Japan Watch

BoJ watch: moving our base case for BoJ NIRP/YCC exit to the March MPM

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Economics
Japan

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Revisiting the March vs. April debate

Since the January Monetary Policy Meeting (MPM), there has been a steady drumbeat of BoJ communications signaling that the central bank is nearing an exit from its extraordinary easing program. We have been in the camp that the BoJ will wait until the 25-26 April MPM to declare its 2% inflation "in sight," exit NIRP, and overhaul its current easing framework (see BoJ review: One step closer to normalization, 23 January 2024).

The strongest argument for waiting until April is that the extra month gives the BoJ access to several pieces of high-quality data, including the 1) 1Q BoJ Tankan, 2) FY24 Shunto data up to Rengo's 4th response round; 3) feedback from the quarterly BoJ branch mangers' meeting. We do not think these datapoints would affect the BoJ's decision to exit NIRP/YCC by the end of the spring per se. Rather, they are important because they can be used to bolster the central bank's case to move off emergency policy settings.

A close call, but we now see a move at the 19 March MPM

While the argument is still valid, and the decision is a close call, we now see a higher chance that the BoJ's exit from NIRP/YCC will come earlier, and change our base case for the move to the 19 March MPM. We think the case for March is strengthened by 1) recent improvement in capex data, which paint a better picture for domestic demand; 2) aggressive union wage demands, which raise the likelihood that FY24 Shunto wage hikes will beat last year's by a significant margin; and 3) recent media reports suggesting discussion over the post-YCC framework are in the very advanced stages (Exhibit 3).

Even if the BoJ ends up holding in March, we think it is highly unlikely that it will be a "head fake," the likes of which we saw after the June, September, and December 2023 policy meetings. Instead, the BoJ is likely to send a much more explicit signal that it is thinking of moving at its next policy meeting, on 25-26 April MPM.

New policy framework a return to simpler times

As flagged by recent media reports, the BoJ's decision to declare its 2% price stability target "in sight" and exit NIRP will likely be accompanied by a fairly comprehensive overhaul of the BoJ's current easing framework. Exhibit 4 summarizes the menu of expected policy revisions. Though we expect YCC to be scrapped alongside NIRP, recent media reports support our view that the BoJ will guide towards maintaining the current pace of JGB purchases, consistent with our base case of no QT in 2024 (see also: YCC removal could be dovish if BoJ keeps current monthly JGB purchases, 12 March 2024).

Given that many of the potential policy revisions are now well-telegraphed, the market's focus is on the BoJ's messaging around additional rate hikes. Given the uncertainties around the inflation outlook, we think the BoJ will refrain from explicitly offering new rates forward guidance that pre-commits the central bank to an extremely gradual hiking pace. That said, we expect Governor Ueda use his post-MPM press conference to re-iterate recent comments hinting at gradualism. We keep unchanged our call that the BoJ's exit from NIRP will be followed by additional hikes in 4Q CY24 and 2Q CY25.

BoJ comm's signal Mar/Apr policy revision a done deal

Since the January MPM, there has been a steady drumbeat of BoJ communications signaling that the central bank is nearing an exit from its extraordinary easing program (BoJ Watch: Jan MPM Summary of Opinions: further signals for Mar/Apr policy change).

Board member Takata (29 February): Speaking in Shiga prefecture on 29 February, board member Hajime Takata sent a strong message that the BoJ was close to unwinding extraordinary easing, while "there are uncertainties for Japan's economy…my view is that the 2% price stability target is finally coming into sight." He added that, given these developments, "it's necessary to consider taking a nimble and flexible response, including on how to exit, or shift gear from the current extremely accommodative monetary policy." Though he did not explicitly express his support for a decision in March, he strongly suggested that he would endorse a move by the April MPM.

Board member Nakagawa (7 March): Meanwhile, in a speech in Shimane prefecture on 7 March, board member Junko Nakagawa also expressed growing confidence in the achievement of the 2% price stability target, stating that "prospects for the economy to achieve a positive cycle of (rising) inflation and wages are in sight." She pointed to a shift in the wage-setting behavior of firms in support of this view, noting that there are "clear signs of change in how companies set wages," and that "there is a high likelihood that this spring's wage revisions will set a higher level compared to the past."

