

FLASH NOTE – BOJ AND BOE QUICK UPDATE

Our quick take on Bank of Japan governor Ueda's comments today is that at first glance it looks as if the BoJ is hardening the signal that it is inclined to raise rates next week absent an adverse market reaction to initial Trump trade policy announcements in the first hours and days of the new US administration that target Japan as well as other economies.

We have maintained a BoJ January hike in our baseline all along, but admit our confidence dipped after Ueda's dovish December press conference appeared to hedge between January and March with focus on uncertainty around wages, the US and Trump policy shocks.

Ueda's comments today largely repeat deputy governor Himino's comments yesterday that the BoJ will discuss whether to hike or not next week, that the US economy is strong and the latest news on wage negotiations continues to be positive. The obvious interpretation is that this was intended to reinforce the message after the market was unsure how aggressively to trade the signal from Himino.

More from us on Japan later.

Meanwhile, finally a bit of luck for the UK with a timely weakening in core and services inflation for December – though some of the softness was in volatile travel and hospitality – easing a bit concerns about inflation persistence and stagflation.

The news has sent oversold gilts higher with yields lower and UK risk assets higher – though sterling is largely unchanged, presumably reflecting more scope for cuts balancing less demand for a UK risk premium from global investors.

We think the market repriced the BoE much too far in the hawkish direction given very weak growth – even recognizing the ill-designed prices higher / growth lower shock from the NICS payroll tax hike.

We think there is scope to put more cuts back in even after today's repricing that has hardened bets on a February cut we think the BoE was going to deliver even with in-line inflation news.

We still expect four cuts from the BoE this year – it could even be more if the UK government is forced into fiscal consolidation of the kind that weakens demand abruptly.

The timing and cadence of these cuts however could be erratic, even though the Bank wants to stick to a gradual quarterly cadence.

After a cut in February, we think the BoE might have to skip May to police initial pass-through of NICS payroll tax increases. But if so, the payback might be the need to cut more than two times in 2H as economic weakness pulls underlying inflation lower.

We will write in more detail on the BoE in the period ahead.

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