Daiwa Securities

# Daiwa's View

## Signposts for 2024—Expected BOJ Jan meeting highlights

- BOJ Jan *Outlook Report* forecast
  FY24 core CPI likely revised downward, but big move for core-core CPI unlikely
- New messaging at BOJ Gov Ueda's press conference?
  Wage hike effects, forward-looking statements, increased certainty for realizing 2% price stability target since last meeting?
- BOJ must not miss golden opportunity!

FICC Research Dept

**Mari Iwashita**
81-3-5555-8852
mari.iwashita@daiwa.co.jp

Daiwa Securities Co. Ltd

### Expected BOJ Jan MPM highlights, Jan *Outlook Report* Forecast

The BOJ will announce the results of its January Monetary Policy Meeting and the *Outlook for Economic Activity and Prices* report (*Outlook Report*) tomorrow (23 Jan). Since Kazuo Ueda became BOJ Governor in April 2023, the central bank has increased the flexibility with which it conducts its yield curve control (YCC) policy at the meetings in July and October when the *Outlook Report* was released. In an NHK interview broadcast on 27 December 2023, BOJ Governor Ueda said that the Bank's near-term focus is on (1) wage revisions in spring and (2) how changes in wages are reflected in service prices. However, sufficient data is not available for the January *Outlook Report*. Recently, there have been some worrisome developments, including weak consumption due to high prices, the impact of the Noto Peninsula earthquake, and the suspension of production at Daihatsu Motor. And, with there still being a high degree of uncertainty regarding wage increases at small and medium-sized enterprises, the situation lacks clear indicators as to how things will develop going forward. We anticipate that the BOJ will maintain the status quo at its January meeting, viewing this as a time to wait for more data.

On 20 January, the *Nikkei* (online version) ran an article entitled "BOJ's Dialog with Market to Focus on Wage-Price Virtuous Cycle Effects." This article listed five points the Bank will likely discuss at its January Monetary Policy Board meeting. Specifically, these points are ① price outlooks, ② wage hike effects, ③ likelihood of ending negative interest rate, ④ comments about monetary policy outlook, and ⑤ overseas economic and market trends. In this report, the author shares her opinions on these five points. First, price outlooks (above point ①) refer to the figures in the *Outlook Report*. Over the past three months, the uptrend in crude oil prices has let up (with the WTI declining recently from $80-83/bbl at end-Oct to $70-72/bbl). Furthermore, the government has disclosed the details of its measures for coping with inflation (until May). Therefore, the BOJ is expected to lower its FY24 core CPI projection from +2.8% in the previous October report to around the 2.5% level (Chart 1). However, this revision is caused by energy price factors, meaning that (1) projections for the BOJ-focused core core CPI (underling price trends) are revised only slightly and (2) there will be no major impact on FY25 projections. Consequently, the downward revisions to price projections will not serve as a factor in reducing the possibility of policy revisions by the BOJ.

**Chart 1: BOJ Policy Board Members' Projections (median, y/y %)**

| | Real GDP | | | Core CPI | | | Core core CPI | | |
|---|---|---|---|---|---|---|---|---|---|
| | Oct 2023* | **Jan 2024**** | My forecast | Oct 2023* | **Jan 2024**** | My forecast | Oct 2023* | **Jan 2024**** | My forecast |
| FY23 | +2.0 % | **+1.6 %** | +1.5 % | +2.8 % | **+2.8 %** | +2.8 % | +3.8 % | **+3.8 %** | +3.9 % |
| FY24 | +1.0 % | **+1.1 %** | +0.9 % | +2.8 % | **+2.5 %** | +2.3 % | +1.9 % | **+1.9 %** | +1.7 % |
| FY25 | +1.0 % | **+1.0 %** | +1.0 % | +1.7 % | **+1.8 %** | +1.8 % | +1.9 % | **+1.8 %** | +1.7 % |

*Source: BOJ, various materials; compiled by Daiwa Securities.*
**BOJ projections.*
***My estimates for policy board member projections.*

The BOJ's Opinion Survey on the General Public's Views and Behavior released on 17 January asked respondents about their price perceptions. Specifically, the survey asked, "By what percent do you think prices will change one year from now?" The average response was "up 10.0%" (up 10.7% in the previous survey) and the median was "up 8.0%" (up 10.0%; Chart 2). The survey also asked, "By what percent do you think prices will change per year on average over the next five years?" The average response was "up 7.6%" (up 8.0%) and the median was "up 5.0%" (up 5.0%; Chart 2). In general, the expected pace of increase has slowed, but households' inflation expectations are still high.