Greenlight from government for near-term NIRP exit

We also see a much lower risk that political factors could delay the timing of the BoJ policy move. On 7 March, a Bloomberg report noted that the BoJ "has a tacit greenlight from some government officials to end its negative interest rate policy, either in March or April." Previously, some market participants were concerned that the upcoming lower house by-elections, scheduled for 28 April, could affect the timing of BoJ policy revisions. But with the number of contested seats likely to be limited to three, it is unlikely to be a "constraint" for the BoJ to move in either March or April.

Revisiting the March vs. April debate

Regarding the specific timing of the move, we have been in the camp that the BoJ will wait until the 25-26 April MPM to declare its 2% inflation "in sight," exit NIRP, and overhaul its current easing framework (see BoJ review: One step closer to normalization, 23 January 2024).

The strongest argument for waiting until April is that the extra month gives the BoJ access to several pieces of high-quality data, which can help bolster the central bank's argument for a move off emergency policy settings.

These include: the 1) Q1 BoJ Tankan (due 1 April); 2) FY24 Shunto data up to Rengo's fourth response round, which would reflect responses from a much bigger number of corporates (due mid-April); 3) Sakura Report and associated feedback from the quarterly BoJ branch managers meeting (due mid-April); and 4) the semi-annual Financial System Report (due late April), among others (see Exhibit 3 in the Appendix for a calendar of key BoJ-related data releases and events).

Our view is that the core BoJ leadership, particularly Governor Ueda and deputy governor Uchida, would prefer to be able to point to more pieces of evidence to justify its policy decision to the public-at-large, if it only meant waiting another month.

We would also note that, while Governor Ueda has pushed back against the narrative that BoJ policy changes ought to be tied to "Outlook Report rounds" (in January, April, July, and October), the Report provides a convenient vehicle for the BoJ to articulate the thinking around its policy decisions. The Outlook Report that will be published alongside the 25-26 April MPM decision will be particularly important, as it would see the BoJ's forecast horizon extended by one year, to FY26 (ending March 2027)

A close call, but we now see a move at the 19 March MPM

While these arguments are still valid and we think the upcoming decision is as a close call, we now see a higher chance that the move will come earlier. We thus change our base case for BoJ's exit from NIRP and policy overhaul to the 19 March MPM, from April previously.

We think the following factors have tipped the scale in favor of an earlier policy move in March:

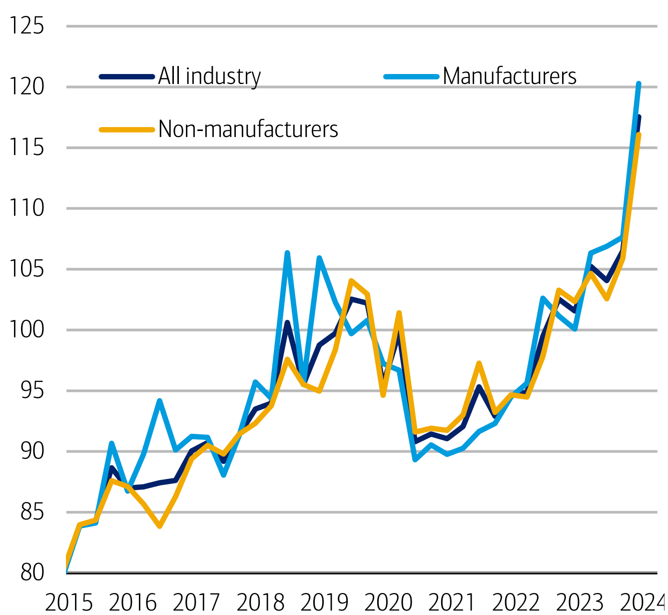
1. Blockbuster 4Q capex print paints better picture for domestic demand

One of the biggest sources of downside risks to the BoJ's forecast for sustained and stable 2% inflation has been the weakness in domestic demand, particularly consumption. But data releases over the past week should ease these worries at the margin.

