Iwashita's Economic & Market Watch

BOJ to wait until last minute before making July rate hike decision

- BOJ preparing to adjust degree of monetary easing; adjustment just matter of timing
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FICC Research Dept

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

Daiwa Securities Co. Ltd

Only matter of time before BOJ recalibrates easing

After Reuters ran an English-language report entitled "BOJ to weigh rate hike next week" (the title of the Japanese-language article was "BOJ to consider rate hike at next week's meeting") on the night of 24 July, there were movements in the market indicating that it was bracing for a rate hike at the July meeting. The English article mentioned that "The Bank of Japan is likely to debate whether to raise interest rates when it meets next week," which differs slightly in nuance from the Japanese title that used the Japanese word for "consider," which can be regarded as expressing the view that discussions are moving towards deciding on a rate hike. However, the word "debate" gives the impression that the final decision on a rate hike has not been made. The (Japanese) press and the BOJ use very particular language to express themselves, so the parties involved usually choose their wording deliberately. The difference in wording (in Japanese) seems to have become somewhat obscured in the English article. However, the article states that, based on BOJ sources, "What's clear is that the BOJ will probably raise rates in coming months", indicating that an additional rate hike by October is a done deal. We have pointed out that it is clear that (1) the BOJ is preparing to recalibrate monetary easing to align with economic, financial, and price conditions, independently of the reduction in its JGB purchases, and (2) the recalibration of easing is only a matter of time[1]. I think we can say that our understanding was correct.

Increasing momentum within LDP for monetary policy normalization

One major change that has occurred over this past week has been an increase in momentum within the Liberal Democratic Party (LDP) for normalization of the BOJ's monetary policy. Underlying factors include (1) strong recognition in the LDP of the need to respond to the weak yen (the cause of inflation) in order to restore its approval ratings, (2) the fact that the ball is in the BOJ's court (the BOJ is expected to play its role) following what appears to have been currency intervention, and (3) the approaching LDP presidential election in September. Following a call for rate hikes by Digital Transformation Minister Taro Kono on 17 July, Prime Minister Fumio Kishida emphasized at a summer forum held by the Japan Business Federation that monetary policy normalization would give a boost to the shift in the economic stage. In his speech on the night of the 22nd in Tokyo, LDP Secretary General Toshimitsu Motegi said that it was clear that excessive depreciation of the yen was negative for Japan's economy, and that the BOJ needed to communicate clearly how it would normalize monetary policy, including considering gradual interest rate hikes. Political support would make it easier for the BOJ to take action. Some are of the opinion that political factors would make it difficult to take action in Sep-Oct. Therefore, it could be seen as better to take action early in July. That said, the LDP presidential election in September will not be an obstacle for the BOJ provided the LDP feels it is necessary to respond to the weak yen. On the other hand, it could be difficult for the BOJ to take action in October if there is a good chance of a general election in October.

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[1] Refer to *Iwashita's Economic & Market Watch: Only matter of time before BOJ recalibrates easing (8 Jul 2024).*

"Bond Market Group" meeting minutes convey important messages

On 19 July, the BOJ released the minutes for its two-day (9-10 Jul) "Bond Market Group" meetings. The Bank usually releases the minutes three weeks after the meeting, so the fact that the minutes were released earlier this time, before the July meeting, is significant. We can probably assume that the BOJ is trying to convey some messages. Regarding the range for reducing the amount of JGBs purchased by the BOJ, we would like to focus on a new written opinion that was not included in the compilation of participants' opinions released on 9 July. Specifically, this new opinion stated, "If the Bank reduces the amount of its monthly purchases to about three trillion yen, that will be a clear message that it is committed to significant reductions. Besides, the share of the Bank's JGB purchases in the issuance amount is likely to decline considerably and bond market functioning is expected to improve." We were left with the impression that in addition to setting a target of around Y3.0tn, the Bank also wants to carefully explain its reasons for setting that target. We also believe that discussions with MOF (Financial Bureau) have progressed. Meanwhile, as for the pace of reductions, a growing number of respondents expressed the view that gradual reductions are desirable. It is expected that the Bank will not reduce the amount abruptly, but will present a plan to reduce the amount on a quarterly or six-month basis. Finally, the Bank included for the first time the following opinion in regards to presenting guidance: "It is desirable for the Bank to pinpoint a specific amount of planned JGB purchases, while keeping options available, such as unscheduled JGB purchases and fixed-rate purchase operations, to enable the Bank to respond to a rapid rise in interest rates in a flexible manner." The BOJ will probably provide written explanations for two opinions, one on unscheduled purchases operations of JGBs and the other on fixed-rate purchase operations. If a JGB purchasing reduction plan is compiled based on the above points, there will be no surprises when the results are announced.

Could adjust degree of monetary easing from risk management perspective

Even though the Japanese economy is now confronting weak consumption, Japanese companies are strong enough that wage increases are spreading, even to small and medium-sized enterprises (SMEs), with higher costs passed on to their prices. Both the output price DI in the June Tankan survey and firms' outlook for prices in general are encouraging. On the wage front, the average wage hike won at this year's spring labor-management negotiations was +5.10% (based on Japanese Trade Union Confederation's (Rengo) final tabulation). Also, the July BOJ branch managers' meeting report confirmed that wage increases are spreading to SMEs and the BOJ has collected good circumstantial evidence from its hearings. From the perspective of risk management, particularly the risk of weak consumption due to high prices and upward pressure on prices due to a weak yen, the BOJ may decide that it is better to adjust the degree of monetary easing as soon as possible.

Meanwhile, some policy board members would like to see a turnaround to positive growth for Apr-Jun real GDP, which will be announced on 15 August. They will also want to make sure that consumption picks up. If the BOJ remains data-driven, wanting to examine the monthly labor statistics for July (reflects wage increases at SMEs), which will be released on 5 September, before making any decisions would be natural. In that case, in order to buy time for examining such data, the BOJ will need to again include the notation about price outlook certainty in its July *Outlook Report* and devise a way to link that to expectations for a rate hike. Some policy board members will make speeches in August. With some advance notice, the BOJ should be able to examine the indicators and ride out September's political factors.

BOJ to assess data up until last minute before making July rate hike decision

On the evening of 25 July, Jiji Press ran an article titled "BOJ discussing whether to hike interest rates again, determining the timing" and on the night of 25 July, the *Nikkei* ran a report titled "BOJ to explore timing of additional rate hikes; argument for July hike also floated." Based on the BOJ's past explanations, it can be read from both articles that the Bank currently cannot make up its mind regarding a July rate hike. Since the start of the new fiscal year, the BOJ has become stricter regarding information management and seems to be making efforts to be more non-committal. Still, the yen temporarily appreciated to the Y151 level on 25 July due to expectations for an additional interest rate hike by the BOJ. On the other hand, the Nikkei Stock Average fell by more than Y1,000 on 25 July, falling below the Y38,000 line. The Bank will most likely wait until 31 July (when policy board members will vote) to assess market trends and decide whether or not to raise interest rates. Provided that there are only a few dissenters and that market turmoil can be avoided, the BOJ will probably not wait too long to decide on raising interest rates.

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