

Colin Asher

Senior Economist

colin.asher@mhcb.co.uk | +44 20 7012 5262

BoJ preview: March vs April

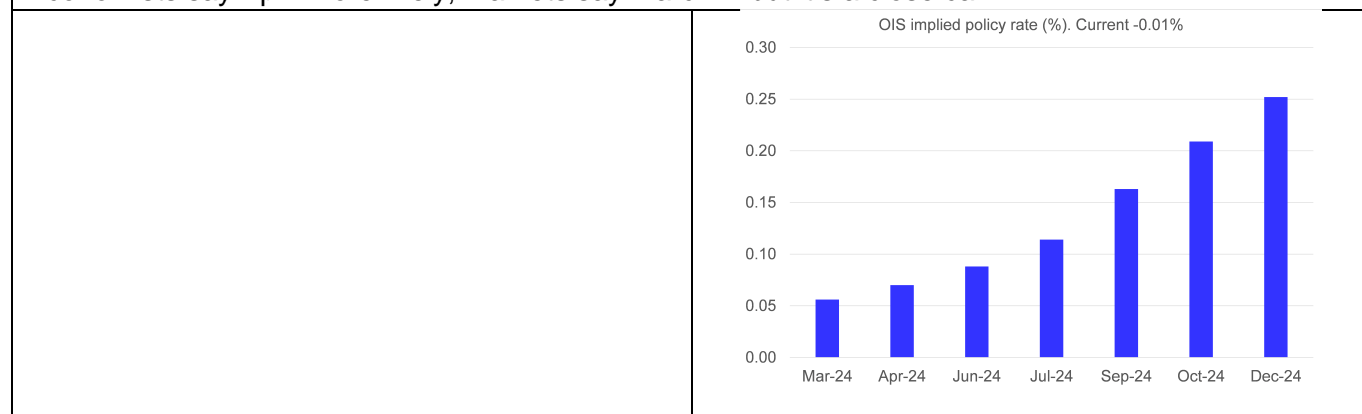
- **Tighter policy is coming. We see April as the most likely timing for a move, amid Ueda caution...**
- **...but a strong spring wage offensive has sharply lifted the odds of a March move**
- **Governor Ueda has stressed that policy will remain loose, pointing to a slow pace of hikes...**
- **...but we still see relative policy rates as a support for JPY in coming quarters.**

Baby steps in 2023 allow for a “bigger” change in 2024

The first point to note is that the BoJ's current framework has multiple aspects to it, as the name implies – Yield Curve Control with Qualitative and Quantitative Easing (YCC w QQE). Negative Interest Rate Policy (NIRP) is technically part of the YCC framework. In addition to YCC w QQE, the BoJ also undertakes forward guidance of which the Inflation Overshooting Commitment is the key plank. The BoJ has already made a number of tweaks to YCC, first widening the 10yr JGB range in Dec-22 and July-23 and then downgrading the upper limit of the range for 10yr JGB yields to a guideline in Oct-23. For us, the repeated tweaks to YCC mean that it has effectively already been abandoned, even if it is still formally part of the framework.

The Inflation Overshooting Commitment comes alongside a pledge to continuously expand the balance sheet. However, of late the balance sheet has been fairly stable. Its possible to argue that much of the current framework has already been retired/has fallen out of use. This makes it possible for the BoJ to change the whole framework at a single meeting, without too much actually changing. A 10bp hike in the policy rate is not likely to push the recovery into reverse.

Economists say April more likely, markets say March...but it's a close call.



Source: Bloomberg

Elements for tighter policy slotting into place, especially wages

Over the course of the past week yen markets have been volatile amid speculation of a near-term policy change. One of the biggest hurdles appears as if it will be overcome. For many months now BoJ members have been noting that they want to confirm whether wage growth continues this spring. Rengo's summary of wage requests, released last week, was up sharply from last year (5.85% vs 4.49%). Combined with the news from UA Zensen that a number of its members had had their requests met in full, this seems to go a long way to meeting the BoJ's desire to confirm that wages are likely to continue rising. Given the focus that the BoJ has put on the spring wage round, it is no surprise that expectations are now rising. The next event on the wages front will be Rengo's publication of a summary of initial company responses on 15 March. The median forecast from the Bloomberg pre-meeting survey is for a gain of 4.1% with a base pay increase of 2.5%. A large upside surprise, of say over 5%, would possibly seal the deal for a March policy move. On the other hand, the survey pegs any slide below 3.8% as potentially pushing near-term action into the summer or later.

