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Japan Watch

BoJ Watch: Could the BoJ end NIRP in 2023?

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Economics
Japan

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In its 9 September Saturday morning edition, the Yomiuri Shimbun published an exclusive interview with Governor Ueda, titled "BoJ Seeks Quiet Exit from Easing – BoJ Governor Ueda: Assessing Wage Increases by Year-End" (our translation of the original Japanese title; the interview itself was conducted on 6 September). All in all, the tone of the interview is hawkish, with the comments reflecting an on-going shift in the BoJ's communications towards 1) a more data dependent stance, and 2) a greater focus on upside risks to the inflation outlook. We highlight the following key points:

1) Shift towards a quiet policy "exit": though not a direct quote from the governor, the article opens by noting that "The Bank of Japan has entered a phase of reducing monetary easing" and that the "focus will now be on the 'quiet exit' that the BoJ is seeking, one that avoids a significant impact on the market."

2) Earlier visibility on FY24 wage hikes: Governor Ueda seemed to push back against the consensus narrative that the BoJ would necessarily have to wait for the results of next year's Shunto = Spring wage negotiations to assess the sustainability of 2% inflation, stating that "it is not impossible that we will have enough [information] by the end of the year to anticipate [wage hikes next spring]." Note, though, that he had made similar comments in press conference remarks following his first monetary policy meeting as governor, on 28 April.

3) End to NIRP possible as early as year-end: Based on the timeline above, and though he did not explicitly spell out the link, Governor Ueda suggested that the central bank may end NIRP as early as the year-end, stating "when we have confidence in sustained [2%] inflation accompanied by wage increases, there are various options we can take, including lifting negative rates"…"Raising interest rates has a negative impact on overall demand (consumption). But if we judge that Japan can achieve sustained 2% inflation even after ending negative rates, we'll do so."

4) Sensitivity towards upside risks: Governor Ueda continued to justify the BoJ's focus on downside risks to the price outlook, as limited policy space meant dealing with a persistent undershoot of the price target is "exceptionally challenging." He thus repeated the BoJ's long-standing stance that "there is still some distance to go in achieving the inflation target" and that the central bank will "'patiently' continue with aggressive monetary easing for the time being." However, he was careful to stress that "this does not mean we are completely disregarding the risk of overshooting," and that the BoJ was not "actively endorsing falling 'behind the curve' on monetary policy."

5) Increased data dependence: Ueda stated that "the degree of data dependency has increased," with the Yomiuri adding that this means that "the Bank's decision-making is now based more on responding to current economic conditions and less on efforts to convince the market that easing would continue."

6) Emphasis on alignment w/ government re: FX: Finally, on FX, Ueda repeated the long-standing stance that "it is desirable for FX to move in line with fundamentals. No matter what the moves may be, we [the BoJ] will evaluate the impact on the economy and prices while maintaining communications with the government."

Implications

We think it is notable that the BoJ arranged to have this exclusive interview run in the weekend edition of *Yomiuri Shimbun*. Compared to the *Nikkei*, the Yomiuri is less known for its grip on the BoJ/economic news. However, it is Japan's most widely-read newspaper and also popular with conservative readers who form the ruling Liberal Democratic Party's base. In other words, the main target audience for Governor Ueda's latest message is the domestic community, including not just market participants but also average households.

We also do not think it is a coincidence that the timing of the interview coincides the recent rally in USDJPY (towards 148), and escalation in verbal intervention by MoF FX Chief Kanda and Finance Minister Suzuki (see Japan Rates and FX Watch: Response to weak yen by MoF or BoJ?, 7 September 2023).

While we do not know the true intent behind the interview with certainty, we think the BoJ arranged the interview with three possible objectives in mind:

1) to begin laying the communications groundwork for an eventual end to NIRP/front-end hikes

2) to open up the optionality of doing so ahead of the release of preliminary FY24 Spring Wage negotiation results, and as early as December '23, if necessary

3) as a form of verbal intervention to keep the pace of yen depreciation in check, and demonstrate the BoJ's alignment with the MoF/government with respect to FX concerns.

