Daiwa Securities

Daiwa's View

BOJ Governor Kazuo Ueda kept saying "highly uncertain"

➢ BOJ has cautious stance, despite changes in companies' price and wage setting behaviors

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BOJ Governor Kazuo Ueda kept saying "highly uncertain"

In Jun, central banks of Japan, US, and Europe each plotted different courses

BOJ stands out, stubbornly taking no action; this is once again accelerating depreciation of yen

During "central bank week" (third week in Jun), the Fed held off on making a rate hike in a hawkish manner, the ECB again raised rates by 25bp, and the BOJ tenaciously maintained its monetary easing. In other words, the central banks of Japan, the US, and Europe each plotted different courses. From the outset, there was no need for the BOJ to make a hasty move as the June meeting was positioned as a period for preparing the July *Outlook for Economic Activity and Prices* report (*Outlook Report*), yield curve distortions have been corrected, and poor JGB market functionality has also improved. That said, the BOJ stands out by stubbornly taking no action at a time when other major central banks are raising rates in order to curb inflation. These different monetary policy vectors among central banks are once again accelerating depreciation of the yen.

At regular press conference, Governor Ueda admitted signs of changes in companies' price/wage setting behaviours

He conveyed cautious stance by repeating phrase of "highly uncertain"

Watch the *Outlook Report*'s Second Perspective section

At the regular press conference by BOJ Governor Kazuo Ueda, there was a change in the price outlook compared to the previous April. The statement maintained the description that "the year-on-year rate of increase in the CPI (all items less fresh food) is likely to decelerate toward the middle of fiscal 2023." However, he mentioned that "looking at data, the pace of the decline is somewhat slower than projected." When asked about the background, he replied that "concretely, the rate of markups of foods, daily necessities, and some services (accommodation fees) is slightly higher than expected. I think that moves to pass on higher costs (such as energy costs) to customers are strong especially for foods and daily necessities, for which we would analyze a little more." Although he admitted the existence of signs of changes in companies' price and wage setting behaviors, he repeated "the outlook is highly uncertain" many times. This conveyed his cautious stance. Regarding judgment on the achievement of the price stability target, he mentioned that "we will make a judgment based on not only the median of price projections but also the accuracy of projections" and "we would like to elaborate on accuracy in the Second Perspective section of the *Outlook Report."*

Companies passing higher costs onto customers in a different manner, prolongation of weak yen, higher-than-expected hikes in wages

Every time I listen to Governor Ueda's detailed explanations about price projections, I empathize with his feeling of having no confidence about the outlook. In the process of price projections, the more we make various simulations, the broader the projected figures are distributed. However, companies are still continuing to pass higher costs onto customers in a different manner from before, although import prices are currently slowing down. If the yen remains weak against other currencies for longer than expected, this would serve as a factor in boosting prices. The rate of wage hikes in the 2023 spring wage negotiations was higher than expected. Even if next year sees a smaller hike than this year, wage hikes may be sustained.[1] There are many upside risks for prices.

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[1] The Bank of Japan Working Paper Series *Nonlinear Input Cost Pass-through to Consumer Prices: A Threshold Approach* (published 22 May 2023) pointed out that "the pass-through to CPI inflation of increases in producer prices, exchange rates, and wages rises once the increase in each of these variables exceeds a certain threshold" and "the estimated impact of the nonlinear pass-through of wage growth tends to be persistent due to the observed higher inertia in wage growth."

FY23 price projection expected to be raised in Jul *Outlook Report*

BOJ would confirm how prices will decline towards mid-FY23

Before the announcement date of the July *Outlook Report,* the following data will become available—June BOJ Tankan (price DIs), the output gap estimated by the BOJ, July *Regional Economic Report*, CPI readings for May and June (through Jul for figures in the ward-area of Tokyo), and Monthly Labour Survey (real wages) for May. Given these new data, it is highly likely that the BOJ will raise its FY23 core CPI forecast. However, if it thinks that sustainability is highly uncertain, a downward revision to its FY24 projection would be highly likely. Until the BOJ confirms how prices will decline towards mid-FY23, it is unlikely to change its price outlook. As the accuracy is expected to change over time, we will carefully watch the description of the Second Perspective section in the July *Outlook Report*.

Hard to expect surge in Japanese inflation expectations during the six weeks up to Jul meeting

Unless 10yr JGB yield tests 0.50%, BOJ would continue to take a wait-and-see stance

Meanwhile, despite strongly rooted market speculation on revisions to the YCC policy, Governor Ueda mentioned that “we will carefully explain projections for prices and economy as well as market functions by comparing its effects and side effects” and “at this point, market functions have improved somewhat, but I'm not saying anything about whether this condition will be maintained when there are movements in Japanese inflation expectations and overseas yields.” Regarding dialogues with the market, he explained that “based on new information over the intermeeting period, an emergence of a certain degree of a surprise would be unavoidable.” This remark provides ground for speculation on revisions in July. However, it is difficult to envisage a surge in Japanese inflation expectations during the six weeks up to the meeting. Unless the 10-year JGB yield tests the upper limit of 0.50% when there is a rise in US yields, it is highly likely that the BOJ will continue to take a wait-and-see stance.

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