

Japan Watch

BoJ review: One step closer to normalization

At its first monetary policy meeting (MPM) of the year, the BoJ left all key policy targets unchanged, as widely expected. In a housekeeping exercise, the BoJ board voted unanimously to extend by one year the deadline for its funding-for-lending program. Elsewhere, there were little changes to the policy statement. The central bank also left all components of its forward guidance intact (Exhibit 6).

Outlook report: Optimism on 2% price stability

While the policy statement did not contain language hinting at an immediate policy move, the BoJ's latest Outlook Report reflected the policy board's growing optimism that the achievement of its 2% price stability target was drawing closer. We highlight the following three key points:

1) Having re-iterated its long-standing baseline scenario that "underlying CPI inflation is likely to increase gradually toward achieving the [2%] price stability target" toward the end of the projection period [ending Mar '26], the BoJ added new language stating that "the likelihood of realizing this outlook has continued to gradually rise, although there remain high uncertainties over future developments."

Governor Ueda had made similar comments verbally in recent press conference remarks. However, this was the first time that such comments appeared in the Outlook Report, suggesting that optimism around the prospects of sustained and stable 2% inflation is becoming consensus on the 9-member policy board.

2) For its latest GDP projections, the BoJ downgraded slightly its FY23 forecast while nudging up FY24 to 1.2% and keeping FY25 unchanged at 1.0%. Previously, it had characterized the risks around economic activity as skewed to the downside in FY25. However, it now sees those risks as "generally balanced" through its forecast horizon (FY23-FY25).

3) Finally in its assessment of current inflation, the BoJ explicitly acknowledged the recent improvement in services prices, stating that their rise had supported the continued pick-up in Japan-style core (CPI ex fresh food) inflation in the 2-2.5% range despite the waning of imported inflation pressures.

Note that for its CPI projections, the BoJ downgraded its FY24 Japan-style core (CPI ex fresh food) projection by 0.4ppt to 2.4% (Exhibit 1). But as we had expected, the BoJ explained in its Outlook Report that the downward revision was largely due to lower energy prices. The more stable BoJ-style core (CPI ex fresh food & energy) projections were unchanged at 3.8% in FY23, 1.9% in FY24, and 1.9% in FY25.

Governor Ueda press conference: hawkish

Questions at Governor Ueda's post-MPM press conference focused on the BoJ's assessment of the "distance" to the achievement of sustained and stable 2% inflation, and the policy path thereafter. (continued overleaf)

23 January 2024

Economics
Japan

Izumi Devalier
Japan and Asia Economist
BofAS Japan
+81 3 6225 6257
izumi.devalier@bofa.com

Takayasu Kudo
Japan and Asia Economist
BofAS Japan
+81 3 6225 8592
takayasu.kudo@bofa.com

Shusuke Yamada, CFA
FX/Rates Strategist
BofAS Japan
+81 3 6225 8515
shusuke.yamada@bofa.com

Tomonobu Yamashita
Rates Strategist
BofAS Japan
+81 3 6225 7950
tomonobu.yamashita@bofa.com

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Exhibit 1: BoJ Policy Board median CPI projections vs. consensus

