# Global Macro Research - Insight

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#Japan / #Monetary Policy / #Inflation



# The Bank of Japan hopes for a virtuous cycle

## The Bank of Japan (BoJ) kept policy unchanged and signalled cautious optimism over price and wage growth. We expect it to wait for clarity from the next Shunto before removing yield curve control (YCC) and negative interest rates (NIRP).

**Key Takeaways**

- The Bank of Japan (BoJ) unanimously decided to leave its policy settings unchanged. The policy rate was left at -0.1% and the target for 10-year bond yields was maintained at 0% with an upper bound of 1%.
- The BoJ also extended by one year the deadline for loan disbursement under the Fund-Provisioning Measure to Stimulate Bank Lending.
- The near-term forecasts for inflation were lowered a touch to reflect the recent decline. We continue to think inflation will fall further over the next few quarters as pressures from past import inflation abate.
- However, the BoJ's fiscal year 2025 inflation forecast was nudged up to 1.8%, and the wording around service price expectations was strengthened to reflect the potential for a virtuous cycle between wages and prices.
- The usual mix of caution and optimism was evident throughout the statement, forecasts and press conference. On the one hand, Governor Ueda believes that the likelihood of hitting the inflation target over the medium term continues to rise. On the other hand, even as the price goal looks to be in sight, the BoJ will maintain an easy stance.
- We continue to expect that yield curve control (YCC) and negative interest rate policy (NIRP) will be removed later this year, after the BoJ has confirmed a strong Shunto wage round. Timing the precise meeting for any policy change is difficult, but, on balance, we expect a move by July.

**Nudging the inflation outlook toward target**

The Bank of Japan (BoJ) voted unanimously to maintain interest rates at -0.1% and the target for 10-year yields under yield curve control (YCC) at 0%.

The statement and outlook forecasts were mildly more optimistic, with the BoJ expecting underlying inflation to increase gradually toward the 2% price-stability target.

While the fiscal year (FY) 2024 forecast for inflation was downgraded, the more important FY2025 was nudged up 0.1pt to 1.8%, signalling a marginally more optimistic outlook for achieving price stability.

**Figure 1: BoJ Median Economic Outlook**

| | January | October |
|---|---|---|
| **Real GDP % y/y** | | |
| FY 23 | 1.8 | 2.0 |
| FY 24 | 1.2 | 1.0 |
| FY 25 | 1.0 | 1.0 |
| **Core CPI % y/y (Core-core CPI)** | | |
| FY 23 | +2.8 (+3.8) | +2.8 (+3.8) |
| FY 24 | +2.4 (+1.9) | +2.8 (+1.9) |
| FY 25 | +1.8 (+1.9) | +1.7 (+1.9) |

Source: abrdn, Haver, January 2024

**The BoJ continues to face the challenges of being a monetary policy outlier**

However, the usual mix of caution and optimism were evident throughout the statement, outlook and price conference.

Governor Ueda expressed greater certainty around reaching the inflation target but added that it is difficult to signal the timing. He also flagged the dangers of removing policy too soon and sliding back into deflation.

When asked about the ability to assess the overall trend regarding wages, Ueda stated that it would be possible to judge based on a range of data and reports as well as rising service prices.

The governor also added an extra dose of uncertainty by stating that the BoJ does not need to wait for an “Outlook report” meeting (April and July) to adjust policy.

However, an important clarification was included in the Q&A session. Even if the price goal looks to be in sight, the BoJ will maintain an easy stance.

This supports our view that even as YCC and NIRP are removed, any tightening cycle is likely to be truncated. The BoJ will maintain accommodative policy to ensure inflation is supported.

**A broad range of wage signals and reports to monitor**

While global drivers such as commodity inflation and supply-chain bottlenecks drove the first leg of the acceleration in Japanese inflation, the focus going forward for the BoJ will be the sustainability of domestic wages and price pressures.

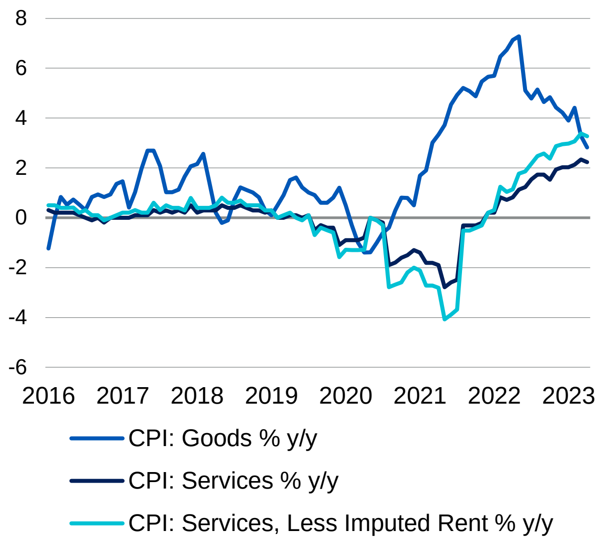
Core inflation measures, in particular labour-intensive service inflation, stand at 30-year highs. Domestic wage trends are key to determine the inflation outlook as pandemic- and war-related pressures unwind.

Rengo, Japan’s largest labour union, is targeting wage increases of “more than 5%” in the 2024 wage rounds, compared to “around 5%” last year.

However, these have yet to filter through to realised wage growth. Going forward, the BoJ will monitor a broader range of indicators.

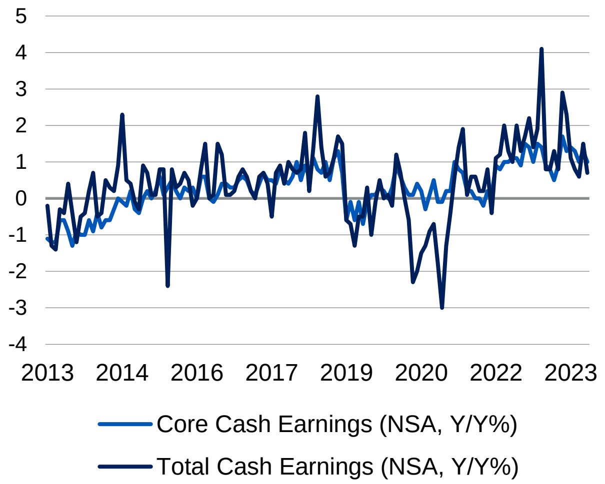
The Shunto initial indications will be announced in mid-March. The BoJ is also placing greater weight on the Regional Economic Report, which surveys household behaviour and the ability for corporates to pass on input costs (next due April 20th). The 18-month policy review is still underway, and the next policy review meeting is scheduled for May.

**Figure 2: Services inflation exceeds 2% after years of flat or negative growth**




Source: abrdn, Haver, January 2024

**Figure 3: Wages fail to break out of historic trend**




Source: abrdn, Haver, January 2024

Consensus forecasts suggest a policy adjustment could occur at the April meeting. The market is now pricing a 55% probability for an April hike and has shifted to 100% by June.

Risks around timing remain high, but, considering the deceleration in price trends and the timing of wage negotiations, data and reports, we think the BoJ should shift policy by July.

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