

Economic Commentary

BOJ Governor's speech, future focus points

- Governor Kazuo Ueda reiterated that BOJ will not hurry to raise rates as it seeks to carefully assess state of US economy
- Runoff between Ishiba/Takaichi likely to follow 27 Sep LDP leadership vote; Ishiba seems to have a slight advantage
- Focus in BOJ Tankan (1 Oct) on corporate earnings/behavior based on changes in backdrop since Aug

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BOJ governor's speech in line with recent press conference

BOJ Governor Kazuo Ueda gave a speech at a meeting with business leaders in Osaka on 24 September. He had stated at his post-MPM press conference only the previous business day (20 Sep) that the BOJ was in no hurry to raise rates as it seeks to carefully assess the state of the US economy. Speeches soon after these regular press conferences tend to be similar in content, and this time was no exception. We think Mr. Ueda's next scheduled speech will be during a trip to Nagoya within the year.

In his speech, Mr. Ueda noted regarding future policy conduct that "if the outlook for economic activity and prices...is realized, the Bank will accordingly raise the policy interest rate", but also noted developments in the US and other overseas economies, financial and capital markets, and the impact of rising interest rates as uncertainties for economic activity and prices. He also stated that "the upside risk to prices reflecting higher import prices has become smaller" and that "the Bank will need to carefully assess factors such as developments in financial and capital markets at home and abroad and the situation in overseas economies underlying these developments. We have enough time to do so". In short, the BOJ's current policy reaction function is (1) whether the Japanese economy trends in line with its outlook and (2) whether there is upside risk for consumer prices. While US economic trends and corresponding developments in financial and capital markets create uncertainty regarding point (1), the risk in point (2) is diminishing, giving the BOJ time to carefully assess point (1).

Mr. Ueda also cited "the outlook for private consumption" as a risk to the economic outlook. He noted that "a precondition for the scenario in which private consumption rises moderately is that wages continue to show solid growth and household income increases". On this point, even if there is no clear recovery in consumer spending data, confirmation of the sustainability of wage hikes and an increase in household income would create the preconditions for the BOJ's scenario and further solidify expectations for a consumer spending rebound, which we think the BOJ would see as in line with its scenario.

Mr. Ueda also noted "[the impact of] developments in overseas economies and other factors...on Japan's corporate profits and corporate behavior" as a risk to the inflation outlook. He added that "the Bank will continue to closely monitor whether sustained wage hikes and their pass-through to selling prices will be achieved in a wide range of firms and whether the linkage between wages and prices will strengthen steadily". In the near term, it will need to assess the results of the BOJ Tankan (Sep survey; release 1 Oct), the level of wage hikes demanded in the 2025 spring labor-management wage negotiations basic plan (mid-Oct), and whether this year's substantial wage hikes are reflected in the Tokyo CPI release (particularly service prices; 25 Oct).