The BoJ left its ex-energy core inflation projections intact in January

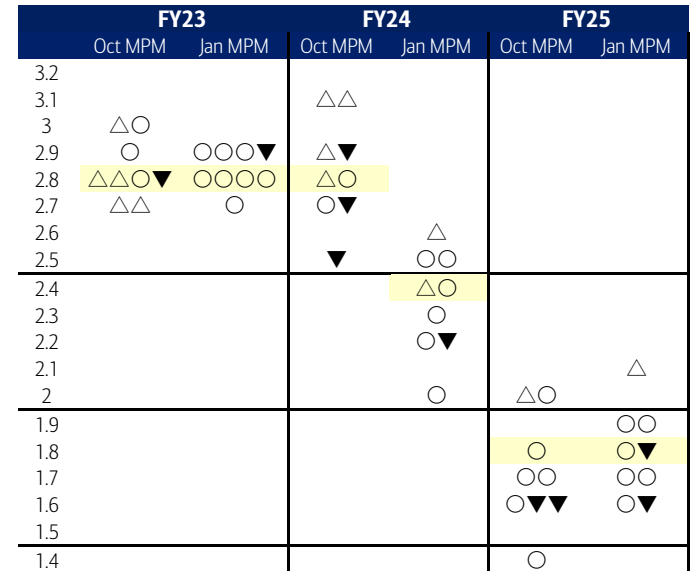
CY	CPI ex fresh food				CPI ex FF & energy			
	BoJ (Oct)	BoJ (Jan)	BBG (12 Jan)	BofA (9 Jan)	BoJ (Oct)	BoJ (Jan)	BBG (12 Jan)	BofA (9 Jan)
23	--	--	3.1	3.1	--	--	4.0	3.9
24	--	--	2.3	2.5	--	--	2.2	2.5
25	--	--	1.7	1.9	--	--	1.6	2.0
FY								
23	2.8	2.8	2.9	2.8	3.8	3.8	3.9	3.9
24	2.8	2.4	2.2	2.4	1.9	1.9	2.0	2.2
25	1.7	1.8	1.7	1.8	1.9	1.9	1.7	1.9

Source: Bank of Japan

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Exhibit 2: BoJ CPI ex Fresh Food forecasts (Jan vs. Oct)

Policy Board Members' Forecasts and Risk Assessments



Source: Bank of Japan, BofA Global Research; Note: The locations of O, Δ, and ▼ in the charts indicate the figures for each Policy Board member's forecasts to which they attach the highest probability. The risk balance assessed by each Policy Board member is shown by the following shapes: O indicates that a member assesses "upside and downside risks as being generally balanced," Δ indicates that a member assesses "risks are skewed to the upside," and ▼ indicates that a member assesses "risks are skewed to the downside." The yellow-shaded figure refers to the median of the Policy Board members' forecasts.

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On the "distance" to the 2% target

Consistent with the increased optimism in the Outlook Report, Governor Ueda confirmed that the data—including early signals from the spring wage negotiations—were moving in the right direction, and that the BoJ is getting closer to declaring its 2% price stability "in sight".

He also stated clearly that when the BoJ reaches this point when it can project the achievement of underlying 2% inflation on a forward-looking basis, "it would need to consider whether to continue the various large-scale monetary easing measures that it currently has in place, including negative interest rate policy." He later mentioned that this would also include discussions over the BoJ's ETF purchase program.

We think it is notable that the Governor delved deeper into further details around the policy exit today and think it is reflective of growing consensus on the policy board for policy change in the coming months.

On the prospect of additional hikes post NIRP exit

Governor Ueda was also asked about the timing of subsequent hikes, following the lift off from NIRP. On this point, the governor acknowledged that the BoJ would be making the judgment to exit NIRP while also thinking about the subsequent path for policy rates.

We take this to mean that, under its baseline scenario, the BoJ does not foresee policy the exit from NIRP being followed by "zero interest rates (ZIRP) forever," as expected by some market participants before today's policy meeting.

On the pace of normalization & avoiding "discontinuity" in policy

However, Governor Ueda balanced these remarks by suggesting that the BoJ currently sees the risks of an unwanted overshoot in inflation to be low, and that the pace of policy normalization will likely be gradual. He stressed several times that the BoJ would take care to ensure that the policy normalization does not cause "serious or major discontinuities."

On ETF purchases, he all but ruled out the idea that the BoJ was considering selling its ETF holdings in the foreseeable future. He also implied that the BoJ will continue intervening in the bond markets (via its JGB purchases) even after it transitions away from its current Yield Curve Control framework, in order to avoid “discontinuities” around the time of an exit from its large-scale easing program.

Most importantly, Governor Ueda stressed that, based on the BoJ’s current assessment for the outlook for Japan’s economy and prices, monetary policy will likely remain accommodative even after the BoJ declares 2% inflation “in sight” and exits NIRP.

We think the governor’s remarks are consistent with our view that the exit from NIRP will be followed by additional hikes, albeit at a gradual pace and to levels well below estimates of Japan’s nominal neutral rate (see [BoJ Watch: Eyes on April 11 January 2024](#)).