Meanwhile, according to December CPI data (released on 19 Jan), nationwide core CPI rose 2.3% y/y, slowing for the second straight month (up 2.5% in Nov). Core-core CPI (excludes energy) also slowed to 3.7% growth (up 3.8% in Nov), but remained at a high level, holding above 2% for the 15th straight month. In December, a large increase in lodging fees[1] contributed to CPI growth, but lower electricity/gas prices[2] and a lull for the rise in food prices weighed on CPI. The rise in goods prices, starting with import prices, has peaked for the time being. However, if the yen depreciation beyond USD/JPY145 is allowed to take hold for a prolonged period, pressure to raise prices may again increase. Also, BOJ Governor Kazuo Ueda has repeatedly stated that he would like to see higher service prices reflecting higher service sector wages. Service price growth is slowing in the food service sector, but has held steady in other service sectors (Chart 3).

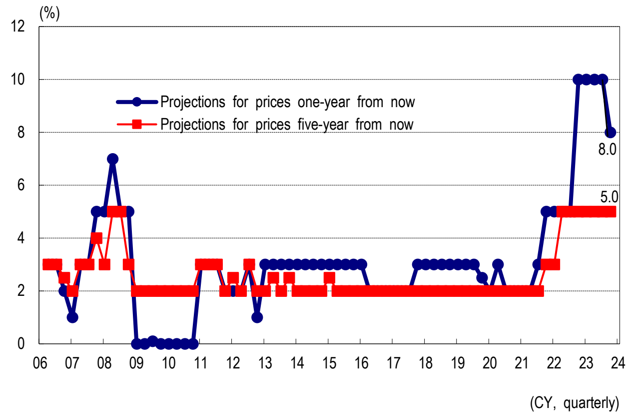
## Level of wage hikes based on report at Jan BOJ branch managers' meeting

The latest information from hearings regarding the level of wage hikes (the second factor) was announced on 11 January in a report about the current state of the economy from the perspective of each region (at Jan 2024 branch managers' meeting). Comments about the closely watched wage and price setting behaviors are as follows (indicated in bold, author underlined points considered particularly important).

**<u>Some large companies have already announced plans to raise base salaries to the same extent as last year or to an even greater extent</u>. While there are some regional variations, <u>momentum for wage increases has been building at a somewhat earlier stage than last year</u>, even in the local regions. That said, <u>many BOJ branches reported high levels of uncertainty regarding the spread and extent of wage hikes. They said that many companies have not yet decided to hike wages</u> as they are still waiting to see if their competitors do so, <u>adding that many companies, especially small and medium-size enterprises (SMEs), remain cautious due to earnings constraints.</u>**

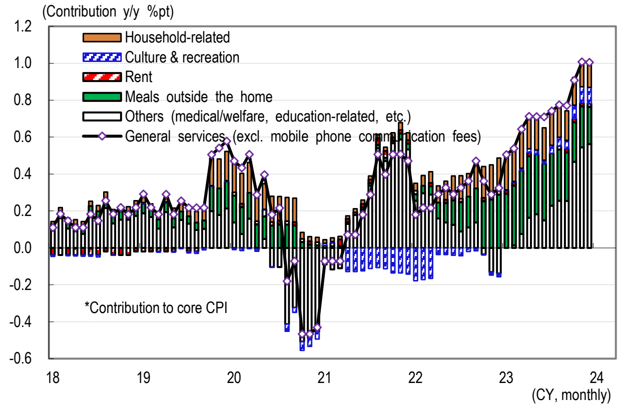
[1] The growth rate for nationwide lodging fees slowed to up 59.0% y/y (up 62.9% y/y in Nov) as the boost from the October 2022 government support for domestic travel dropped off, but remained at a high level due to a recovery in the number of foreign visitors to Japan.
[2] Regarding December nationwide CPI, the MIC estimated that the government's inflation measures placed a 0.41ppt drag on electricity charges and a 0.08ppt drag on city gas charges, totaling to a 0.49ppt drag (the same as the Oct-Nov figures). Government's measures are likely to put downward pressure on CPI until May 2024 data.

