Krishna Guha | Marco Casiraghi

BOJ COMMENTARY – YEN UP AS UEDA SHORES UP BASE CASE JAN HIKE, TEASES DEC BY WITHDRAWING "AMPLE TIME" GUIDANCE

The Bank of Japan held rates unchanged at its October meeting but Ueda retired the guidance that it had "ample time" to assess developments before considering another hike, shoring up the yen.

The removal of this guidance confirms the BoJ remains oriented towards nudging rates higher and sees progress on the three preconditions – US soft landing, global market stability and supportive Japanese data – for making another move.

There is a debate as to whether this should be read as signalling a December hike.

Clearly the new formulation does not exclude December. But we read the move more as reinforcing our base case of a January hike, while teasing the possibility of December in a way that discourages yen shorts, and keeping open that option in case the yen weakens too much.

We think the BoJ was unhappy about the yen falling back to around Y153, would prefer the mid-high Y140s and categorically does not want the yen to threaten Y160 again, which is challenging given the strength of the dollar.

Too much perceived certainty about the BoJ's near-term intentions risked reinforcing FX weakness and encouraging a rebuilding of yen carry trades.

Taking out the guidance creates greater uncertainty and perception of two-sided risk.

As Ueda explained, the BoJ sees excessive yen weakness as presenting upside risk to inflation at a time when wage-price setting behaviors and inflation expectations are adjusting.

The new projections confirm the BoJ reads the domestic data as pointing to underlying inflation converging on target over the next two to three years, and Ueda underlined his foundational position that as the economy normalizes, rates will need to normalize further too over time.

But we still see no evidence the BoJ sees a need to rush. We view the central bank as bruised by the turmoil of July-August, and likely to proceed methodically in the base case with a hike in January, and another by the summer to 75bp.

As noted in our preview, a key wild card is Japan's political turmoil and possible vulnerability to a Trump trade war shock that could derail favorable prospects for the next Spring wage round while also threatening more yen weakness. Ueda, like the rest of us, will have to wait to find out before firming up his plans.

The October meeting confirms that the BoJ sees the temporary block on further rate moves associated with late summer concerns about the US soft landing and related global market nerves as lifting given strong US data. As Ueda put it the "fog is clearing up" regarding the US.

Meanwhile, the meeting also confirms that the BoJ views the domestic data as evolving in a way that is consistent with its forecast that sees underlying inflation moving up to 2 per cent over the projection horizon.

The new projections nudged up the forecast for core inflation ex fresh food and energy from 1.9 to 2 for FY 24 and reaffirmed 1.9 and 2.1 for FY 25 and 26 respectively.

We fundamentally agree with this constructive assessment of domestic dynamics, with a tight labor market, resilient though flattish consumption, spreading wage gains, and more price increases in wage-driven service sectors even as imported price pressures abate.

Ueda continued to underline his core message that provided the economy continues to move along this path, it will be necessary and appropriate to move real rates higher from deeply negative to more neutral levels.

He said "It is important to explain and adhere to our stance that we will adjust the degree of easing if the economic and price outlook is realized."

We think there is broad agreement on the Policy Board that the BoJ could hike at least another couple of times to 75bp and still be accommodative, with most oriented towards getting to 100bp next year, representing the plausible low end of the range for longer-run neutral, subject to learning along the way.

Our own base case is two hikes next year in January and around mid-year to 75bp, with two-sided risk.

The speed with which the BoJ needs to nudge rates up is in our view a function of risk management and the balance of upside and downside risk.

At present underlying domestic developments are moving the right way but not in a hurried manner, and, we think the BoJ is still bruised from July-August.

We still see no reason to rush with a December hike unless further unwarranted and marked yen weakness or some other set of new developments were to raise upside inflation risk materially.

If the removal of the calendar-type guidance in October succeeds in creating a perception of two-sided risk around the yen, this could in our view help keep the BoJ on a steady course for January, absent new shocks.

As noted in our preview, we think the BoJ is only beginning to get to grips with a challenging domestic and international political situation with the risk that a second Trump term could pose bigger challenges to Japan than the first, with Japanese political turmoil making it harder to replicate Abe’s success in managing Trump risk previously.