Policy outlook: high likelihood of NIRP/YCC exit in April

Looking ahead, we expect the BoJ to declare its 2% price stability target “in sight” and exit NIRP+YCC in April-July ’24 (see [BoJ Watch: Eyes on April 11 January 2024](#)). In our view, the more optimistic tone in the January Outlook Report and Governor Ueda’s press conference remarks strengthen the probability that the BoJ will make the move at the 25-26 April MPM, in line with our baseline scenario.

Note that unlike his post-Dec MPM press conference where he downplayed the chances of policy change at the January MPM, Governor Ueda did not rule out the possibility that the BoJ may have enough data to declare its 2% price stability “in sight” and therefore change policy at its next MPM, on 18-19 March.

While we certainly would not rule out such a scenario, we still think that probability that the BoJ actually delivers policy changes at the March MPM is relatively low. Though Japan’s largest umbrella union (Rengo) is scheduled to publish the results of the first response round of the FY24 Shunto on 15 March, waiting until April will allow the BoJ to confirm the results of the 1Q BoJ Tankan (due 1 April), as well as reports from the April BoJ branch managers’ meeting (Exhibit 5).

The BoJ’s next Outlook Report, in April, will also see the policy board extending its growth and inflation forecasts to FY26. Having already penciled in 1.9% ex-energy core inflation in FY24 and FY25, we think it is likely that the FY26 projection will also see inflation sustained at around 2%, supporting the case for a move off emergency policy settings.

Beyond that, we expect the BoJ to follow up its exit from negative rates policy in April ’24 with two additional 25bp hikes, in 4Q ’24 and 2Q ’25, taking the policy rate to 0.5% by mid-2025 (see [BoJ Watch: Eyes on April 11 January 2024](#)).

- Izumi Devalier & Takayasu Kudo, Japan Economists

Rates: JGB yields to rise only in a gradual manner

As noted above, the BoJ maintained the status quo. The yen rates market reaction was limited after BoJ’s announcement, but JGB futures were sold during Governor Ueda’s press conference. We can say that the yen rates market interpreted BoJ Governor Ueda’s press conference as hawkish.

In our view, excess JGB supply will push up the yields on the JGBs throughout 2024 (for details, see [Liquid Insight: Japan risks for 2024 18 January 2024](#)). However, we expect the JGB yields to rise only gradually. As discussed above, Governor Ueda stressed in his press conference that the BoJ would seek to avoid “discontinuities” around the exit, suggesting that it would proceed with additional rate hikes and balance sheet normalization in a cautious and gradual manner. In addition, according to our FX and Rates sentiment survey, the consensus for NIRP to end is 2Q24 (for details, see [FX and](#)

[Rates Sentiment Survey: Hung jury 12 January 2024](#)). Thus, we see a JGB sharp selloff in the near term as unlikely.

- Tomonobu Yamashita, Rates Strategist

FX: Key dates = March 19, April 26, April 28

As our economists note, there was no major hawkish surprise (policy change, or signal to hike rate in March) but no dovish surprise either. The BoJ acknowledged further developments toward the price stability target, which keeps our scenario of the NIRP removal at the BoJ's April MPM in place. Hence, USD/JPY's slight sell-off was understandable after the pair's rise in recent sessions.

There are three key dates for JPY in the next three months:

- March 19 (Mar MPM): If the BoJ is to remove NIRP in April, the BoJ may give a signal for policy change at the March MPM.
- April 26 (Apr MPM): If Japanese economy continues to recover and the inflationary trend persists, the BoJ may be ready to remove NIRP in the April MPM (our economists' base case)
- April 28 (By-elections): At least one, but likely a few more by-elections due to the recent political scandal, may be held on April 28, and would be important for Prime Minister Fumio Kishida whose approval ratings have fallen to a danger zone.

Consensus as well as we think the BoJ will remove NIRP in April MPM (see [FX and Rates Sentiment Survey: Hung jury 12 January 2024](#)). It comes just two days before the by-elections, which may be a non-economic consideration for the BoJ as it may be more difficult to change policy around the election date all else equal.

The market may debate the possibility of the BoJ avoiding the Apr MPM, which may impact pricing for the Mar MPM and Jun MPM vs Apr MPM. But overall, these event risks may support USD/JPY vol.

