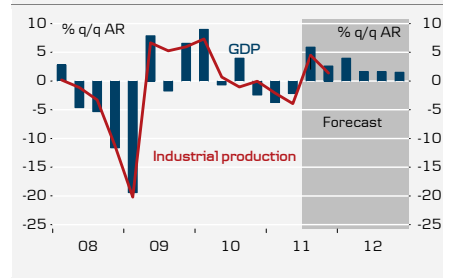
Note: \* Bank of Japan board member forecast from July 2011. FY= fiscal year April-March

### Japan has largely recovered from the earthquake in March



Source: Reuters Ecowin and Danske Markets

### Resilient H2 in Japan despite weaker global economy



Source: Reuters Ecowin and Danske Markets

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