Japan Watch

BoJ Watch: Eyes on April

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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

Key takeaways

- We push back our base case for the timing of BoJ NIRP + YCC removal to the 25-26 April MPM, from Jan previously.
- Looking at the big picture, we remain optimistic on the prospects of a self-sustaining rise in inflation & wages in Japan.
- Our view of gradual BoJ policy and interest rate normalization remains unchanged.

Pushing back our baseline scenario for NIRP+YCC exit

We have changed our outlook for BoJ monetary policy in light of recent developments.

We had previously expected the BoJ's next move to be NIRP+YCC removal in Jan-Apr '24, with our base case the 22-23 January MPM. However, recent communications from the BoJ imply a very low probability of policy change in January. We push back our expected window for the likely timing of BoJ policy adjustments to Apr-Jul '24, and make the 25-26 April MPM our new baseline forecast for NIRP+YCC removal.

While we would not rule out an earlier move at the 18-19 March MPM completely, we think the probability is lower than that of further delays to June/July, given the BoJ's cautious stance and the data calendar.

NIRP – Negative interest rate policy

YCC – Yield curve control

MPM – monetary policy meeting

Transition to self-sustaining inflation cycle still on track

Looking at the big picture, there are no changes to our view that the rise in Japan's underlying inflation will be sustained (see Starts aligning for sustained 2% inflation, 29 September 2023), and that monetary policy is headed for gradual normalization.

Recent newsflow on the FY24 Shunto spring wage negotiations remains upbeat, supporting our view that growth in base pay will improve further in FY24, from the around 2% pace in 2H FY23 (see Wages update: Momentum building further for FY24 Shunto, 9 January 2024).

With services inflation taking over from goods inflation, we expect ex-energy BoJ-style core inflation to remain at or above 2% over the medium term (see December CPI: Lull to continue; adjusting our forecasts, 9 January 2024).

No change to our view of gradual normalization

As such, we keep unchanged our forecast that the exit from NIRP/YCC will be followed by additional 25bp hikes in Oct-Dec '24 and Apr-Jun '25, to take Japan's policy rate to 0.5% by mid-2025 (see Global Economics: Year Ahead 2024: Growing apart, cutting together, 20 November 2023). We also keep intact our view that QT will be delayed until 2025, despite the recent reduction in BoJ bond purchases.

Dec MPM recap: status quo

At its last meeting of the year, on 18-19 December 2023, the BoJ policy board left all key policy targets unchanged (see BoJ review: Status quo, 19 December 2023). Though this was not a surprise, the MPM statement was also largely a carbon copy of October's.

Moreover, while Governor Ueda acknowledged continued progress towards its 2% price stability target in his post-MPM press conference and retained the optionality for a policy move in January, he implied that more time would be needed for the BoJ to judge whether conditions for BoJ policy normalization had been met. This includes a further rise in wages, as well as the positive feedback from wages to further price hikes. On the latter, Governor Ueda stated that the BoJ would like to monitor further firms' price-setting behavior in addition to various price data, particularly for services.

Importantly, Governor Ueda seemed to imply that it was unlikely that the BoJ would have sufficient evidence by its next MPM, on 22-23 January, to make the judgment that the self-sustaining cycle of inflation and wage hikes was in place. Though he highlighted the next BoJ branch managers' meeting scheduled for 11 January as an important avenue to glean anecdotal information on firms' wage and price-setting behavior, he described some of the early feedback as mixed and added that, overall, there wouldn't be a lot of new data available before the January MPM.