The 4Q MoF Corporate Survey showed a surprisingly strong, 10.4%QoQ SA surge in Oct-Dec '23 capex (including software, all-industries basis), following a +2.3% pick-up in Jul-Sep '24 (Exhibit 1). This marked the strongest pace of growth since 4Q CY11 and confirmed that the long-awaited acceleration in capex indicated by forward-looking survey data, was finally materializing. The strong 4Q capex reading also helped Japan avert a technical recession in revised estimates of GDP (see Oct-Dec GDP (2nd prelim): Technical recession cancelled, 11 March 2024).

Exhibit 1: Private capex based on MoF corporate survey (2019=100 SA, nominal)

The 4Q MoF Corporate Survey reflected a long-awaited acceleration in business investment



Source: BofA Global Research, MoF

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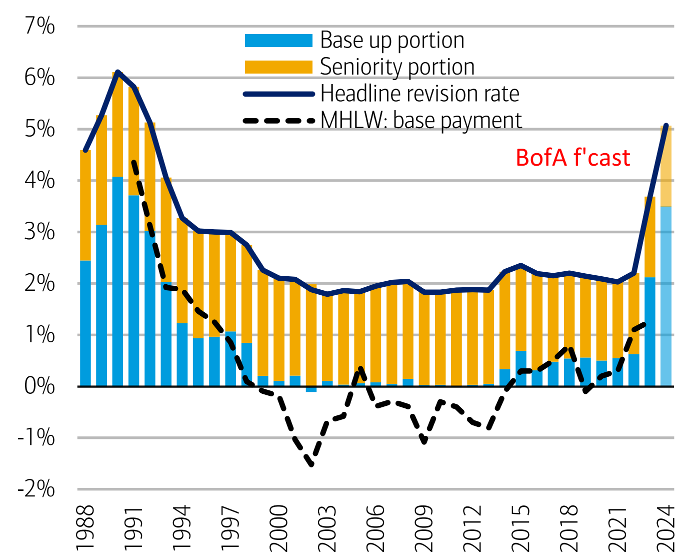
Exhibit 2: Shunto revision rate and macro level base payment growth (FY basis yoy%)

We expect initial estimates of FY24 Shunto wage hikes to show a 3.5% jump in base pay



Source: BofA Global Research, MHLW, Rengo

*Rengo base revision rate, data until 2014 are BofA estimates based on headline revision rate from Rengo and base-up portion from Central Labor Relations Commission; BofA forecast as of 7 March 2024

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2. Robust FY24 Shunto wage hikes raise odds of self-sustaining inflation cycle

In contrast, recent hard data point to continued weakness in household consumption. However, recent soft data, such as consumer confidence, continue to show signs of bottoming out, pointing to a recovery in spending ahead.

More importantly, there are increasing signs that the on-going FY24 Shunto negotiations, which the BoJ has long-flagged as a key input into its judgment of sustained and stable 2% inflation, will result in another significant jump in wage hikes.

The latest update from the Japanese Trade Union Confederation (JTUC, "Rengo"), published 7 March, showed average wage hikes demanded by unions in the FY24 Shunto rising to a 31-year high. The demands were even stronger than our projections, which have been far ahead of consensus.

Based on the union demands, we raised our forecast for initial estimates of FY24 base pay hikes to around 3.5%, or a 5%+ increase for the total wage revision rate if we include the seniority-based (teisho) component (Exhibit 2; see Shunto update: Raise base-up estimate to 3.5% on strong union demands, 7 March 2024).

Though there are lingering uncertainties around managements' response, we now think it is much more likely that the Shunto results will settle in a range of 3.2-3.8%, vs. our previous expectation of 2.5%-3%. That means that, even if the figure ends up being at the lower end of our forecast range, it would be much higher than FY23's initial result of 2.3%. Rengo will announce the results of the FY24 Shunto first reporting round on 15 March.

