

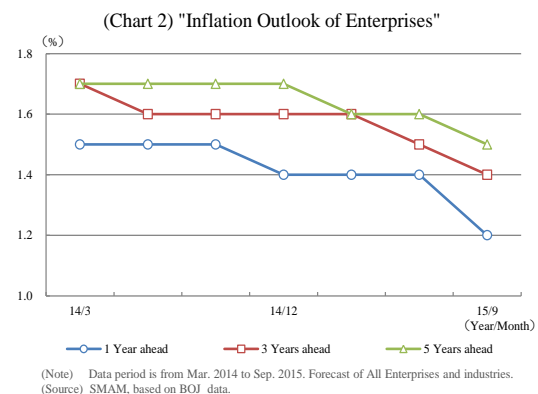
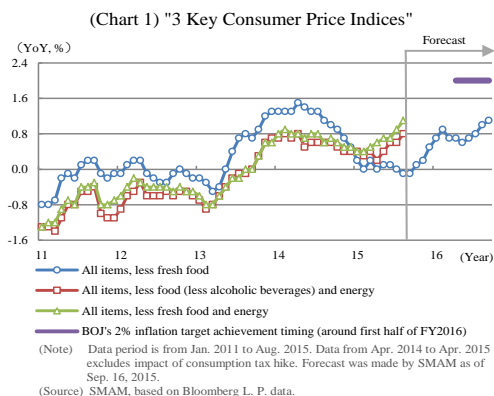
BOJ's Policy Board Members and Monetary Policy Outlook (Part 2)

- The effect of the “Positive cycle of income to expenditure” mechanism can be observed in households at this moment.
- No concern over deflation is necessary although China's slowdown is negatively impacting corporate activities and the rise in prices is small.
- Additional monetary easing is expected by January 2016. It may be the appropriate time to revisit current policy theories.

The effect of the “positive cycle of income to expenditure” mechanism can be observed in households at this moment.

As discussed in my previous report, there are few reasons for abrupt additional monetary easing on October 30th, considering the diverse standpoints of policy board members (3 positive, 3 negative and 3 neutral), the recent trend of private consumption and the relatively stable USD/JPY rate. However, I believe that the possibility of additional easing is higher than in this spring as the financial market volatility rose in the past few months.

Therefore, in this report, I will discuss on BOJ's next move and the timing of its implementation. As a start, let's look into the consumption trend to outline the Japanese domestic macro environment. According to the August Monthly Labour Survey, the real wage index rose +0.2% YoY for two consecutive months and according to the Family Income & Expenditure Survey on the same month, real consumer expenditure (Two-or-more-person Households) also rose +2.9% YoY for the first time in three months. In other words, as pointed out by BOJ's Governor Kuroda, the effect of the “positive cycle of income to expenditure” mechanism was confirmed.



No concern over deflation is necessary although China's slowdown is negatively impacting corporate activities and the rise in prices is small.

Next, let's look into corporate activities. BOJ's September Tankan showed Current DI of large manufacturers deteriorated whereas that of non-manufactures improved. On the other hand, the August Industrial Production index slowed by -0.5% MoM, decreasing for two months in a row and Machinery Orders of the same month also decreased by -5.7% MoM, decreasing for three consecutive months. In addition, basic assessment of both indices was revised downward confirming significant impact of China's slowdown.

As for the August Consumer Price Index growth rate (YoY), while "All items, less fresh food" fell -0.1% MoM, both "All items, less food (less alcoholic beverages) and energy" and "All items, less fresh food and energy" increased by +0.8% and +1.1% MoM, respectively (Chart 1). Although Inflation Outlook of Enterprises for the 1, 3 and 5 years ahead of All Enterprises and industries slightly decreased from the previous survey (Chart 2), it is not large enough to fear falling back into deflation.

Additional monetary easing is expected by January 2016. It may be the appropriate time to revisit current policy theories.

Accordingly, I highly expect the possibility of additional monetary easing on October 30th being postponed. However, even if the inflation forecast is revised downward in the Outlook Report to be released on October 30th and the timing of achieving the inflation target is postponed, I expect additional easing will be implemented by January 2016 when the next Outlook Report will be publicized, since BOJ's Governor Kuroda himself admitted they are still half way to achieving the 2% inflation target. In such case, the key monetary policy will be to increase the purchase of long term JGBs (increase the annual balance to around JPY 10 trillion) if the Yen were to appreciate sharply against the US Dollar or, if not, purchase bonds with longer maturities to lengthen the average duration and increase the amount of ETFs to be purchased.

I think it may be the appropriate time to revisit current policy theories. For example, the timing of achieving the inflation target should be changed from "around 2 years" to "in medium term" when stable price growth is confirmed. Bearing in mind the impact of massive purchases of JGBs to the financial market, there should be discussions on changing back the operational target from monetary base to interest rates.

*** Please note that this report is a translation of Japanese report written on October 9th, 2015.**

Disclaimer

Please read this disclaimer carefully.

- This material is for non-Japanese institutional investors only.
- The research and analysis included in this report, and those opinions or judgments as outcomes thereof, are intended to introduce or demonstrate capabilities and expertise of Sumitomo Mitsui Asset Management Company, Ltd. (hereinafter "SMAM"), or to provide information on investment strategies and opportunities. Therefore this material is not intended to offer or solicit investments, provide investment advice or service, or to be considered as disclosure documents under the Financial Instruments and Exchange Law of Japan.
- The expected returns or risks in this report are calculated based upon historical data and/or estimated upon the economic outlook at present, and should be construed no warrant of future returns and risks.
- Past performance is not necessarily indicative of future results.
- ☐ The simulated data or returns in this report besides the fund historical returns do not include/reflect any investment management fees, transaction costs, or re-balancing costs, etc.
- The investment products or strategies do not guarantee future results nor guarantee the principal of investments. The investments may suffer losses and the results of investments, including such losses, belong to the client.
- The recipient of this report must make its own independent decisions regarding investments.
- The opinions, outlooks and estimates in this report do not guarantee future trends or results. They constitute SMAM's judgment as of the date of this material and are subject to change without notice.
- The awards included in this report are based on past achievements and do not guarantee future results.
- The intellectual property and all rights of the benchmarks/indices belong to the publisher and the authorized entities/individuals.
- This material has been prepared by obtaining data from sources which are believed to be reliable but SMAM can not and does not guarantee its completeness or accuracy.
- All rights, titles and interests in this material and any content contained herein are the exclusive properties of SMAM, except as otherwise stated. It is strictly prohibited from using this material for investments, reproducing/copying this material without SMAM's authorization, or from disclosing this material to a third party.

Registered Number: Kanto Local Finance Bureau (KINSHO) No.399

Member of Japan Investment Advisers Association, The Investment Trusts Association, Japan and Type II Financial Instruments Firms Association

© Sumitomo Mitsui Asset Management Company, Limited