- Shusuke Yamada, FX/Rates Strategist

Appendix

Exhibit 3: Schedule of BoJ monetary policy meetings and key releases in 2023-2024

2023-2024

Date of MPM		Outlook Report	Summary of opinions	MPM Minutes
30 Oct (Mon)	31 Oct (Tue)	31 Oct (Tue)	9 Nov (Thu)	22 Dec (Fri)
18 Dec (Mon)	19 Dec (Tue)	-	27 Dec (Wed)	26 Jan '24 (Fri)
22 Jan (Mon)	23 Jan (Tue)	23 Jan (Tue)	31 Jan (Wed)	25 Mar (Mon)
18 Mar (Mon)	19 Mar (Tue)	-	28 Mar (Wed)	2 May (Thu)
25 Apr (Thu)	26 Apr (Fri)	26 Apr (Fri)	9 May (Thu)	19 Jun (Wed)
13 Jun (Thu)	14 Jun (Fri)	-	24 Jun (Mon)	5 Aug (Mon)
30 Jul (Tue)	31 Jul (Wed)	31 Jul (Wed)	8 Aug (Thu)	26 Sep (Thu)
19 Sep (Thu)	20 Sep (Fri)	-	1 Oct (Tue)	6 Nov (Wed)
30 Oct (Wed)	31 Oct (Thu)	31 Oct (Thu)	11 Nov (Mon)	24 Dec (Tue)
18 Dec (Wed)	19 Dec (Thu)	-	27 Dec (Fri)	TBD

Source: BofA Global Research, Bank of Japan

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Exhibit 4: G3 central bank decision calendar

2024

	2024											
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
BoJ	23 (Tue)		19 (Tue)	26 (Fri)		14 (Fri)	31 (Wed)		20 (Fri)	31 (Thu)		19 (Thu)
Fed		01 (Thu) [T+1]	21 (Thu) [T+1]		02 (Thu) [T+1]	13 (Thu) [T+1]		01 (Thu) [T+1]	19 (Thu) [T+1]		08 (Fri) [T+1]	19 (Thu) [T+1]
ECB	25 (Thu)		07 (Thu)	11 (Thu)		06 (Thu)	18 (Thu)		12 (Thu)	17 (Thu)		12 (Thu)

Source: BofA Global Research, Bloomberg Note: Blue shaded dates represent decisions associated with Summary of Economic Projections (SEP) for the FOMC, Staff projections for the ECB, and Outlook Report for the BoJ.

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Exhibit 5: Calendar of key BoJ-related events

Mar-Apr data key for the BoJ's assessment of sustained and stable 2% inflation

Date	Key events
2024 Jan-Feb	Response period for BoJ special survey on corporate behavior since the mid-1990s (part of Broad Perspective Review)
Jan 11	Regional Economic Report & Quarterly meeting of BoJ Branch Managers
Jan 22-23	BoJ MPM (outlook report)
Late January	Keidan to release "Report of the Special Committee on Management and Labor Policy", reflecting big business' recommended negotiating stance
Jan 26	Start of Regular Diet Session
Jan 31	BoJ Jan MPM Summary of Opinions
End Jan / Early Feb	Release of Survey on wage increases by Institute for Labour Administration
Feb 15	4Q CY23 GDP (1st estimate)
Mar 4?	Rengo to announce tabulation of unions' wage demands for FY24 Shunto (as of 1 Mar)
Mar 11	4Q CY23 GDP (revised)
Mar 15	Rengo announces results of FY24 Shunto preliminary respond
Mar 18-19	BoJ MPM
Mar 28	BoJ Mar MPM Summary of Opinions
Mar - Jul	Spring wage negotiation results to be announced by industry organizations
Apr 1	BoJ Tankan (1Q)
Early Apr	Regional Economic Report & Quarterly meeting of BoJ Branch Managers
Apr 25-26	BoJ MPM (outlook report)
Apr 28	By-elections (Lower House Shimane 1st District)
Around May	2nd Workshop re: BoJ Broad-Perspective Review
9 May	BoJ Apr MPM Summary of Opinions
Mid-May	1Q CY24 GDP (1st estimate)
Late May / early Jun	2024 BoJ-IMES Conference
June	JPY40K/person flat-rate income tax reductions commence
Early Jun	April Monthly Labour Survey (preliminary)
Early Jun	1Q CY24 GDP (revised)
Jun 13-14	BoJ MPM
Mid-Jun?	End of Regular Diet Session
Mid-Jun?	Cabinet approval of Basic Policy on Economic and Fiscal Management and Reform 2024 (Strong Bone Policy)
Jun 24	BoJ Jun MPM Summary of Opinions
Jul 7	Tokyo Gubernatorial Election
Late Jul	May Monthly Labour Survey (final)
Jul 30-31	BoJ MPM (outlook report)
Aug 8	BoJ Jul MPM Summary of Opinions
Sep	LDP presidential election
2025 Summer	Upper House election
Fall	Lower House term ends