We think the likely very strong starting point for reported FY24 Shunto wage hikes will ultimately allow the BoJ to have sufficient confidence in the breadth of wage hikes (including at SMEs), especially since it is likely to be supported by feedback from the BoJ's hearings with corporates.

Note that Jiji Press reported on 11 March that "support for ending NIRP in March is growing within the BoJ," and that the central bank would deliver the decision if initial estimates of FY24 Shunto wage hikes "significantly" exceed last year's figure (Exhibit 3). If the Jiji report is accurate, it would point to a high probability of a move in March if the our Shunto forecasts above are correct.

Exhibit 3: Recent BoJ-related reports in the media

Reporting around the upcoming 19 Mar MPM to intensify further around the blackout period, starting 14 March

Date (JST)	Outlet	Headline
6 Mar	Jiji	BoJ board member to express opinion on exiting NIRP in March--first rate hike in 17 years if decided
7 Mar	Bloomberg	Some Japan Government Officials Support Near-Term BOJ Rate Hike
8 Mar	Reuters	BOJ's growing confidence in prices, wages shifts focus to March meeting
8 Mar	Jiji	BoJ considering scrapping YCC, introduce new "quantitative" monetary policy framework showing outlook for JGB purchases to facilitate smooth normalization from easing
11 Mar	Jiji	Support for March NIRP exit spreading within BoJ as FY24 Shunto likely to exceed last year's
12 Mar	Bloomberg	BOJ Is Said to Mull March Hike With Outcome Too Close to Call
12 Mar	Reuters	BOJ to offer guidance on bond buying pace upon ending YCC - sources
13 Mar	Kyodo	BoJ to discuss raising interest rates in MPM from 18th; virtuous cycle of wages and prices

Source: BofA Global Research, various media outlets; English translation of the titles of the 6 Mar, 8 Mar and 11 Mar Jiji and 13 Mar Kyodo articles are BofA's own, since an English version of the original Japanese is not available

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3. Recent media reports suggest post-NIRP/YCC discussion in advanced stages

Other media reports on the BoJ's upcoming MPM also suggest that discussions around the exit from NIRP and details of the post-YCC policy framework are in the very advanced stages.

For example, Jiji Press reported on 8 March that the BoJ was considering a "new 'quantitative' monetary policy framework" to facilitate communications around its purchases of JGBs, once YCC was scrapped alongside NIRP (Exhibit 3; for details of the article and its implications, please see: YCC removal could be dovish if BoJ keeps current monthly JGB purchases, 12 March 2024). The reported contours of the post-YCC policy framework was notable in its specificity and echoed by a separate article by Reuters from 12 March.

The BoJ's thinking around its management of JGB purchases post YCC was one of the few remaining areas of uncertainties that had not been addressed explicitly in recent BoJ communications.

Though it remains unclear whether the Reuters/Jiji is a deliberate trial balloon from the central bank, we find the timing and specificity of the articles' contents to be slightly odd if the BoJ has in mind the April MPM (nearly a month-and-half later) as its "base case" for policy change.

BoJ to send strong signal for April move, even if they pass on March

Despite the markets hand-wringing over March vs. April, we think the most important takeaway is that the BoJ has effectively made up its mind to move by the end of the spring.

Thus, even if the BoJ ends up holding in March, we think it is highly unlikely that it will be a "headfake," the likes of which we saw after the June, September, and December 2023 policy meetings. Instead, the BoJ is likely to send a much more explicit signal that it is thinking of moving at its next policy meeting, on 25-26 April MPM.

We think this could take the form of Chairman's instructions to the Bank's staff to explore options for changes to the central bank's policy framework in the policy statement or further signals in Governor Ueda's post-MPM press conference.

Expected details of the BoJ's post-QQME+YCC framework

Exhibit 4 summarizes our best guess for the potential revisions to the BoJ's current framework at the time of its next move, either in March or April.

As signaled earlier in Governor Ueda's post-Jan MPM press conference and the January MPM Summary of opinions, we think policy changes will not to be limited to an exit from NIRP.