In addition, the H2-23 recession has been revised away. It's a relief for the BoJ that any near-term policy change will not come against the backdrop of a recession. Furthermore, last week the Tokyo CPI surprised on the upside, as did the January wage data.

Finally, media reports noting the prospect of near-term policy change have been frequent. One from Reuters noted "A growing number of Bank of Japan policymakers are warming to the idea of ending negative interest rates this month (March) on expectations of hefty pay hikes in this year's annual wage negotiations".

Both markets and economists are split on the prospects of a March move

The pre-BoJ meeting Bloomberg poll, conducted from 5-11 March shows 40% of respondents expecting the BoJ to change its main policy settings in March and 54% looking for April. That said 90% saw a risk that the BoJ would move in March. Markets are currently pricing in a ~60% chance of a 10bp move in March.

April still our base case for an end to NIRP

Despite the fact that the possibility of a March move has clearly risen over the past week, we still see April as the (slightly) more likely month for an end to NIRP for the following reasons (although we suspect policy change will be heavily telegraphed in the March meeting, especially the press conference):

- 1) The Governor has been extremely patient and cautious to date, almost going out of his way to avoid surprises. We suspect that he would like more data on wages before committing. Rengo are due to publish additional updates on wages 3 times between the March and the April BoJ meetings. In addition, the main data releases between the two meetings will be the BoJ's Tankan and the BoJ's Sakura Report, which provides input from the regions. The BoJ will also publish its semi-annual Financial System Report ahead of the April meeting. This should provide comfort that the financial sector is prepared for higher rates.
- 2) The BoJ will publish new economic forecasts at the April meeting. When the situation is evolving rapidly, it doesn't make sense for a central bank to wait for new forecasts before acting. In Japan's case, it seems hard to argue that the situation is evolving rapidly. As such, the BoJ can afford to be patient and alter policy once its forecasts are aligned with the policy decision. Here, we have been waiting for the BoJ to forecast 2.0% inflation at the back end of the forecast horizon, which would imply that the BoJ sees 2% inflation as sustainable over the medium term.
- 3) Waiting also potentially allows the government the chance to assess whether to declare an end to deflation. This would leave the government and the BoJ on the same page. The Kishida administration's popularity is at rock bottom and a declaration that deflation has been defeated might boost PM Kishida's ratings.

With regard to the media reports none are especially conclusive. It depends on the source. If the Governor (or Deputy Governors) are the source then policy change is a lot more likely. The Governor and Deputy Governor will likely vote as a block and are not likely to be outvoted.

In the bigger picture, which month BoJ policy tightening starts is less important than how far and how fast it goes. Governor Ueda has been keen to reassure investors that any tightening will be a slow process and liquidity will remain plentiful even after tightening has started. We currently expect that the pace of rate increases will be slow and see the policy rate at just 0.2% on a 12-month horizon. The Bloomberg survey pegged a 0.5% terminal rate which is roughly in line with current market pricing. One factor to consider here is that rates elsewhere will be on the way down as the BoJ hikes. This will likely limit the scope for the BoJ to hike. Peak global inflation (and the peak rates that accompanied it) is increasingly in the rear-view mirror. The yen has been extremely weak as the BoJ lagged hiking cycles elsewhere. We expect that as the BoJ catches up (albeit slowly) the yen will pare some of its recent underperformance, which will be helped by falling policy rates elsewhere. As noted in our recent monthly outlook (<https://www.mizuhogroup.com/emea/what-we-do/insights-and-research/insights>), we expect USD/JPY to decline towards 135 by year end.

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