Attention focusing on LDP leadership election

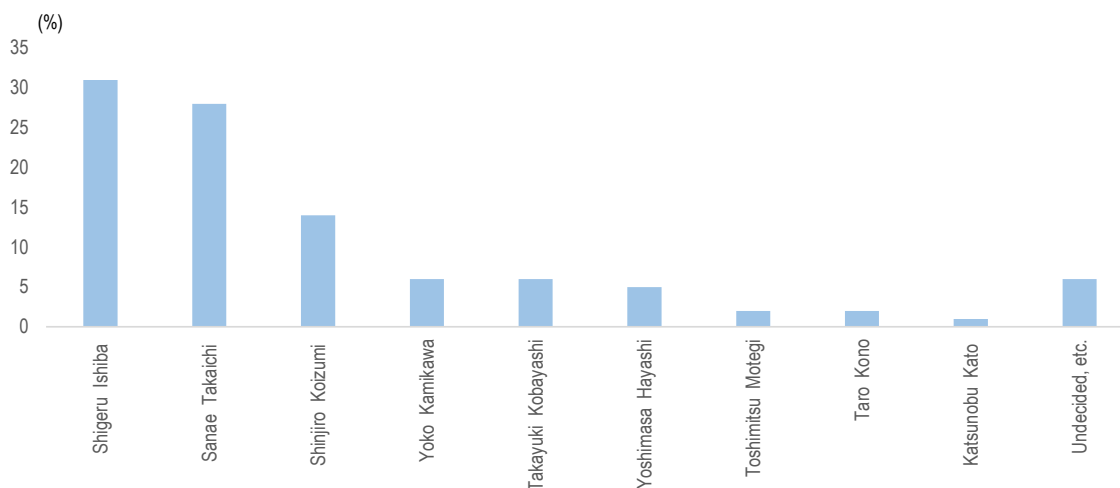
In Japan, the ruling Liberal Democratic Party's (LDP) leadership election will take place later this week (27 Sep). The cabinet is set to convene an extraordinary Diet session on 1 October to nominate a new prime minister, and the new prime minister could potentially dissolve the Lower House and call a general election soon after (as early as 27 Oct). Sanae Takaichi has indicated a markedly different stance on monetary policy than the rest of the leadership candidates, and we therefore think the election is also drawing attention as a clue to Japan's monetary policy outlook.

Ms. Takaichi has repeatedly sought to discourage the BOJ from raising interest rates, stating that interest rates should remain low to avoid a negative impact on consumer spending and corporate capex. Mr. Ueda commented at his recent (20 Sep) press conference that "the BOJ will continue to communicate fully with the new administration", but we think differences in direction between the government and BOJ could constrain the latter's ability to raise rates.

Another focus among political journalists appears to be a Nippon Television Network (NTV) survey that correctly called the outcome of the 2021 LDP leadership election. NTV's 20-21 September survey of LDP members and supporters put Shigeru Ishiba in the lead with 31%, Sanae Takaichi second with 28%, and Shinjiro Koizumi third with 14%. Based on these results, we think a runoff election between Mr. Ishiba and Ms. Takaichi is likely after the initial 27 September vote.

Elsewhere, former prime minister Yoshihiko Noda was appointed as the new leader of the Constitutional Democratic Party. Given the potential for a general election in the near future and the Upper House elections scheduled for July 2025, we think LDP MPs could favor Mr. Ishiba for his ability to go head to head with Mr. Noda and reduce the risk of a change in government. Mr. Ishiba's popularity with the general public in opinion polls could also boost his chances.

Chart 1: LDP Leadership Election: NTV's Poll of Party Members/Supporters (as of 22 Sep 2024)



Source: Nippon Television Network; compiled by Daiwa.

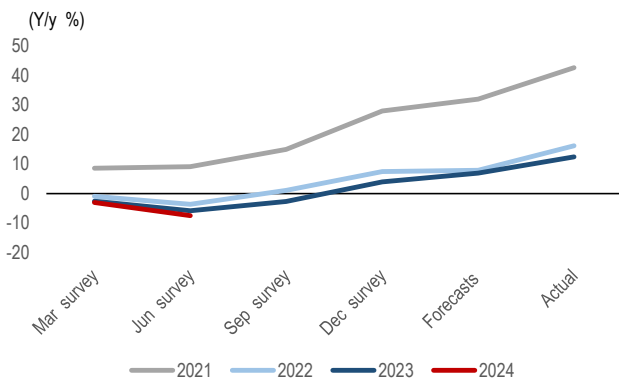
BOJ Tankan (Sep survey, release 1 Oct): Focus on corporate earnings/behavior

The results of the September BOJ Tankan survey will also be released on 1 October. The survey will be key in confirming how the yen's rally and changes in overseas economic conditions since August have affected corporate earnings and behavior. Within the survey, we will be looking first at "recurring profits" (forecast) and "predicted exchange rates". We look to confirm the impact of changes in conditions since the June survey (JPY rally, concerns about slowing overseas economies) on profit forecasts mainly at exporters.