Source: BofA Global Research, Reuters, Bank of Japan

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Exhibit 6: Summary of BoJ monetary policy statement (January 2024)

Key changes from December '23 MPM in red

23 January MPM	
Overall assessment of Japan's economy	Has recovered moderately
Exports	Have been affected by the developments in overseas and more or less flat, supported by a waning of the effects of supply side constraints
Business investment	Has been on a moderate increasing trend
Private consumption	Has continued to increase moderately, despite being affected by price rises
Housing investment	Has been relatively weak
Public investment	Has been more or less flat
Industrial production	Have been affected by the developments in overseas and more or less flat, supported by a waning of the effects of supply side constraints
Labor market	Has improved moderately
Financial conditions	Have been accommodative
Consumer prices	The negative contribution of energy prices to the year-on-year rate of increase in the CPI (all items less fresh food) has been relatively large, partly due to the government's economic measures - is slower than a while ago, mainly due to the effects of pushing down energy prices from the government's economic measures. That said, the rate of increase in the CPI has been in the range of 2.0-2.5% at around 3% recently, mainly on the back of the fact that, despite waning, owing to the effects of a pass-through to consumer prices of cost increases led by the past rise in import prices have remained, and services prices have increased moderately.
Inflation expectations	have risen moderately
Outlook for the Japanese economy	<p>Japan's economy is likely to continue recovering moderately, supported by factors such as the materialization of pent-up demand, although it is expected to be under downward pressure stemming from a slowdown in the pace of recovery in overseas economies. Thereafter, as a virtuous cycle from income to spending gradually intensifies, Japan's economy is projected to continue growing at a pace above its potential growth rate.</p> <p>The year-on-year rate of increase in the CPI (all items less fresh food) is likely to be above 2% through fiscal 2024, due to factors such as the remaining effects, albeit waning, of the pass-through to consumer prices of cost increases led by the past rise in import prices and a waning of the effects of the government's economic measures pushing down CPI inflation of the previous year. As for fiscal 2025, the rate of increase is projected to decelerate owing to dissipation of these factors. Meanwhile, underlying CPI inflation is likely to increase gradually toward achieving the price stability target, as the output gap turns positive and as medium- to long-term inflation expectations and wage growth rise. The likelihood of realizing this outlook has continued to gradually rise, although there remain high uncertainties over future developments.</p>
Risks to the outlook	<p>Concerning risks to the outlook, there remain extremely high uncertainties for Japan's economy, including developments in overseas economic activity and prices; developments in commodity prices, and domestic firms' wage- and price-setting behavior. In this situation, it is necessary to pay due attention to developments in financial and foreign exchange markets and their impact on Japan's economic activity and prices.</p> <p>With extremely high uncertainties surrounding economies and financial markets at home and abroad, the Bank will patiently continue with monetary easing while nimbly responding to developments in economic activity and prices as well as financial conditions. By doing so, it will aim to achieve the price stability target of 2 percent in a sustainable and stable manner, accompanied by wage increases. The Bank will continue with QQE with Yield Curve Control, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner.</p>
Conduct of monetary policy	It will continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeds 2 percent and stays above the target in a stable manner
Overshoot commitment	
Future conduct of monetary policy and forward guidance for rates	For the time being, the Bank will not hesitate to take additional easing measures if necessary,

Source: Bank of Japan, BofA Global Research

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