Daiwa Securities

Economic Commentary

Autumn 2024: “Summary of Opinions” and Sep Tankan survey

- Birth of Ishiba administration, snap election set for 27 Oct
- Likely to follow policy framework direction laid out by Kishida administration
- Expectations for better communication based on Sep “Summary of Opinions”
- Sep Tankan survey confirms no major changes for corporate activity

FICC Research Dept.

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

Kento Minami
81-3-5555-8789
kento.minami@daiwa.co.jp

Daiwa Securities Co. Ltd.

Birth of Ishiba administration, snap election set for 27 Oct

The autumn of 2024 has arrived. The ruling Liberal Democratic Party (LDP) held its presidential election on 27 September. The differences in the candidates’ views on the BOJ were seen as key catalysts for markets, which fluctuated wildly in a way that the author had never before experienced. The first round of voting for the nine candidates took place at 1:00 p.m. on 27 September. Soon after 2:10 p.m., the announced results put Sanae Takaichi, who opposed the BOJ’s decision to hike interest rates, in first place. At that time, the yen briefly depreciated to the USD/JPY146 level. Then a runoff was held between Takaichi and Shigeru Ishiba, who came in second place during the initial voting. Just after 3:30 p.m., Ishiba was announced the winner of the runoff, making him the new party president (ergo the new prime minister). As Ishiba respects the BOJ’s independence, the yen appreciated to a low USD/JPY142 level on the unwinding of previous USD/JPY trades (on 30 Sep briefly traded at USD/JPY141 level). 27 September will go down in the history of the market and we want to remember these swings for the future, when similar developments may emerge. The significant strong dollar/weak yen trend has been changing ever since the Fed cut rates on 18 September, which demonstrates that forex trends are also sensitive to BOJ actions.

After that, Fed Chairman Jerome Powell delivered a speech on 30 September, in which he stated that there was no rush to lower interest rates. As the market had expected a 25bp interest rate cut in November, the 10-year US Treasury yield rose and the dollar gradually strengthened. As of 1 October, the pair briefly returned to a USD/JPY144 level. If the US economy does not suddenly slow down, we can view the US as entering a corrective rate-cutting phase. While the US is making a corrective cut for its policy interest rate, which is too high, Japan can probably adjust its degree of monetary easing, starting with its real interest rate, which is too low. This time, the monetary policy vectors for Japan and US are different, but they have one thing in common—both central banks are in no hurry and so will take their time adjusting excessive conditions. During such a process, it would be difficult to imagine a continuation of rapid yen appreciation.

An extraordinary Diet session was convened on 1 October, at which Ishiba was appointed as Japan's 102nd prime minister. That evening, the new Ishiba Cabinet was officially inaugurated. In a somewhat unusual move, Ishiba announced one day before becoming prime minister that he plans to dissolve the Lower House for a snap election on 27 October. Ishiba is viewed as a specialist in security issues and there are high expectations for regional revitalization. On the other hand, the fact that he mentioned financial income taxation in the early stages of the LDP presidential election is likely to cause concern among markets. However, with the Lower House election coming up, Ishiba probably wants to win support from the electorate by following the major policy framework trends set by the Kishida administration. Katsunobu Kato was appointed as the closely-watched Finance Minister. We expect that efforts will be made to strike a balance between fiscal soundness and monetary normalization. It seems that an extension of the current measures to counter the high cost of living has become the default policy. It also seems that the budget for FY25 can be compiled within this year. We can assume that the unique texture of the Ishiba administration will not be felt until after the Lower House election (will the LDP only lose around 30 seats?). Meanwhile, the BOJ is also in no hurry to hike interest rates, so it will likely use the period up until the October meeting to monitor the direction of elections in the US and Japan, while trying to get a clearer picture of overall conditions. With that in mind, the immediate market focus is once again shifting to trends in the US. The outcome of the US presidential election will be a key factor in determining whether the US economy can make a soft landing.

Expectations for better communication based on Sep "Summary of Opinions"

The BOJ released the "Summary of Opinions" for its September meeting on 1 October. Of the 11 opinions provided for the opening "Economic Developments" section, three focused solely on the US economy. In general, there is the opinion that the US economy must be carefully assessed, which will take time. Also, there is the understanding that one of the major factors behind the BOJ's lack of urgency in hiking interest rates is the US economy. The G20 Meeting of Finance Ministers and Central Bank Governors will be held in Washington on 23-24 October. Here, BOJ Governor Kazuo Ueda tends to be cautious in his statements at press conferences following G20 meetings (this was the case just before the meeting in July 2023 when the BOJ decided to make its YCC policy more flexible). As in this case, when trying to assess the US economy, which is the main source of uncertainty, a more cautious approach seems likely.