We think the September survey is unlikely to show a marked decline in profit forecasts given that forex assumptions of Y144-145/\$ in the June survey were close to recent levels. However, if profit forecasts did worsen materially, this could limit companies' ability to fund wage hikes and impede 2025 pay increases. The yen's rally will also affect consumer prices by reducing import prices. Forex movements have a broad-based impact on corporate earnings and prices, which we hope to see the BOJ analyze in its October *Outlook for Economic Activity and Prices* report (*Outlook Report*).

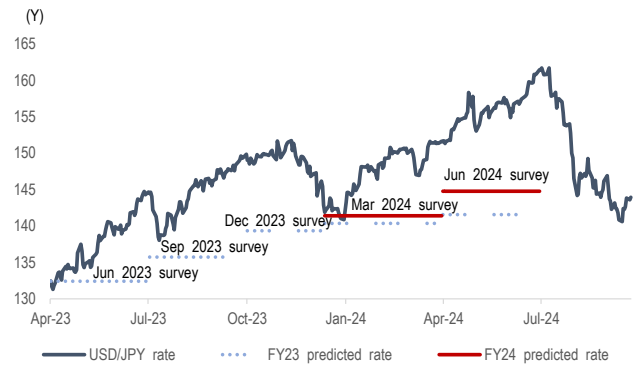
We also look for evidence from the output price DI of whether companies continue to pass on rising costs as the stronger yen slows the uptrend in import prices. Elsewhere, we focus on the impact of rising interest rates caused by BOJ rate hikes on the "financial position" and "change in interest rate on loans" DIs. While we think the loan rate DI will unavoidably rise, we look to confirm how the impact differs by company size.

Chart 2: Recurring Profit Forecasts (all-size firms)



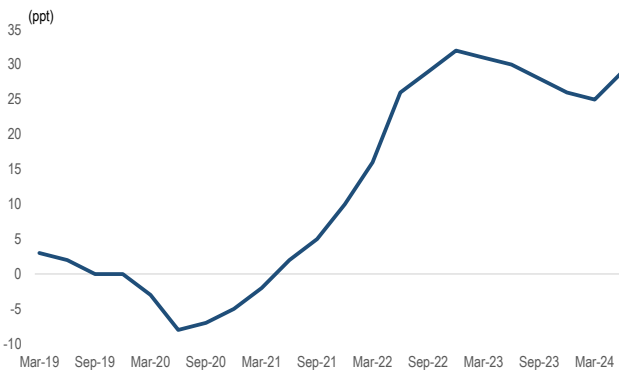
Source: BOJ; compiled by Daiwa.

Chart 3: Predicted USD/JPY Rate, Market Rate



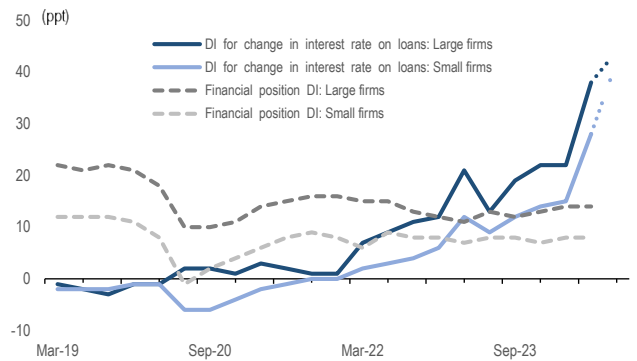
Source: BOJ; compiled by Daiwa.

Chart 4: Output Price DI (rise – fall, all-size firms)



Source: BOJ; compiled by Daiwa.

Chart 5: DI for Change in Interest Rate on Loans*, DI for Financial Position (by size)**



Source: BOJ; compiled by Daiwa.

Note: Dotted lines indicate forecasts as of Jun 2024 survey.

*Rise – fall, **Easy – tight.

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