Rather, we think the BoJ's decision to declare its 2% price stability target "in sight" and exit NIRP will be accompanied by a fairly comprehensive overhaul of the BoJ's current easing framework, including:

1) Removal of YCC and transition back to a simple policy target focused on the uncollateralized overnight call rate (to be initially set in a range of 0-0.1%);

2) Formal end to risk asset purchases, particularly equities and J-REITs;

3) Removal of the 2% inflation overshooting commitment

If we are correct, the changes would bring the BoJ statement much closer to the way it looked before the introduction of Quantitative and Qualitative Monetary Easing (QQME), in April 2013.

As mentioned earlier, one of the lingering uncertainties related to the post-YCC framework was the way in which the BoJ would communicate its purchase pace for JGBs. But as discussed above, the aforementioned Jiji and Reuters reports strongly suggest that the BoJ would be transitioning to a "quantitative" guideline focused on monthly flow JGB purchase amounts.

The guideline is likely to be initially set at the current pace of JPY6trn/month and unlikely to be reduced for the time being. This is consistent with our long-standing base case that the BoJ would not start quantitative tightening (QT) until 2025 (for a detailed discussion of the post-YCC framework for JGB purchases, please see: YCC removal could be dovish if BoJ keeps current monthly JGB purchases, 12 March 2024).

Exhibit 4: The BoJ's current policy settings and our expectations for changes under the "new" policy framework

We expect the BoJ to overhaul its policy framework at the time of its NIRP exit

	Existing framework: QQME+YCC	New policy framework
(1) Yield Curve Control		
Guideline for market operations		
- Short-term policy interest rate	IOER on the Policy-Rate Balances: -0.1%	Uncollateralized Overnight Call Rate: 0〜0.1%
Ref: Complementary deposit facility	3 tiers of IOER at -0.1%/0.0%/+0.1%	IOER to be consolidated to single tier of +0.1%
- Long-term interest rate	10-year JGB yields: around 0%	removed
Conduct of yield curve control		
- Upper bound for 10-year JGB yields	1.0%	removed
- Nimble responses	Increasing the amount of JGB purchases and conducting fixed-rate purchase operations and the Funds-Supplying Operations against Pooled Collateral	Increasing the amount of JGB purchases if needed (to be noted under guidelines for JGB purchases in (2) below)
(2) Guidelines for asset purchases		
- JGBs	-	Continue current pace of monthly JGB purchases of ~¥6tn for the time being
- ETF	Purchase as necessary with upper limits of about ¥12tn on annual paces of increase in the amounts outstanding	Maintain the amount outstanding of around ¥37tn
- J-REIT	Purchase as necessary with upper limits of about ¥180bn on annual paces of increase in the amounts outstanding	Maintain the amount outstanding of around ¥650bn
- CP	Maintain the amount outstanding of ¥2tn	no change
- Corporate bonds	Purchase at about the same pace as pre-COVID, so that the amount outstanding will gradually return to ¥3tn.	no change
(3) Forward guidance		
- QQME+YCC framework	The Bank will continue with QQME+YCC, as long as it is necessary for maintaining the target in a stable manner	removed
- Monetary base commitment	The Bank will continue expanding the monetary base until the YoY rate of increase in the observed CPI (ex fresh food) exceeds 2% and stays above the target in a stable manner	removed
- Additional easing if necessary	The Bank will continue to maintain the stability of financing, mainly of firms, and financial markets, and will not hesitate to take additional easing measures if necessary	no change
Other	-	Governor Ueda to emphasize, i.e. in post-MPM press conference, the gradualism of potential, future hikes, reiterating that "it is hard to imagine a path in which [the BoJ] keep raising the interest rate rapidly [following the exit from NIRP]."

Source: BofA Global Research, BoJ

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What kind of forward guidance can we expect?

BoJ wary of "forward guidance trap"

Perhaps the remaining source of uncertainty is whether the BoJ will offer new rates forward guidance that pre-commits the central bank to an extremely gradual hiking pace.