**Chart 2: Opinion Survey on General Public's Views and Behavior (perception of price levels, median)**




*Source: BOJ; compiled by Daiwa.*

**Chart 3: Factor Breakdown of General Service Prices in Nationwide CPI**




*Source: Ministry of Internal Affairs and Communications (MIC); compiled by Daiwa.*

The BOJ has a positive outlook on the wage hiking policies of large companies. Indeed, the Bank has said, “Momentum for higher wages is building somewhat earlier than last year.” Meanwhile, the BOJ has said that uncertainty is high regarding the spread and extent of wage increases among small and medium-size enterprises (SMEs), suggesting there is still a sense of caution. It seems as if the Bank wants to take a little more time to get a better picture. First, it will wait for the results of the annual spring labor-management wage negotiations due out on 15 March (date at which most responses have been tallied). Then, it will probably want to use the next report from the April branch managers’ meeting (early April) to confirm whether a more positive trend among SMEs is spreading. The January branch managers’ meeting report was not a decisive factor for policy revisions. However, we want to confirm any positive comments from Ueda regarding the effects of wage hikes at his 23 January regular press conference.

As for the likelihood of ending negative interest rate (above point ③), the BOJ will probably not make that change at the January meeting. As for price outlooks (above point ①) assumes that core-core CPI will remain elevated with a virtuous cycle between wages and prices in place. The Bank will continue trying to ascertain whether the accuracy of the forecast figures is increasing. The effect of wage hikes (above point ②) is inconclusive as of January. Also, some time is needed to determine the impacts of the 1 January Noto Peninsula earthquake. At this time, the scale of the disaster is smaller than the 2011 Great East Japan Earthquake and the 2016 Kumamoto Earthquake. Therefore, it appears that additional support operations for the impacted areas could be unnecessary.

## New messaging at Ueda’s regular press conference?

Point ④ (comments about monetary policy outlook) to be discussed at the January meeting, will be a key focus at Ueda’s regular post-meeting press conference on 23 January, along with point ② (wage hike effects).

During his 19 December 2023 post-meeting press conference, Ueda touched on achieving the Bank’s 2% price stability target. He said, “The prospects are gradually heightening. But in terms of whether the threshold would be met, we’d prefer to look at more data. We still need to scrutinize whether a positive wage-inflation cycle will fall in place.” In this manner, he maintained a cautious stance on ending negative interest rates. Noteworthy points from Ueda’s 25 December speech at the Japan Business Federation (*Keidanren*) included trends in service prices and the impact of the Japan FTC’s guidelines on price negotiations for the appropriate shifting of labor costs to prices. On top of that, he said, “If the virtuous cycle between wages and prices intensifies and the likelihood of achieving the price stability target of 2% in a sustainable and stable manner rises sufficiently, the Bank will likely consider changing its monetary policy." Also, in an NHK interview broadcast on 27 December, Ueda was asked about the intent of his expression "wages rise markedly" used during the aforementioned Keidanren speech. Here, he said that it is desirable for wages to rise in 2024 at around the same pace as spring 2023 "or somewhat faster."

We believe that as of January, the BOJ's perception is that the accuracy for realizing this virtuous cycle between wages and prices has steadily increased since the last meeting, but is still not high enough. Still, the BOJ should make some statements about its expectations ahead of the key spring management-labor wage negotiations. We note that the OECD released its "Economic Survey of Japan 2024" on 11 January. This survey recommends that the BOJ should gradually raise its policy rate and make its JGB yield curve control policy more flexible, assuming inflation holds steady around the 2% target. The number of those in favor of the BOJ revising its monetary policy, both in Japan and overseas (OECD), has increased. This means it should be easier for the BOJ to work under the circumstances that those around them want.

The BOJ began full-scale preparations for a monetary policy exit in the summer of 2023. Under a major policy normalization process, Japan's economy is moving forward in line with the outlook, which the author perceives as steady progress. The labor share can likely be raised mainly at large companies, backed by solid corporate earnings. Furthermore, the BOJ probably wants to wait a little longer for the Japan FTC's guidelines regarding price negotiations for appropriately passing on higher labor costs to prices to take effect. Until spring, the BOJ is likely to discern whether wage hikes will lead to a rise in service prices (second force).

