

Iwashita's Economic & Market Watch

FICC Research Dept

Ueda-led BOJ likely to enter gradual rate-hiking phase

- Aiming for gradual policy rate hikes up to neutral interest rate
Concept of adjusting degree of monetary easing; early response in increments of 0.25% is good
- Our main scenario calls for additional rate hike in Dec-Jan (policy outlook chart provided)
Additional hike possible as early as Oct meeting (rate could reach 1.00% in Apr 2025 at earliest)

Mari Iwashita

81-3-5555-8852

mari.iwashita@daiwa.co.jp



Daiwa Securities Co. Ltd

Ueda's July press briefing suggests further rate hikes possible this year

At the BOJ's Monetary Policy Meeting held on 30-31 July, the Bank decided to further raise interest rates by a majority vote (uncollateralized overnight call rate hiked from 0.0~0.1% to 0.25%). In this report, we would like to briefly comment on BOJ Governor Kazuo Ueda's post-meeting press conference (bold lettering for Ueda's comments, BOJ's statements), the concept of adjusting the degree of monetary accommodation, and the policy rate path.

First, when asked about a further rate hike this year, Ueda said, "**It depends on the data going forward. If rates are in line with or exceed the outlooks, there could be a further adjustment for short-term interest rates.**" As for the conduct of monetary policy, the BOJ's July meeting statement included the following passage, "**Given that the current real interest rates are at significantly low levels, if the outlook for economic activity and prices presented in the July Outlook Report will be realized, the Bank will accordingly continue to raise the policy interest rate and adjust the degree of monetary accommodation.**" The BOJ has strongly signaled that additional adjustments are possible going forward provided that outlooks for the economy and prices remain on track. By raising rates in July, Ueda kept his promise made in April. As such, we must next be aware of the possibility of an October hike. Indeed, the possibility of an additional rate hike by the end of this year is in sight.

Regarding rate hike impacts, Ueda explained that gradual adjustments would be desirable. He specifically said, "**Over a longer term, a gradual adjustment for very low interest rates in accordance with economic activity and price conditions would be more positive overall in that it would reduce the risk of being forced to make a very sharp adjustment in a hasty manner.**" This time, the interest rate was raised by a 0.15% increment, but as the IOER is 0.25% and the basic loan rate is 0.50%, small incremental increases of 0.25% in the future seems to be the established (default) policy. Ueda also presented a concept described as, "**Early adjustments are good for achieving a sustainable and stable price target over the medium to long term.**" In light of these two factors, we can probably assume the Bank will proceed with rate hikes in increments of 0.25% along with early responses.

Next, when asked about the policy rate path and destination, Ueda said, "**There is considerable uncertainty regarding the neutral interest rate. This is the second interest rate hike and we will consider the implications going forward. Currently, the rate is well below the range of uncertainty.**" As for the fact that Japan's policy rate has not exceeded 0.5% for the past 30 years, Ueda said, "**The Bank does not view a 0.5% policy rate as a particular barrier (to rates going even higher).**" Ueda suggested that the Bank expects to reach a level higher than 0.5% as, unlike in the past, companies are becoming more aggressive with their wage/price-settings.

Main scenario calls for additional rate hike in Dec-Jan, hike as early as Oct possible

The BOJ's 19 March decision to revise its monetary policy framework was viewed as dovish by the market due to the Bank's excessive emphasis on "discontinuity" and "continuation of an accommodative environment." In the *Outlook Report* released on 26 April, the BOJ switched to a more hawkish tone, stating, "If the outlook for economic activity and prices will be realized and underlying inflation will increase, the Bank will adjust the degree of monetary accommodation." On 31 July, the BOJ decided to hike rates without delay, while also presenting a plan to reduce its JGB purchases. In its statement, the Bank clearly laid out its intention to gradually raise the policy rate to the neutral interest rate level against the backdrop of low real interest rates. At this juncture, we assume that the neutral interest rate targeted by the BOJ is around 1%, but there is no guarantee that the Bank can reach that level even with its early adjustments.