In the section on monetary policy management, there were more cautious opinions than at the previous meeting in July, in light of the market turmoil since August and the economic slowdown in the US. The market interpreted this as a sign of the BOJ's growing dovishness and JGB yields fell, in contrast to the trend of rising long-term US Treasury yields in overseas markets on the previous day. At his inauguration press conference on the 1 October, Ishiba said in regards to the complete elimination of deflation, "I expect that the basic tone of monetary easing will be maintained." On that day, Economic Revitalization Minister Ryosei Akazawa (who attended BOJ Policy Board meetings until Jul as a vice minister of finance), also told reporters at the Prime Minister's Office that, in order to prioritize overcoming deflation, he would like the BOJ to make "careful decisions" regarding interest rate hikes.

The "Summary of Opinions" specifically stated, "For the time being, the Bank should assess developments in overseas economies, particularly the US economy, those in financial and capital markets, and how these developments will affect the outlook for Japan's economic activity and prices, the risks surrounding them, and the likelihood of realizing the outlook." Here, the "Summary of Opinions" again demonstrated a commitment to assessing the US economy and financial/capital markets, saying, "It is appropriate for the Bank to monitor developments in overseas economies and market developments for the time being and make further adjustments to the degree of monetary accommodation when such uncertainties decline. In the current phase, the Bank should patiently maintain the current accommodative financial conditions." Here, it was indicated that further additional interest rate hikes will be carried out once uncertainty has decreased. The "Summary of Opinions" also indicated that the Bank would continue to pay attention to downside risks in its assessment of the outlook for economic activity and prices. Specifically, it said, "In conducting monetary policy, it will be necessary for the Bank to give due consideration to downside risks to Japan's economy and monitor the data carefully." Meanwhile, in regard to assessing the likelihood of a soft landing for the US economy, it said, "It is necessary to closely examine developments in the US economy until it is confirmed that the economy, particularly the labor market, has bottomed out." The monthly US employment statistics will probably be given more weight in determining whether to raise interest rates in the future.

The last four opinions on the conduct of monetary policy all touched on the BOJ's dialogue and communication with the market. These opinions specifically mentioned the need for the BOJ to carefully communicate (1) policy stance when conducting further policy interest rate hikes, (2) changes in the Bank's economic perceptions due to developments for economic conditions, (3) information about underlying inflation, the outlook for economic activity and prices, as well as the risks surrounding them, and (4) the likelihood of realizing the outlook. Communication with the market is essential in order to minimize halation (blurring) for the economy and financial/capital markets due to BOJ policy changes. In light of the additional interest rate hike in July and the subsequent market fluctuations, we can say that the BOJ has demonstrated its commitment to communicating with the market this time around.

We have repeatedly pointed out that the BOJ needs to improve its communication with the market. First, at the very least, someone in the BOJ should give a speech between each meeting. If that is not possible, then efforts should be made to continuously disseminate information through interviews and other channels. This time, the BOJ express opinions with a real sense of involvement and we are awaiting even further improvements on that front. Before the BOJ's October meeting, speeches will be delivered by board members Asahi Noguchi on 3 October (in Nagasaki) and by Seiji Adachi on 16 October (Takamatsu). Before the December meeting, Ueda and board member Toyoaki Nakamura will probably visit Nagoya. At the end of each year, the BOJ governor delivers a speech at the Japan Business Federation (Keidanren). Still, we would still like for the BOJ to provide even a little more information before the January 2025 meeting.

BOJ Tankan Sep Survey: Insights into corporate trends

Yesterday's BOJ Tankan (Sep survey) report was a key data point in confirming whether changes in business conditions since the previous June survey (results published 1 July), including (1) another BOJ rate hike, (2) the yen's rally, and (3) growing concerns about a slowdown in overseas (mainly US) economies, have caused a shift in corporate behavior. More than 70% of responses had been received by the 11 September response deadline.

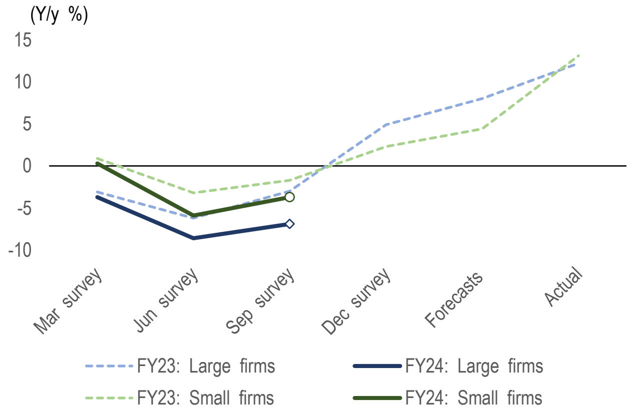
The business conditions DI for large manufacturers was unchanged from the June survey at +13, but the DI for large non-manufacturers improved to +34 from +33. The DIs for small enterprises also improved, to 0 (from –1) for manufacturers and to +14 (from +12) for non-manufacturers. We think this reflects the improving semiconductor cycle and progress with passing on higher costs. Among non-manufacturers, the DI for retailing improved versus the June survey due to the impact of summer heat, but worsened for services for individuals, signaling a clear divergence by industry. Despite concerns about the impact on the September survey from the yen's rally and slowdown in overseas economies, at this point it appears that corporate sentiment has yet to decline.