Oct-Dec '23 seems too early for NIRP removal but...

On 1) and 2), at this stage we do not necessarily think the interview is a definitive signal of immediate changes to NIRP.

As we highlighted earlier, Governor Ueda did not say that there would be sufficient data to judge the durability of the 2% inflation target by year-end—instead, he said that the possibility was "not zero." Second, a 4Q CY23 verdict on sustainable 2% inflation would be even earlier than the "baseline" timing of Jan-Mar '24 suggested by policy board member Naoki Tamura, who has been a leading advocate of gradual normalization on the 9-member BoJ board (though we should add that Tamura-san did not "rule out" the possibility that a judgment could be made by year-end either).[1]

Having said this, it is also true that upside risks to the BoJ's inflation projections, including for FY24 and FY25, continue to build. First, a resilient US economy led to the pricing out of early Fed cuts, putting upward pressure on USDJPY. Second, global energy prices have continued to move higher over the past month. Third, fiscal policy continues to be inflationary for the medium-term inflation outlook, with the government poised to extend energy subsidies while also drawing up a new stimulus package as early as this month.

While domestic activity data, including GDP-based private consumption and capex were weak in 3Q CY23, the recent acceleration in nominal income growth (i.e. profits and wages) point to an improvement in 2H FY23, barring a crash in overseas economies (see also: July wage data: Headline slows, but underlying trend still improving, 8 September 2023).

While preliminary results of the FY24 Shunto negotiations will not be available until mid-March, when umbrella union Rengo delivers the results of the first reporting round, the BoJ will have increasingly more information to work with after October (Exhibit 1). Depending on the level of the yen, and developments in the data, the BoJ may feel the

[1] See Mr. Tamura's press conference remarks following his 30 August Speech at a Meeting with Local Leaders in Eastern Hokkaido. Transcript availability in Japanese only from the Bank of Japan website.

need to end NIRP within the year, with the December MPM being a bigger risk than October, in our view.

Given that this is a real risk, it makes sense to begin laying down the communications groundwork early. Compared to a rise in long-end rates, an increase in the short-term policy rate has more relevance for households and corporates. Ultimately, we think a modest rise in front-end yields can be absorbed by households and corporates, given that it would come amidst an environment of rising nominal incomes. But flagging the potential for such moves at an early stage for the public could lessen the shock to sentiment and allow households and corporates to incorporate the information into their borrowing decisions.

…rising risk of front-end adjustment in 1Q CY24

Our long-standing view is that BoJ ends NIRP + YCC by the middle of next year, after confirming the results of the FY24 spring wage negotiations, but have been flagging the risk of an earlier end to NIRP in 1Q CY24 given the upside risks to Japan's inflation outlook (see BoJ flexibilizes yield curve control—quick take, 28 July 2023). Taken at face value, the interview adds to the risk of a 1Q CY24 end to NIRP.

Could the BoJ end NIRP earlier, by the end of the year? We think it's possible, but still a low probability scenario, in our view. There are only three BoJ policy meetings remaining in 2023: 21-22 September, 30-31 October (Outlook Report), and 18-19 December (Exhibit 1). If and when the BoJ decides to end NIRP, we think it will be preceded by an official shift in communications (and not just a trial balloon in an interview), at least one meeting preceding the change. Considering the data/event calendar, December is more likely than October, with the BoJ perhaps using its October Outlook Report to signal greater confidence in a shift in inflation dynamics to set the stage for an end to NIRP.

In this sense, the interview has raised the "stakes" of upcoming BoJ meetings, as our strategists discuss below, with the 31 October MPM gaining much more importance among market participants. It will also increase the market's focus on FX (USDJPY) as an important input into the BoJ's policy response.

Market Implications – JGB buying reduction, MPM risks

We do not think the risk for the BoJ's rate hike has materially risen for the next two MPMs (Sep, Oct) – though the risk for the Dec '23 MPM may have risen as our economists note. There was no detailed discussion in sequencing of policy normalization and Ueda did not directly link the "year-end" timing when the BoJ may be able to judge sustainable 2% inflation will be achieved to the timing of NIRP removal.