Exhibit 1: 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
	Late January?	Start of Regular Diet Session
	Late January	Keidan to release "Report of the Special Committee on Management and Labor Policy", reflecting big business' recommended negotiating stance
	Jan 22-23	BoJ MPM (outlook report)
	End Jan / Early Feb	Release of Survey on wage increases by Institute for Labour Administration
	Feb 15	4Q CY23 GDP (1st estimate)
	Mar 11	4Q CY23 GDP (revised)
	Mar 15	Rengo announces results of FY24 Shunto preliminary respond
	Mar 18-19	BoJ MPM
	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
	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)
	Jul 7	Tokyo Gubernatorial Election
	Late Jul	May Monthly Labour Survey (final)
	Jul 30-31	BoJ MPM (outlook report)
	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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Recent communications do not signal imminent rate hike

Subsequent communications reinforce the Governor's message at the Dec MPM that more time would be needed for the BoJ to have confidence in the durability of inflation, and that an exit from NIRP and YCC was not imminent:

Governor Ueda speech (25 Dec): Governor Ueda's 25 December speech at Keidanren's year-end conference was balanced. In the speech, Governor Ueda discussed the positive aspects of a return to a positive interest rate environment, a theme that deputy Governor Himino had also focused on in his 6 December remarks (see: BoJ Watch: Moving closer to the end of NIRP, 8 December 2023).

That said, the speech contained no signal of imminent policy change. Moreover, Governor Ueda flagged the BoJ's on-going large-scale survey on corporate behavior[1] as an important element in judging firms' wage and price-setting behavior, and how it might change going forward. Given that the results of the survey will not be available before the 22-23 January MPM (the survey period runs from November 2023 – February 2024), we think it is unlikely that the central bank will be able to make an assessment on the prospects for a positive wage-price cycle this month.

Ueda NHK interview (27 Dec): Governor Ueda's year-end interview with public broadcaster NHK also reinforce our view that major policy change is unlikely at the January MPM. Asked again about his 19 December press conference remarks that "we won't see that much new data [before the January MPM]," Governor Ueda reiterated that, while "it is not impossible" that the BoJ could gain "quite a bit of information"—for instance, from the 11 Jan BoJ branch managers' meeting—he didn't think "it's very likely at the moment."

Summary of Opinions of the December MPM (27 Dec): The Summary of Opinions (SOP) of the 18-19 December MPM also reinforced the message of gradualism from Governor Ueda's press conference remarks. While the number of comments mentioning an "exit" and "normalization," increased vs. October, there were just as many comments calling for the central bank to wait a little longer to make the judgment on the achievement of its 2% price stability target.

1 January Noto Peninsula Earthquake: Finally, we think the magnitude 7.6 earthquake that struck the Noto Peninsula in central Japan on 1 January, will make it difficult at the margin for the BoJ to change policy in January, even if the impact on growth is likely to be small.

Pushing back our call for NIRP/YCC exit to April '24

Taking on board the above developments, we push back our baseline scenario for NIRP+YCC removal. Our expected window for the timing of the NIRP+YCC removal shifts to Apr-Jul '24, from Jan-Apr '24 previously, with our base case that the BoJ will declare the 2% price stability in target in sight at the 25-26 April MPM (see Exhibit 2 for a calendar of BoJ monetary policy meetings).

Exhibit 2: Schedule of BoJ monetary policy meetings and key releases in 2024
2024

Date of MPM		Outlook Report	Summary of opinions	MPM Minutes
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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[1] The survey, which targets 2,000 to 2,500 firms, is being conducted as part of the BoJ's broad-perspective review of monetary policy.

Why not March?
While we would not rule out an earlier move at the 18-19 March completely, we think the likelihood is low.

First, while there will be much more information on the outlook for FY24 spring wage hikes, including Rengo's Shunto first response round on 15 March, we think the BoJ would like to confirm the results of the April Tankan (due 1 April) as well as the April BoJ branch managers' meeting (early April) in order to have greater confidence in the positive feedback from wages hikes to inflation (see Exhibit 1 for calendar of key releases and events related to the BoJ outlook).

Second, while policy changes do not necessarily have to coincide with an Outlook Report meeting (Jan/Apr/Jul/Oct MPMs), we think it would be more natural for the BoJ to move when updating its forecasts.

What could cause further delays?
What could delay the decision beyond April?

