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Krishna Guha | Marco Casiraghi

FLASH NOTE – BOJ'S UEDA SURPRISINGLY DOVISH, CRATERS YEN, LEAVES JAN HIKE MUCH LESS SECURE THOUGH STILL OUR BASELINE

The BoJ held rates steady at 0.25 per cent at its end 2024 meeting with Governor Ueda surprising dovish by declining to prepare the market for a January hike.

Ueda said the economy is on track and the BoJ is just waiting for "one last notch" of information, which implies January remains in play.

But his focus on the need to get more confidence in the strength of the upcoming Shunto Spring wage round and visibility on Trump policies – along with his admission that he does not know how much more information he will have on this by January – suggests the hike could easily slip to March or May.

We see clear signs here that the BoJ is being buffeted both by looming Trump shocks – which have pushed the Fed more hawkish – and domestic politics.

Early indications for the Shunto remain good, but we think the BoJ is concerned that Japan's big exporters could pull back on wage awards in the face of Trump trade uncertainty, and that others would follow, undercutting domestically generated inflation.

The latest Tankan, though generally positive, showed an increase in uncertainty over the outlook.

Meanwhile the opposition DPP party which is in the position of kingmaker after Japan's election is demanding no hike before the Spring and until wage growth hits 4 per cent.

Ueda – who unlike both his predecessors was not chosen by the PM who is in any event in a very weak position – lacks political cover as well as experience communicating with markets.

But with the Fed turning sharply more hawkish to preposition for Trump policy shocks, Ueda's wobbly messaging risks further marked Yen weakness.

We maintain a January hike baseline though with significantly less confidence.

Yen weakness presents upside risk to inflation via imported cost-push pressures, and is politically unpopular as it hits household real incomes.

Without a January hike we think the Yen will threaten to cross Y160, and our bet is that this will give Ueda the conviction – and political cover – he needs to hike then.

It was only a few weeks ago that the market was betting on a hike at this December meeting. Based on the Nikkei / QUICK survey of BoJ watchers from December 12-13 eight still expected a December move with 12 favoring January and only 3 for March or not at all.

We consistently argued against December, but we thought Ueda would compensate with a clearly hawkish hold that teed up a January hike in recognition of progress already made and to shore up the Yen.

That did not materialize. Ueda's larger comments also drifted dovish at several points, observing for instance that underlying domestic inflation pressures are moving in the right direction but more slowly than he feared when he first took office. This in theory gives the BoJ the option to be more patient and learn more about the outlook and shocks coming its way – above all regarding Trump and the potential impact of trade wars on the Shunto.

As we have discussed before, looming Trump trade war risk pushes the Yen down, generating more imported inflation pressure, but also creates risk to the Shunto, and so to domestic inflation dynamics that are more important in the medium to longer-run.

Our view has been that the BoJ would split the difference by delivering one up-front hike to 0.5 per cent in January to prevent extreme Yen weakness but any further action would be conditional on a solid Shunto.

Ueda's comments suggest there is some risk that we are wrong in making this clean distinction in both timing and certainty between the next move and subsequent moves.

We nonetheless still favor a January hike as more likely than not, because of FX pressures and the political economy around them.

The BoJ institutionally is wary of thinking it can manage the bilateral exchange rate that is easily dominated by big swings in Fed rate expectations. We liken this to a child on a see-saw with a grown man on the other side.

Still, we continue to think that Y160 is a very sensitive line and approaching it will help the BoJ harden its own thinking, as well as potentially lead the DPP to ease back on its opposition to another rate hike.

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