

Pro growth Japan—One Team, One Dream

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We expect added Bank of Japan (BOJ) action. A move as early as this week is possible—the BOJ policy board meets Oct 7, but I personally think that a move at the next meeting, on October 30, is more likely. That's because the key in Japan is coordination of policy, with both monetary and fiscal policy being eased together. Team Abe¹ is very focused on reasserting the “one team, one dream” focus; so I expect a simultaneous and well-coordinated announcement of both monetary and fiscal easing. **A ¥600 Trillion Nominal Gross Domestic Product (GDP) Target for the BOJ?** In my view, it is also possible that the BOJ will accept Prime Minister Abe's newly announced nominal GDP target of ¥600 trillion—a move from a Consumer Price Index (CPI) target to a nominal GDP target is in the cards, in my view. In essence, this would mean that the BOJ promises to stay accommodative until nominal GDP hits ¥600 trillion (it currently is at about ¥510 trillion).² This would not only free the BOJ from the terms-of-trade and commodity price-related volatility of the CPI but would significantly raise the commitment credibility of a coordinated all-out pro-growth policy. **A Supplementary Budget Boost** For an added fiscal boost, we expect a supplementary budget of around ¥5 trillion, with ¥1–¥2 trillion in added public works and the remainder for childcare and elderly support. Given political schedules, it looks unlikely that a supplementary budget proposal would be ready by October 7, but October 30 is possible. **A Sizable Boost from the BOJ** For the BOJ, we expect a sizable increase in exchange-traded fund (ETF) and real estate investment trust (REIT) purchases as well as a broadening of the bond-buying mandate to include local and regional government bonds in addition to “zaito” bonds (issued by the fiscal investment and loan program administered by the Ministry of Finance); currently only national government-issued Japanese government bonds (JGB) are eligible. For ETFs, the BOJ has purchased ¥2.49 trillion in ETFs year-to-date, which is roughly 83% of its ¥3 trillion target. This is well ahead of schedule—we are only 67% through the year. I expect the BOJ to double its ETF purchase budget to ¥6 trillion (from the current ¥3 trillion).³ Similarly, Japanese real estate investment trust (J-REIT) purchases are also ahead of budget, with ¥76.6 billion year-to-date, i.e., 85% of the budgeted ¥90 billion. I expect the J-REIT budget to double as well, to ¥180 or ¥200 billion (from the current ¥90 billion).⁴ **Negative Rates?** There is some discussion about the BOJ's introduction of negative interest rates. Here, we are not convinced this will happen. A primary reason is the potentially negative impact of negative rates on the banking system's profit margins. Specifically, the upcoming privatization of the Postal Bank reduces the probability of negative rates as a policy tool in Japan, in our view. This being said, we are moving closer to Abenomics rebuilding its pro-growth credentials. In our view, the potential for a de facto new BOJ policy regime toward nominal GDP targeting is poised to reignite global and local investor interest in yen risk assets, equities and real estate. The coming four weeks will likely be of key importance in verifying our thesis. ¹Refers to Japanese prime minister Shinzo Abe and his supporters.

2Source: Bank of Japan, as of 9/30/15. 3Source: Bank of Japan, as of 9/30/15. 4Source: Bank of Japan, as of 9/30/15.

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