Daiwa's View

BOJ Governor Ueda's NHK interview and December Summary of Opinions

➢ Room for discerning virtuous cycle, while still maintaining free hand; message reduces likelihood of Jan rate hike to some extent
➢ Also signaled intention to not wait until July, when wage data for SMEs becomes available; left with impression that time frame for policy change has narrowed considerably
➢ Honest determination to move to "world with interest rates"; discussed rate hike timing, not pros and cons

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Two important sources of information were provided by the BOJ on 27 December. These were (1) an exclusive interview with BOJ Governor Kazuo Ueda conducted by public broadcaster NHK and (2) the Summary of Opinions for the December Monetary Policy Board meeting. Both the interview and Summary of Opinions seem to complement each other and convey the Bank's desired messaging at this juncture. In this report, we will share our first impressions[1].

Virtuous cycle between wages and prices: Two points of interest for BOJ

In his NHK exclusive interview, Ueda discussed in greater detail the key points for determining whether a virtuous cycle between wages and prices is in place. Here, he said, "In terms of the focus of our attention for now, we are looking at next year's annual spring labor-management wage negotiations and how wage trends up to this point will be reflected in service prices." The BOJ has long stressed that it is targeting a "virtuous cycle between wages and prices along with sustained moderate inflation of around 2%." This confirms that the BOJ has placed the same degree of emphasis on the spring labor-management wage negotiations and the pathway for higher wages leading to higher prices.

In terms of the pathway from higher wages to higher prices, the Bank's December Summary of Opinions clearly stated, "In examining progress toward intensification of the virtuous cycle between wages and prices, attention is warranted on whether higher personnel expenses due to wage hikes will be passed on to selling prices in the services industry, where it is more difficult relative to the manufacturing industry to absorb cost increases by raising productivity." Here, the focus is now on how service industries are passing on higher labor costs to their prices.

The opinion that "Moves to pass on higher personnel expenses to prices have spread and the year-on-year rate of increase in services prices, which are sticky, has continued to be high" was presented with some confidence. However, the report also included the cautious opinion that, "Many firms have reported that it remains difficult to pass on higher wages to services prices." The fact that "many" firms have expressed difficulty in doing so suggests that a little more time is needed for a virtuous cycle to take hold. This reduces to some extent the likelihood of a rate hike in January 2024.

[1] For a more comprehensive discussion, please see our report prepared by Chief Market Economist Mari Iwashita, due out later.

Did Ueda essentially deny possibility of Jan rate hike?

During the NHK interview, Ueda was asked about the timing and conditions for making a monetary policy shift. He said that the possibility of considerable optimism at the January bank managers' meeting, for example, with the accumulation of a large volume of information was not zero. However, he added that he thinks such an outcome is not very likely at this juncture.

This part about the branch managers' meeting is noteworthy as Ueda had said "We still need to discern (a virtuous cycle)" and "There won't be that much new information (up until the Jan meeting)" at his press conference following the BOJ's December meeting. This deliberate lowering of expectations for the BOJ's branch managers' meeting, the most anticipated data between the December and January meetings, is probably a definitive signal (that rates will not be hiked in January).

Also, during his NHK interview, Ueda stressed that the BOJ is not in a hurry to change policy. The December Summary of Opinions also included passages such as, "It would not be too late even if the Bank makes a decision after it sees developments in labor-management wage negotiations next spring" and "Increasing the flexibility in the conduct of yield curve control at the previous meeting has lowered the likelihood of distortions on the yield curve. Therefore, unless underlying inflation strengthens to an excessive degree, the Bank will have sufficient leeway to determine whether the 2% target can be achieved through a virtuous cycle between wages and prices." Ueda's NHK survey reconfirmed this stance that the Bank is not in a hurry to change policy. In effect, these comments can be interpreted as a signal that the likelihood of a January rate hike is close to zero (with Ueda using his signature phrase "not zero" to maintain a free hand).

Won't wait until July

That said, during the NHK interview, Ueda also said, "It will take considerably more time before we can confirm the last of the data on wages for small and medium-size firms" and "It will require substantial time before the data of all smaller firms becomes available." These comments may be signals that Ueda will not wait until the final round of responses from SMEs in July to compile data on the spring 2024 wage negotiations—one of the two points he is focusing on for confirming a virtuous cycle. Looking at the wage negotiation results for 2023, the release date for the first response tally was 17 March and the release date for the seventh (and final) response tally was 5 July. If a decision in January is unlikely and waiting until July is also unlikely, then the number of Monetary Policy Board meetings where negative interest rates could to be ended would naturally be narrowed down to three (18-19 Mar, 25-26 Apr, and 13-14 Jun).

Honest determination to move to "world with interest rates"

The December Summary of Opinions included such opinions as "Buds of change in the structure of the economy have appeared, driven by labor shortages. It is appropriate that the Bank focus on encouraging these changes so as not to lose this golden opportunity and continue with the current monetary easing for the time being" and "As the idea that cost increases due to wage hikes should be absorbed by firms' efforts has been entrenched, a pass-through of wage hikes to selling prices requires improvement in customer satisfaction. To achieve this, human resource development as well as investment in human capital and research and development (R&D) are important." Some of these opinions are similar to those included in Deputy BOJ Governor Ryozo Himino's 6 December speech, in terms of the sense of scale. From this, it is clear that the theme is not a low-level discussion about ending negative interest rates (reducing side effects) versus continued easing, but rather the true goal is to realize changes for the Japanese economy, changes that absolutely must succeed, such as changing economic structures and increasing productivity. It is our understanding that the timing of interest rate hikes is being carefully considered in order to ensure the successful completion of this transition without any major setbacks.

In summary, the BOJ is now sensing positive changes around the world and is growing more confident in the broadening momentum for wage increases and the passing on higher costs to prices. At the same time, the Bank recognizes that currently it will not fall behind the curve even if it does not rush to hike rates. Also, the JGB yield curve is now less likely to become distorted after the BOJ made its yield curve control policy more flexible at past meetings. As a result, the Bank has sufficient leeway to ascertain the true state of the virtuous cycle between wages and prices. The BOJ is not in a hurry to make a decision, but will keep a close watch on wage hike trends, especially among SMEs. At the very least, the Bank will make a decision after confirming the spring 2024 wage negotiation trends and progress in terms of higher wages leading to higher service prices. That said, the Bank could possibly make decisions pertaining to the spring 2024 wage negotiations, even if the wage hike results for SMEs are not yet available. Our impression, based on the content of the NHK interview and Summary of Opinions, is that the BOJ wants to maintain a free hand, while still not waiting too long to change policy.

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