On the external front, the biggest risk is an unexpected deterioration in US data that points to recession. While Governor Ueda has repeatedly pushed back against the view that the start of Fed cuts would prevent the BoJ from pursuing normalization, he has stressed the importance of the context for the cuts.

If the cuts are in response to an on-going improvement in inflation, it would be consistent with resilient US growth, which would be positive for the Japanese economy. On the other hand, if the cuts are in response to signs of US recession, it would point to greater uncertainties around the outlook for Japan's economy and inflation, making the BoJ cautious.

On the domestic front, we think the bigger risk is around the pace of recovery in domestic demand, particularly consumption, rather than momentum around FY24 wage hikes, which appear on track to improve further based on recent newsflow (see Wages update: Momentum building further for FY24 Shunto, 10 January 2024).

As discussed earlier, the BoJ has been clear that, in order to conclude that the rise in inflation is durable, it would need confidence not only in the strength of wage growth but their feedback to further price hikes.

The good news is that consumer confidence is showing signs of bottoming and likely to improve further over the coming months, thanks in part to an easing of imported inflation (see December CPI: Lull to continue; adjusting our forecasts, 9 January 2024). However, if data around domestic demand remains notably weak, we think it will prompt the BoJ to delay policy changes until the summer, when it can get a better sense of the strength in the consumption recovery in 2H CY24.

Additional swing factors: FX, politics
Other factors potentially affecting the timing of the BoJ's move are FX and politics. Though BofA's FX strategy team thinks that USD/JPY has peaked for this cycle, they remain bearish relative to consensus on the yen, on the view that structural outflows would keep USDJPY supported should it drop below 140 (see World at a Glance: Kickoff for the new year, 4 January 2024).

That said, a renewed bout of yen weakness (i.e. past the cycle high of 151.95) would increase the likelihood of an earlier BoJ move at the margin. In contrast, a sharp move higher in the yen (i.e. below USDJPY of 135) would likely make the BoJ more cautious and raise the risks of delayed normalization, especially if it is being driven by renewed US recession concerns.

On politics, in addition to the timing of snap elections, which could affect the timing of the BoJ's move, developments around the on-going slush fund scandal centered on the ruling Liberal Democratic Party (LDP) need to be monitored.

No change to our view of gradual normalization

Looking at the big picture, there are no changes to our view that the rise in Japan's underlying inflation will be sustained (see Starts aligning for sustained 2% inflation, 29 September 2023), and that monetary policy is headed for gradual normalization. As such, we keep unchanged our forecast that the exit from NIRP/YCC will be followed by additional 25bp hikes in Oct-Dec '24 and Apr-Jun '25, to take Japan's policy rate to 0.5% by mid-2025 (see Global Economics: Year Ahead 2024: Growing apart, cutting together, 20 November 2023).

What about balance sheet policy?

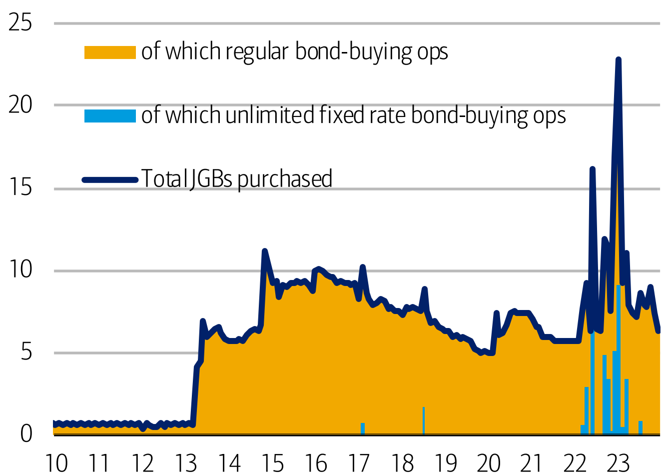
While much of the market's focus has been on the timing of the BoJ's exit from NIRP/YCC and pace of subsequent hikes, we think the BoJ's decision around balance sheet normalization is equally—if not more—important for bond markets.

