

FX Insight

What a Ueda Selection Means?

More Gradual Policy Shift Expected for BOJ with the Boat Unlikely to Be Rocked So Soon

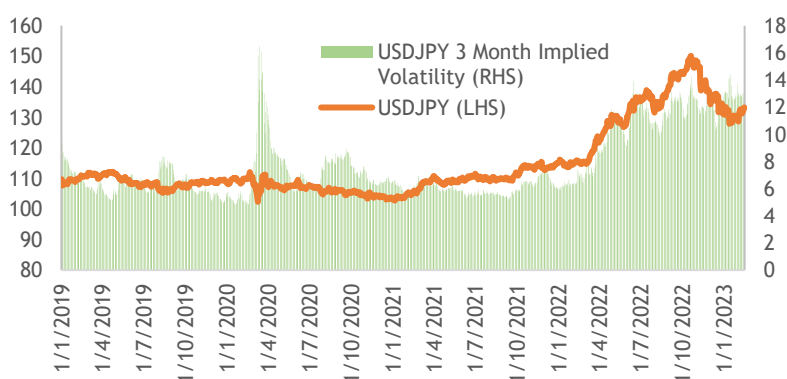
Last week's Nikkei report on the potential nomination of Kazuo Ueda as the BOJ Governor caused much of a surprise in markets given that his name came almost out of thin air. The news itself was confirmed when the Japanese government on 14 Feb had submitted his name as their nominee. Despite the surprise, his appointment does not actually change our outlook regarding the BOJ actions and the JPY. Ueda has in the past been supportive of an easy interest rate policy although he was more wary of QE and YCC. As such, he would be unlikely to lead the exit out of NIRP so soon whilst the lifting of the YCC would probably be more gradual. A widening of the YCC band by 25bps to +/-0.75% we believe would be the more likely action within 2023.

USDJPY Forecasts Stand Whilst BOJ Less of a Source of Volatility Near Term

Our USDJPY forecasts which sees a downward trend for the pair this year had been based on assumptions of such actions. Resultantly, our strategies have also therefore not changed. We believe to still go short on the USDJPY and to long the JPYPHP. The JPY is likely to outperform the PHP given the fundamental risks associated with the latter including a deep twin deficit and persisting elevated inflation. The ASEAN currencies that we had found previously to most strongly benefit from JPY strength include the IDR and THB.

In the interim until end April when Ueda is likely to take office, we expect the BOJ's actions and words to be less of a source of volatility for the JPY. The potential new governor may aim try to ensure as much market stability as possible until he takes office. This was in way echoed in his words last Friday after the Nikkei report had first emerged. The academic had said that "continuing monetary easing will be necessary" in a sign that he does not wish to shock the markets so soon with major adjustments.

Chart 1: USDJPY Vols More Elevated in the Last Year



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Background

The Japan government on the 14 Feb submitted Kazuo Ueda, an academic to the National Diet as their choice to be the next Bank of Japan (BOJ) Governor. A Nikkei report last Friday on 10 Feb had surprised many in the market when it had mentioned that the relatively unknown Ueda was going to be selected. Finding information about Ueda online has been challenging given that the academic was part of the BOJ Board long ago and many comments made by him were rather dated. Two other Deputy Governor nominees have also been announced which were namely Shinichi Uchida, BOJ Executive Director and Ryozi Himino, former FSA Chief.

The Academic had Shown Support in the Past for Some of the BOJ's Loose Interest Rate Policies

Ueda was part of the BOJ board back in 1999 when zero interest rates were first introduced and was known to have backed the policy. He had advocated aggressive action by the BOJ to tackle demand weakness in the Japanese economy although at the same time he had also insisted in effective communication so as not to confuse markets and ensure that they adapted to the BOJ's actions. Later in 2000, he had dissented against a BOJ decision to lift the zero interest rates as he was concerned about equity market weakness. He was to be proven right about this as the Nikkei index kept falling until 2003. Ueda would later on show support for the BOJ's decision in 2016 to introduce a negative interest rate policy (NIRP) as he appeared to believe that it would give the BOJ continued ammunition to support the economy. Despite being supportive of easy interest rate policies, the academic has warned in the past that "the textbook understanding that identifies lower interest rates with greater easing effects may not always be right". As it stands, the economic case is not strong for the BOJ to move interest rates so it looks likely that Ueda led Board would not adjust.

However, Ueda Appears More Wary of The BOJ's QE or Yield Targeting Programmes

Ueda over the years looks to have repeatedly warned about the consequences of the BOJ's QE or yield targeting. The immediate impression is that he doesn't seem to have even supported the introduction of QE. He had previously emphasized that a "commitment of zero interest is stronger than quantitative terms" and warned about the disastrous impact if inflation still does not pick up and economy does not improve after such measures are introduced. He had also mentioned that YCC would only lead to more speculative activity on the bond market and that it is "unclear how long the bank can keep buying JGBs" as the "functioning of the market has deteriorated significantly". The academic looks to have been proven right to some extent about the issues in the bond market and that he is pretty much now taking on the challenge to deal with this in his capacity as the new BOJ Governor. Given his views, existing bond market issues and the BOJ December move, there is an increasing possibility that Ueda may try to lift the YCC policy. The move though is likely to be more gradual as Ueda himself has in the past often warn about the risk of adverse market reactions with sudden moves such as when the bank lifted zero interest rates in 2000.

Ueda Also Holds a Bit of an “Unassociated” Slate to Adjust BOJ Policy

As an academic who hasn't served on the BOJ board for a long time, Ueda may have the perception of neutrality in addition to a disassociation from the current regime. This should ease his communication with the markets as he would be less likely to face the credibility issues that existing board members may encounter. However, establishing and keeping effective communications with the market during his term may prove challenging given macro uncertainty and the speculation that can rock the JPY related assets.

However, We Believe Ueda is Likely Not to Rock The Boat Too Soon

Last Friday, following the Nikkei report, Ueda had said that the “current BOJ policy is appropriate” and “that continuing monetary easing will be necessary”. This gives some indication that Ueda may not choose to give any indication near term of making any major adjustments to the BOJ monetary policy stance. He maybe choosing to act as such given that he would most likely want to ensure as much market stability as possible at the start of his potential new term.

What are the Key Dates?

24 Feb: Lower and Upper House hearings would be held for the Governor and Deputy Governor nominees

20 Mar and 9 Apr: If they are confirmed by both houses, the new Deputy Governors take office on the 20 Mar and the new Governor on 9 Apr

27 - 28 Apr: First BOJ meeting under the new Governor

What are the implications for the JPY?

As a whole, the potential appointment of Kazuo Ueda does not change our forecasts for the USDJPY of which we expect a downward trend for the pair. Our forecasts had been based on the assumption that the BOJ would not exit NIRP this year whilst also seeing that any dismantling of the YCC would be rather gradual with only a widening of the band by 25bps to +/- 0.75% being done in 2023. A Ueda lead board we believe is likely to undertake such actions as per our assumptions.

Therefore, our strategy still holds to go short USDJPY. Additionally, we had also recommended long JPYPHP and similarly this hasn't change given the JPY is likely to still outperform the PHP due to fundamental issues related to the latter. Meanwhile, the ASEAN currencies that we had found previously to benefit most from JPY strength include the IDR and THB.

In the interim until at least Ueda's first meeting in April, we expect the BOJ related events to be less of a source of volatility for the JPY given the potential new governor may avoid rocking the boat too soon.

USDJPY Forecasts:

Forecast	1Q 2023	2Q 2023	3Q 2023	4Q 2023
USDJPY	132	128	125	122

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