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Industry Note

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BOJ: Expect NIRP Exit in April

KEY TAKEAWAYS

Last April, the IMF warned off the potential for spillover effects to the global bond markets as Japan exited its negative interest rate policy (NIRP): rising Japanese yields could 'provide an incentive for the repatriation of Japanese portfolio investments as well as drawing foreign investors into Japanese bonds – pushing up the foreign exchange value of the yen and putting upward pressure on [global] interest rates.'

We continue to expect the BOJ to raise its policy rate by 10bps at the meeting of April 25, after the Spring wage negotiations, thereby ending NIRP. This will make US treasury's relatively less attractive than JGBs both on a currency-hedged basis (since the cost of currency-hedging results in a significantly negative spread) and on an outright basis (since there will be less tolerance than last year, as NIRP ends, for the risk of an appreciating yen).

Ratings

Howard Mason
Monetary Policy
212.537.8814
hmason@renmac.com

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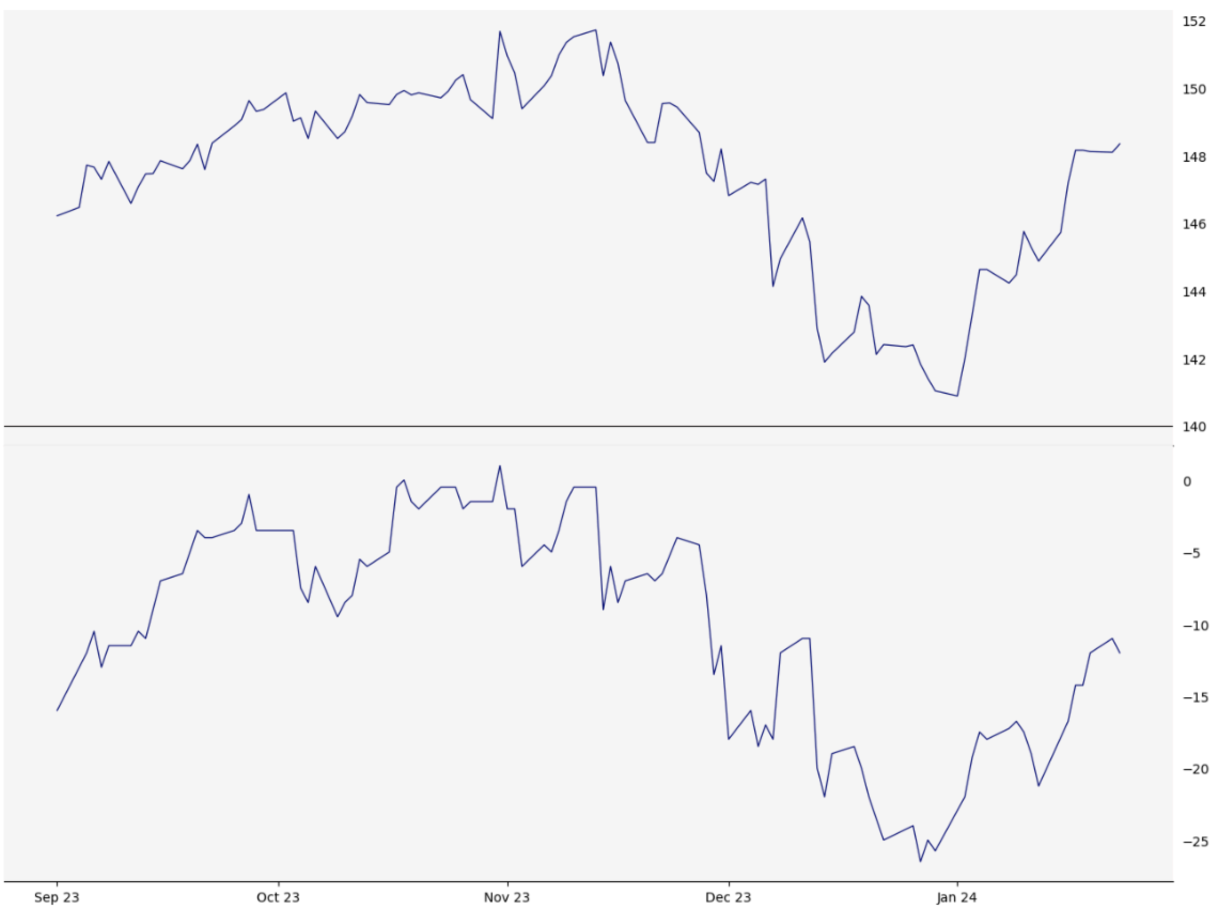
Dollar-yen has tracked market expectations for a FED cut in March with the dollar strengthening as the market pricing has retreated over the last month from a full cut at the March meeting to nearer half a cut today (Ex 1). It has not helped the yen that, over the month to January 11, the market has shifted from pricing at least a full BOJ hike at the April meeting to nearer a 20% chance of a hike (although that probability has since increased to over 50%).