The increase in the de facto ceiling of the YCC 10yr yield target over the past 6 months, combined with the recent rally in global duration has enabled the BoJ to taper its monthly JGB purchases to JPY6.4trn in December, down from JPY7.4trn in November, and JPY9.0trn in October (Exhibit 3).

Based on the latest purchases sizes in the BoJ's regular bond-buying operations and recent reductions in planned purchase frequencies for the super-long JGBs (per the central bank's purchase plans for the Jan-Mar quarter), the BoJ's JGB purchases are on track to fall to JPY5.9trn in January.

If the pace holds, this would be lower than the pace of redemptions on its JGB holdings, which is expected to average JPY6.4trn/month in Jan-Mar 2024, though still slightly higher than the FY24 average of JPY5.6trn (see Japan Rates Watch: No easy path to reducing BoJ's JGB purchases, 28 November 2023).

Exhibit 3: Monthly BoJ bond purchases (JPY trn)
Following the surge in 1H FY23, the BoJ's JGB purchases have slowed over Nov/Dec.



Source: Bank of Japan, Bloomberg

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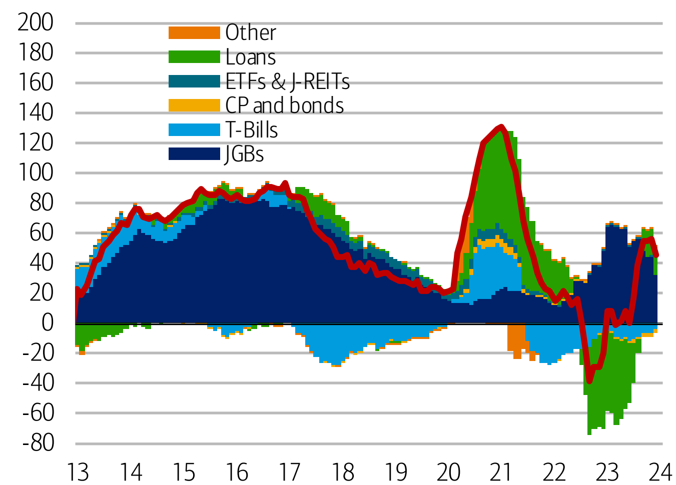
Exhibit 4: YoY change in Bank of Japan Assets (JPY trn) (monthly)
Given the large redemptions on its JGB holdings, further reductions in JGB purchases would cause the BoJ's balance sheet to contract



Source: Bank of Japan

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We do not expect BoJ QT until 2025

The upshot is that further reductions in the BoJ's bond purchases would raise the likelihood of a persistent contraction in the BoJ's balance sheet in 2024, implying quantitative tightening (QT) (Exhibit 4). It would also seemingly violate the BoJ's inflation overshooting commitment, which obliges the central bank to "continue expanding the monetary base until the year-on-year rate of increase in observed CPI (all items less fresh food) exceeds 2% and stays above the target in a stable manner."[2]

Given these developments and the BoJ's history of saying one thing while doing another, investors seem increasingly on guard for the possibility that the BoJ might proceed with stealth QT by quietly continuing its reduction of JGB purchases.

However, while the BoJ now places much less emphasis on the role of QE in driving inflation, distancing itself from the monetarist ideology that dominated the early years of the Kuroda regime, we think it will tread cautiously on QT, given the uncertain impact on bond yields and expectations.

Thus, while the BoJ may abolish its 2% overshooting commitment at the time of NIRP/YCC exit in light of the fact that realized inflation has been running above target for nearly two years and is likely to be sustained at 2%, we do not expect the central bank to start conducting QT in earnest until it can work out a proper strategy for balance sheet normalization. This is likely to take more time. We therefore keep unchanged our view that the start of BoJ QT will be delayed until 2025.

[2] The forward guidance was added in September 2016, alongside the introduction of Yield Curve Control.

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