This cuts both ways in the sense that Trump risk raises the possibility of supercharged dollar strength and severe yen weakness that could prompt a BoJ hike, but also raises the possibility that prospects for strong wage gains in the next spring wage round could weaken sharply, undermining hard-won progress on underlying domestic inflation dynamics – with the latter in our view the more fundamental of the two risks, even though we think the BoJ will initially be more focused on the former.

The BoJ will also need to keep an eye on the domestic fiscal outlook as new coalition combinations come into view.

We see fiscal as likely easier under a weaker government with more partners to please, supporting some further hiking at the margin, though again, in our view, this is probably a 2025 not 2024 story.

GENERAL DISCLOSURES

This report is approved and/or distributed by Evercore Group L.L.C. (“Evercore Group”), a U.S. licensed broker-dealer regulated by the Financial Industry Regulatory Authority (“FINRA”) and by International Strategy & Investment Group (UK) Limited (“ISI UK”), which is authorized and regulated in the United Kingdom by the Financial Conduct Authority. The institutional sales, trading and research businesses of Evercore Group and ISI UK collectively operate under the global marketing brand name Evercore ISI ("Evercore ISI"). Both Evercore Group and ISI UK are subsidiaries of Evercore Inc. ("Evercore"). The trademarks, logos and service marks shown on this report are registered trademarks of Evercore Inc.

This report is provided for informational purposes only and subject to additional restrictions contained in this disclosure. It is not to be construed as an offer to buy or sell or a solicitation of an offer to buy or sell any financial instruments or to participate in any particular trading strategy in any jurisdiction. The information and opinions in this report were prepared by employees of affiliates of Evercore. The information herein is believed by Evercore ISI to be reliable and has been obtained from public sources believed to be reliable, but Evercore ISI makes no representation as to the accuracy or completeness of such information.

Opinions, estimates and projections in this report constitute the current judgment of the author as of the date of this report. They do not necessarily reflect the opinions of Evercore or its affiliates and are subject to change without notice. In addition, opinions, estimates and projections in this report may differ from or be contrary to those expressed by other business areas or groups of Evercore and its affiliates.

Evercore ISI has no obligation to update, modify or amend this report or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate. Facts and views in Evercore ISI research reports and notes have not been reviewed by, and may not reflect information known to, professionals in other Evercore affiliates or business areas, including investment banking personnel. Evercore ISI salespeople, traders and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed in this research.

Our asset management affiliates and investing businesses may make investment decisions that are inconsistent with the recommendations or views expressed in this research.

Evercore ISI does not provide individually tailored investment advice in research reports. The financial instruments discussed in this report are not suitable for all investors and investors must make their own investment decisions using their own independent advisors as they believe necessary and based upon their specific financial situations and investment objectives. This report has been prepared without regard to the particular investment strategies or financial, tax or other personal circumstances of the recipient. Nothing in this report constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to the recipient’s individual circumstances, or otherwise constitutes a personal recommendation to the recipient. None of Evercore Group or its affiliates will treat any recipient of this report as its customer by virtue of the recipient having received this report.

Securities and other financial instruments discussed in this report, or recommended or offered by Evercore ISI, are not insured by the Federal Deposit Insurance Corporation and are not deposits of or other obligations of any insured depository institution. If a financial instrument is denominated in a currency other than an investor’s currency, a change in exchange rates may adversely affect the price or value of, or the income derived from the financial instrument, and such investor effectively assumes such currency risk. In addition, income from an investment may fluctuate and the price or value of financial instruments described in this report, either directly or indirectly, may rise or fall. Estimates of future performance are based on assumptions that may not be realized. Furthermore, past performance is not necessarily indicative of future performance.

Please note that this report was prepared for and distributed by Evercore ISI to its institutional investor and market professional customers.

Recipients who are not institutional investor or market professional customers of Evercore ISI should seek the advice of their independent financial advisor before considering information in this report in connection with any investment decision, or for a necessary explanation of its contents.