We think that the BoJ would be reluctant to do so, given the high degree of uncertainty around the outlook for the Japanese economy and inflation, on both the upside and downside.

For example, speaking in a press conference following his 6 December speech in Oita, deputy governor Ryozo Himino mentioned MIT professor Athanasios Orphanides' presentation at the May 2023 BoJ IMES conference.

In the presentation, Professor Orphanides discussed how the DM central banks, including the Fed and ECB, fell into a "forward guidance trap" as adherence to strict forward guidance on policy rates delayed lift-off, fueling high inflation.

Deputy governor Himino agreed with the argument that, while it's important for central banks to explain the rationale behind their policy decisions, it's problematic to pre-commit to a specific sequence of actions.

Gov Ueda likely to stress gradualism in his press conference remarks

Having said this, the BoJ is likely wary of being perceived as hawkish and stoking unwanted speculation over an early and aggressive path for additional hikes. As such, we expect Governor Ueda use his post-MPM press conference to re-iterate recent comments hinting at gradualism[1], and the expectation that monetary conditions will remain easy, even after the exit from NIRP.

We continue to see cautious hikes, to 0.25% in October, and 0.5% in April 2025

As for our outlook for the BoJ's rate hike path: for now, we keep unchanged our call that the BoJ's exit from NIRP will be followed by an additional hikes, to 0.25% in 4Q CY24 (October) and 0.5% in 2Q CY25 (April).

In our view, further hawkish repricing of the BoJ hiking path would require evidence of a robust recovery in sentiment and consumer spending following spring wage hikes, which we will not be able to assess for at least a few more months.

What to watch in the days ahead

Ahead of the BoJ's 19 March policy decision, markets will likely remain sensitive to BoJ-related headlines.

On the data front, the last big piece before next Tuesday's MPM is Rengo's announcement of initial estimates of FY24 average base pay hikes, which will be published after the close on Friday, 15 March.

Markets will also be on guard for further BoJ "leaks" by the media outlets. In particular, the Nikkei Shimbun's prognosis for the March MPM will be closely watched, given the paper's track record of flagging policy changes in the past.

[1] For example, Governor Ueda may repeat the comments made by himself and other BoJ officials such as deputy Governor Uchida and board member Takata that, given the central bank's current outlook for the economy and prices, "it is hard to imagine a path in which it would then keep raising the interest rate rapidly."

Appendix

Exhibit 5: Calendar of key BoJ-related events

Focus on the 15 Mar FY24 Shunto wage hike initial estimate ahead of 19 March MPM

	Date	Key events
2024	Jan-Feb	Response period for BoJ special survey on corporate behavior since the mid-1990s (part of Broad Perspective Review)
	Feb 8	**Speech by BoJ Deputy Governor Shinichi Uchida**
	Feb 15	4Q CY23 GDP (1st estimate)
	Feb 29	Speech by BoJ board member Hajime Takata
	Mar 5	Tokyo CPI (Feb, prelim)
	Mar 7	**Rengo to announce tabulation of unions' wage demands for FY24 Shunto (as of 4 Mar)**
	Mar 7	Speech by BoJ board member Junko Nakagawa
	Mar 11	4Q CY23 GDP (revised)
	Mar 13	FY24 Shunto intensive response round (major unions announce)
	Mar 15	**Rengo publishes results of FY24 Shunto preliminary respond**
	Mar 18-19	BoJ MPM
	Mar 27	Speech by BoJ board member Naoki Tamura
	Mar 28	BoJ Mar MPM Summary of Opinions
	Mar 29	Tokyo CPI (Mar, prelim)
	Apr 1	BoJ Tankan (1Q)
	Early Apr	Regional Economic Report & Quarterly meeting of BoJ Branch Managers
	Apr 26	Tokyo CPI (Apr, prelim)
	Apr 25-26	BoJ MPM (outlook report)
	Apr 28	By-elections (3 lower house seats to be contested)
	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?	Cabinet approval of Basic Policy on Economic and Fiscal Management and Reform 2024 (Strong Bone Policy)
	Jun 23	End of Regular Diet Session
	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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