Without the yen weakening to date, we think that the Bank of Japan would have preferred to wait a bit longer before communicating to the public and the markets about a coming end to NIRP due to the risk that such communications could lead to a premature rise in market volatility. In addition, there is still some degree of uncertainty around the outlook for spring negotiations.

As our economists also note, we believe the early timing of the publication of this article implies the BoJ now closely coordinating with the government on the FX market wanted to keep the FX market in check as it came out with USD/JPY above 147 and the MoF verbally intervening.

Higher volatility for Oct MPM

By publishing this article, the market will closely watch the BoJ's upcoming MPMs, especially the Oct MPM with the outlook report, raising market volatility. While the BoJ could buy some time by sending a signal for earlier policy normalization and keeping USD/JPY from rallying, the lack of enough hawkish shift at the Oct MPM (or even Sep MPM) could lead to renewed JPY weakness.

Risk of reduction in BoJ's JGB buying

Yomiuri notes Ueda "showed understanding that long-term interest rates will continue to rise from the current mid-0.6% level in line with economic and price conditions" while on the FX Ueda noted "we will be in contact with the government to properly assess the impact on the economy and prices."

This confirms our view that the tool available for the government and the BoJ to slow the yen weakness amid low FX volatility is a reduction in the BoJ's JGB purchases (see: Japan Rates and FX Watch: Response to weak yen by MoF or BoJ? 07 September 2023). The reduction may come at the time of the monthly update to the purchase schedule at the end of September. But it could come earlier on any day of the BoJ's buying operation.

Still too early to go against USD/JPY carry; expect higher 10yr yields

We do not think it is time yet to go against USD/JPY carry. Note Ueda refrained from discussing how much the BoJ can hike and gave little guidance on the sequencing of the BoJ's policy exit. For USD/JPY to fall on expectations for the BoJ's policy, we believe expectations should arise that the BoJ will hike rates meaningfully higher above 0% when the US policy rate is above 5%. If USD/JPY sells-off on expectations for an imminent rate hike by the BoJ, dip-buying would still be an attractive strategy as we believe additional rate hikes above 0% would be measured and shallower than what the Fed has delivered.

In the rates space, the BoJ increased sensitivity to the risk of a weaker yen continues to drive yields higher, especially around the 10yr sector, as the BoJ would let yields go higher – if necessary – by reducing the amount of its JGB purchases.

Exhibit 1: Calendar of key BoJ-related events
October MPM likely to be watched particularly closely

Date		Key events
2023	Sep 13	Cabinet reshuffle
	Sep 21-22	BoJ MPM
	Early Oct	Regional Economic Report & Quarterly meeting of BoJ Branch Managers
	Late Oct	Rengo (umbrella labor union) announces FY24 Shunto wage demand
	Oct 30-31	BoJ MPM (outlook report)
	Early Nov	Keidanren announces FY24 Shunto negotiating stance
	Late Nov	Tokyo Uni. CARF / BoJ Research & Statistics Dpt. Joint Conference
	Around Dec	1st Workshop re: BoJ Broad-Perspective Review
	Dec 18-19	BoJ MPM
2024	Early Jan	Regional Economic Report & Quarterly meeting of BoJ Branch Managers
	Jan 22-23	BoJ MPM (outlook report)
	Early Feb	Release of Survey on wage increases by Institute for Labour Administration
	Mar 18-19	BoJ MPM
	Mid-Mar	Rengo announces results of FY24 Shunto preliminary respond
	Mar - Jul	Spring wage negotiation results to be announced by industry organizations
	Early Apr	Regional Economic Report & Quarterly meeting of BoJ Branch Managers
	Apr 25-26	BoJ MPM (outlook report)
	Around May	2nd Workshop re: BoJ Broad-Perspective Review
	Late May / early Jun	2024 BoJ-IMES Conference
	Jun 13-14	BoJ MPM
	Jul 30-31	BoJ MPM (outlook report)
	Aug	Results of spring wage increases in major private companies (MHLW)
	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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