Following the July meeting, our main scenario now calls for the next hike (to 0.50%) in December 2024 ~ January 2025 (60% probability). After that, we forecast a rate hike to 0.75% in April 2025, with an eye on the spring 2025 labor-management wage negotiations. It will then become more difficult to forecast the US economy in the second half of 2025 as the US interest rate-cutting path and next US president are unknown at this time. This could change as conditions in the US unfold. We are not confident about the continuation of gradual interest rate hikes. Meanwhile, there is a possibility of a rate hike as early as the BOJ's October meeting when the next *Outlook Report* is released (sub-scenario (1), 30% probability). Data due out this fall will be important. If interest rates continue to rise with each *Outlook Report* release, the policy rate could reach 1.00% in April 2025 at the earliest. That said, a general election could be held in Japan in October, which might make it harder for the BOJ to act. Meanwhile, the US economy could possibly decelerate sharply, the Fed could start a full-fledged interest rate-cutting phase, and the BOJ could adopt a wait-and-see approach while keeping an eye on the spring 2025 labor-management wage negotiations (sub-scenario (2), 10% probability).

Chart 1: Near-term BOJ Monetary Policy Outlook (as of 2 Aug 2024)

Main Scenario	At its Jul 2024 meeting, the BOJ decided to raise interest rates and presented a plan for reducing its JGB purchases. In its Jul meeting statement, the Bank clearly indicated its intention to continue raising the policy rate and adjusting the degree of monetary accommodation once its economic activity and price outlooks are realized . Amid extremely low real interest rates, there are expectations that the BOJ will gradually raise the policy rate to the neutral interest rate. The BOJ confirms whether the underlying inflation rate can be sustained around 2% while monitoring strong corporate earnings, resilient private consumption (effects of income tax cuts), spreading service price hikes (status for shifting higher labor costs to prices at SMEs), and other factors. With companies becoming more aggressive in their wage/price-settings, exchange rate fluctuations are more likely to impact prices. Data due out this fall will be important .
Probability	60% With a US interest rate cut in sight, the yen depreciation momentum starts to weaken due to the different monetary policy vectors in the US and Japan. If expectations for a US economy soft landing are realized, there would be positive implications for the Japanese economy, which would provide a tailwind for the BOJ's efforts to normalize policy. The next rate hike (to 0.50%) is expected in Dec 2024 ~ Jan 2025. After that, the rate will be raised to 0.75% in Apr 2025, with an eye on the spring 2025 labor-management wage negotiations.
Sub-scenario (1)	US dollar depreciation and yen appreciation are limited to gradual movements, as the US economy remains resilient and US inflation remains tenacious, which encourages the Fed to proceed slowly with corrective rate cuts. High oil prices due to the situation in the Middle East and the yen's persistent depreciation again push up import prices. The spread of wage increases among SMEs is confirmed. The effect of the Japan Fair Trade Commission's policy encouraging the shifting of higher labor costs to prices at SMEs also increases the risk of higher-than-expected price outlooks. The next rate hike (to 0.50%) is expected in Oct 2024 when the next <i>Outlook Report</i> is released. If the trends continue to fall in line with the outlooks, further adjustments may be made in Jan 2025 (to 0.75%) and Apr 2025 (to 1.00%). Still, this could change depending on conditions in the US.
Probability	30%
Sub-scenario (2)	The BOJ carefully proceeds with discussions, keeping an eye on the externals. Amid a global economic slowdown, Japan's consumption remains weak and the virtuous cycle between wages and prices is interrupted. The Bank maintains a wait-and-see approach , while keeping monetary conditions accommodative.
Probability	10% The US economy enters a rate-cutting phase due to a stronger-than-expected slowdown. Prolonged stagnation of the Chinese economy also puts more downward pressure on the Japanese economy. US interest rates also decline and USD appreciation / JPY depreciation correct. Core CPI falls to below the 2% y/y level in 2H FY24. The BOJ awaits results of 2025 spring labor-management wage negotiations, which will determine whether additional interest rate hikes are made.

Source: Various materials; compiled by Daiwa.

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

Ratings

Issues are rated 1, 2, 3, 4, or 5 as follows:

- 1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
- 2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
- 4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices

Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities

Please refer to https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association