Electronic research is simultaneously distributed to all clients. This report is provided to Evercore ISI clients only and may not be, in whole or in part, or in any form or manner (i) copied, forwarded, distributed, shared, or made available to third parties, including as input to, or in connection with, any artificial intelligence or machine learning model; (ii) modified or otherwise used to create derivative works; or (iv) used to train or otherwise develop a generative artificial intelligence or machine learning model, without the express written consent of Evercore ISI. Receipt and review of this research report constitutes your agreement with the aforementioned limitations in use.

This report is not intended for distribution to or use by any person or entity in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject Evercore Group or its affiliates to any registration or licensing requirement within such jurisdiction. If this report is being distributed by a financial institution other than Evercore ISI or its affiliates, that financial institution is solely responsible for such distribution and for compliance with the laws, rules and regulations of any jurisdiction where this report is distributed. Clients of that financial institution should contact that institution to effect any transaction in the securities mentioned in this report or if such clients require further information. This report does not constitute investment advice by Evercore ISI to the clients of the distributing financial institution, and neither Evercore ISI nor its affiliates, nor their respective officers, directors or employees, accept any liability whatsoever for any direct or consequential loss arising from their use of this report or its content.

Evercore is not authorized to act as a financial entity, securities intermediary, investment advisor or as any other regulated entity under Mexican law, and no actions, applications or filings have been undertaken in Mexico, whether before the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores “CNBV”) or any other authority, in order for Evercore to carry out activities or render services that would otherwise require a license, registration or any other authorization for such purposes; neither is it regulated by the CNBV or any other Mexican authority. This document, nor its content, constitutes an offer, invitation or request to purchase or subscribe for securities or other instruments or to make or cancel investments, nor may it serve as the basis for any contract, commitment or decision of any kind.

For persons in the UK: In making this report available, Evercore makes no recommendation to buy, sell or otherwise deal in any securities or investments whatsoever and you should neither rely or act upon, directly or indirectly, any of the information contained in this report in respect of any such investment activity. This report is being directed at or distributed to, (a) persons who fall within the definition of Investment Professionals (set out in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the “Order”)); (b) persons falling within the definition of high net worth companies, unincorporated associations, etc. (set out in Article 49(2) of the Order); (c) other persons to whom it may otherwise lawfully be communicated (all such persons together being referred to as “relevant persons”). This report must not be acted on or relied on by persons who are not relevant persons.

For persons in Switzerland: The distribution of these materials to persons or entities in Switzerland is not intended to, and does not, constitute a financial service under the Swiss Financial Services Act (FinSA). In particular, the distribution of these materials does not constitute the provision of personal recommendations on transactions with financial instruments (investment advice) within the meaning of Article 3(c)(4) of FinSA.

For persons in Australia: Evercore does not have an Australian Financial Services License ("AFSL"). This report is only to be distributed to persons who fall within the definition of "wholesale" investors under section 761G of the Corporations Act 2001 (Cth). This report must not be acted on or relied on by persons who are not wholesale investors. Evercore relies on the relief provided under ASIC Corporations (Foreign Financial Services Providers—Limited Connection) Instrument 2017/182 to provide this report to wholesale investors in Australia without an AFSL.

For persons in New Zealand: This material has been prepared by Evercore Group L.L.C. for distribution in New Zealand to financial advisors and wholesale clients only and has not been prepared for use by retail clients (as those terms are defined in the Financial Markets Conduct Act 2013 (‘FMCA’)). Evercore Group L.L.C. is not, and is not required to be, registered or licensed under the FMCA, and unless otherwise stated any financial products referred to in this material are generally only available in New Zealand for issue to those satisfying the wholesale investor criteria in the FMCA.

Applicable current disclosures regarding the subject companies covered in this report are available at the offices of Evercore ISI: 55 East 52nd Street, New York, NY 10055, and at the following site: https://evercoreisi.mediasterling.com/disclosure.

In compliance with the European Securities and Markets Authority's Market Abuse Regulation, a list of all Evercore ISI recommendations disseminated in the preceding 12 months for the subject companies herein, may be found at the following site: https://evercoreisi.mediasterling.com/disclosure.