Ex 1: Dollar-Yen (Upper) and Fund Futures Apr-Jun Calendar Spread (Lower bps)



We expect dollar-yen to weaken from here given the rising risk of government intervention as we approach the psychologically important

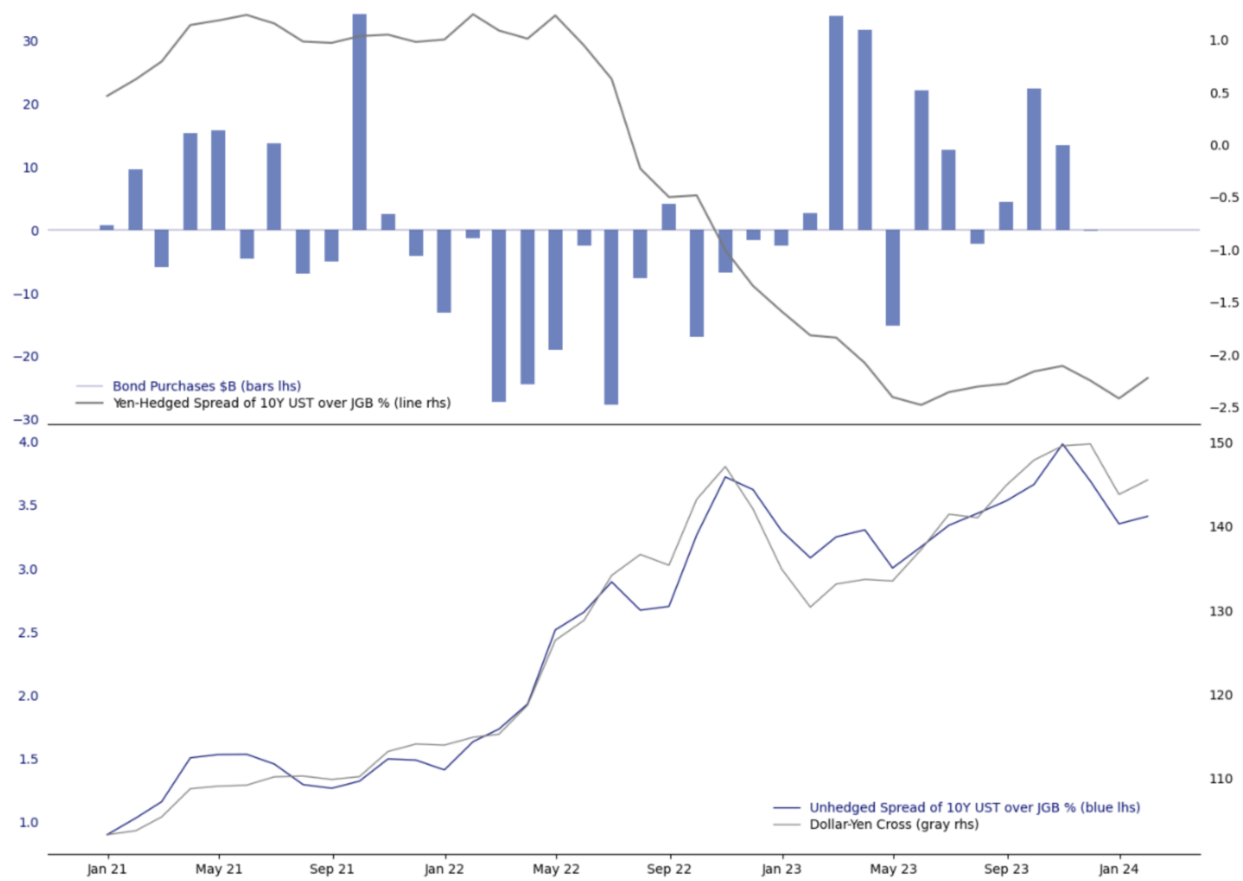
150 level and as market pricing firms for a BOJ hike in April. Given the step-size for the BOJ is 10bps, and that the policy rate is presently negative 10bps, this would represent an exit of the long-standing negative interest rate policy (NIRP). Bloomberg reports that BOJ officials view their expectations for inflation, currently 2.4% for the fiscal year beginning in April as high enough to justify ending the negative rate.

However, there is a concern to ensure inflation is well-anchored to the policy target of 2%. We expect the 'Shunto' wage negotiations in the Spring to support the presence of a sustainable wage-price cycle and hence a hike at the policy meeting of April 25. Governor Ueda appears to be looking to re-assure those concerned about premature tightening when he says, 'extremely accommodative financial conditions will stay in place for the time being even if the negative rate is ended.'

A strengthening yen, and the increase in yields across the curve (including likely further relaxation of the BOJ's policy of yield curve control even after an October recharacterization of the 100bps level for 10-year JGBs as a reference rather than a cap), will increase the relative attractiveness of domestic bonds. The IMF warned, in its financial stability report of April, of potential spillover effects to the global bond markets from rising Japanese yields that could 'provide an incentive for the repatriation of Japanese portfolio investments as well as drawing foreign investors into Japanese bonds – pushing up the foreign exchange value of the yen and putting upward pressure on [global] interest rates.'

There is already a downward trend in net purchases of US treasury bonds by Japanese funds (Ex 2). There were net buys in 2023, despite a significantly negative spread for USTs over JGBs *after currency-hedging*, as Japanese funds chose to absorb the risk of yen appreciation. We expect less tolerance for this risk as the BOJ begins to tighten monetary policy albeit gradually and from a negative policy rate.

Ex 2: Net Purchases of US Treasury Bonds by Japanese Funds and Yen-Hedged Yield



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