## Speculation receding about early policy revisions in Japan and US

Wrapping up, we look at overseas economies and market trends, the fifth point at the January meeting. Since November 2023, expectations for an early US interest rate cut have increased. The 10-year UST yield fell from just above 4.8% at the end of October to a temporary low of just above 3.7% on 27 December. Since the start of 2024, the yield rose to just above 4.1% due to strengthening economic indicators and comments from Fed Governor Christopher Waller, who on 16 January talked about cutting rates at a cautious pace (Chart 4). Looking ahead, attention will shift to the extent to which excessive expectations for a rate cut will drop off. While the start of interest rate cuts is a given, attention will likely shift to the pace of such cuts. We believe that the US economy remains resilient and inflation remains tenacious. Meanwhile, in terms of exchange rates, the yen appreciated from above the USD/JPY151 level as of end-October to temporarily trading just over USD/JPY140 on 28 December. This strengthening of the yen was in conjunction with the decline for the 10-year UST yield. The pair is currently trading at the USD/JPY148 level (dollar appreciation, yen depreciation) as speculation about early US rate cuts and the BOJ ending its negative rate policy is now receding (Chart 5). As the BOJ views foreign exchange trends as a policy reaction function, we should note that these trends are likely to continue.

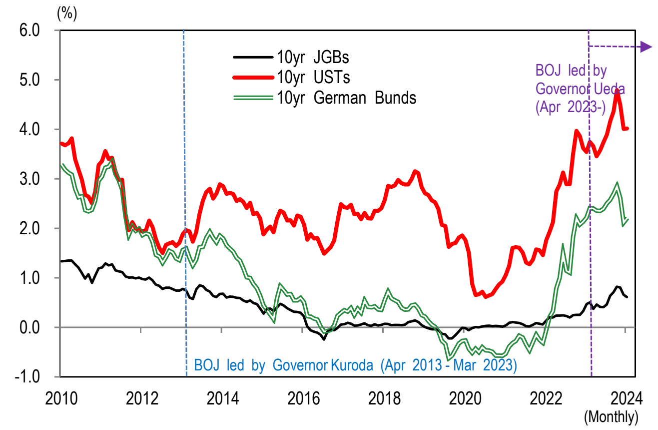
Looking ahead, if the view that the US will start cutting interest rates in mid-2024 or later strengthens, the BOJ may be pressured into normalizing policy in response to speculative selling of the yen. On the other hand, downward pressure on the Japanese economy would intensify in such cases as (1) the US economy unexpectedly stalls (concerns that Jan-Mar quarter could be impacted by major cold waves), (2) the US enters a phase of interest rate cuts, or (3) the Chinese economy stagnates for a prolonged period (spread of new mutant coronavirus strain JN-1). Even if the BOJ can explain that monetary conditions are still accommodative even after ending negative interest rates, its next rate hike would be more challenging.

## BOJ must not miss golden opportunity!

The author believes that the BOJ should move quickly while it still can. However, cautious parties within the BOJ want to avoid a situation where they are criticized for failing due to a hasty response. As such, there is the possibility that they will adopt a more discerning stance until all uncertainties are eliminated. That said, there is now a tailwind that the market, to some extent, already assumes the BOJ will end negative interest rates and many are saying that policy should be ended. The BOJ must not miss this golden opportunity. If the Bank fails to revise policy in the first half of 2024, it could become unable to move until the end of the US interest rate cutting cycle, in the worst-case scenario.

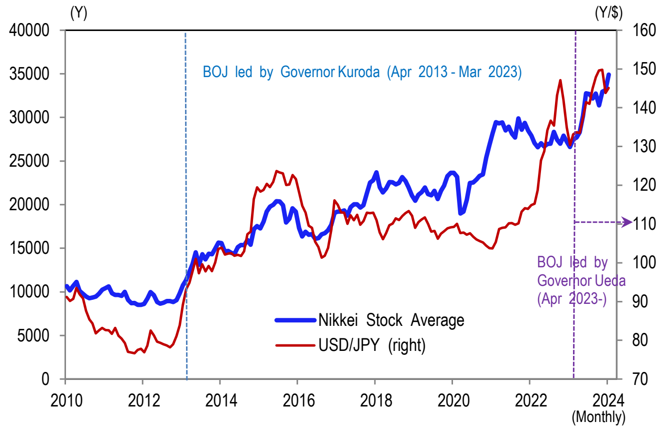
During the press conference following his 6 December 2023 speech, BOJ Deputy Governor Ryozo Himino was asked about the timing for exit monetary easing. He explained that in the real economy "We don't have a green light for all conditions" and "With so many different signals being observed in the mix, we must make a decision somewhere." Toward spring, I await Ueda's courageous decision.

**Chart 4: Long-term Yields in Japan, US, Germany (from 2010)**




*Source: Bloomberg; compiled by Daiwa.*
*Note: Jan 2024 data uses average through the 19th.*

**Chart 5: Nikkei Stock Average, USD/JPY Rate (from 2010)**




*Source: Bloomberg; compiled by Daiwa.*
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