Both large and small enterprises also revised up their full-year recurring profit plans. However, they revised up for 1H and down for 2H, and we think the upward revisions for the full year mainly reflect steady progress versus cautious expectations in 1H. Given the need to continue monitoring the impact of changing conditions since August in 2H, and the fact that the average all-enterprise/all-industry forex assumption was revised upward from Y144.77/$ in June to Y145.15, this suggests that a further JPY rally could depress profits mainly at exporters. We will again be looking for evidence of this in the December Tankan.

Large enterprises revised down capex plans (incl. software and R&D, excl. land purchases) to +11.1% y/y from +11.9%, while small enterprises revised up to +5.9% from +5.0%. This may partly reflect supply-side factors such as construction delays caused by labor shortages, but we also think capex appetite is strong on the demand side, including greater demand for investment in green and digital transformation (GX/DX) and labor saving.

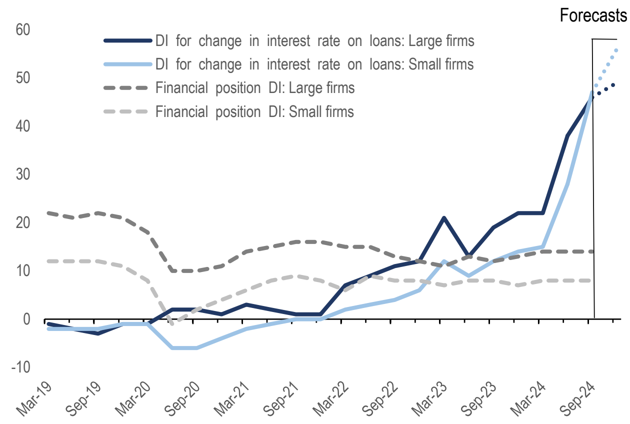
The change in interest rate on loans DI rose for all industries due to the impact of rising interest rates, but the financial position DI was largely unchanged, suggesting that rising rates are not materially affecting corporate activity at this point.

Chart 1: Recurring Profit Forecasts (by size)



Source: BOJ; compiled by Daiwa.

Chart 2: Change in Interest Rate on Loans DI*, Financial Position DI (by size)**



Source: BOJ; compiled by Daiwa.
**Rise – fall, **Easy – tight.*

BOJ Tankan Sep survey confirms inflation on track with outlook

Changes in the environment since August could affect the inflation outlook as well as corporate earnings and sentiment. For instance, slower growth in import prices caused by a stronger yen and a decline in demand caused by slowing overseas economies are negative for forecast inflation. On that point, the latest Tankan confirmed that inflation remains on track with the BOJ's outlook.

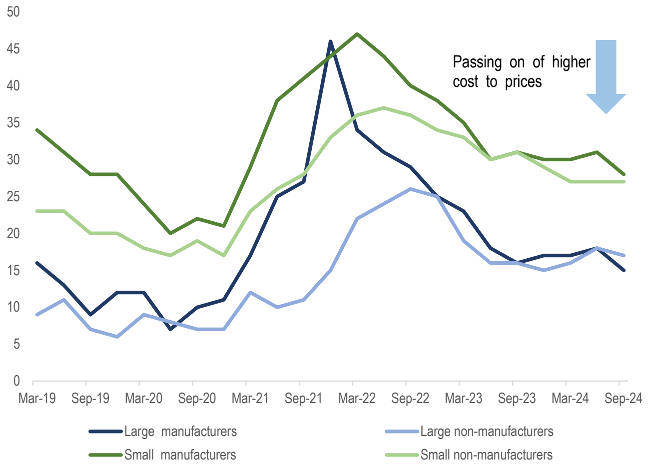
The outlook for general prices one to five years out was unchanged from the previous survey for all-size enterprises in all industries. Output price forecasts (all-size enterprises/all industries) were unchanged from the previous survey for one and three years out, but the five-year forecast rose from 4.8% to 4.9%. Companies continue to expect general prices to rise by more than 2%, and output price forecasts also remain high. We think this indicates that inflation expectations are continuing to rise toward the BOJ's 2% price stability target.

Pseudo terms of trade (cost pass-through), the difference between the input and output price DIs, also improved except at small non-manufacturers. Input prices fell as the uptrend in raw material prices paused, but output prices have not fallen as much as input prices, confirming companies' continued strong desire to pass on higher costs.

Given the increasing shortage of labor signaled by the all-size enterprise, all-industry employment conditions DI of –36 (–35 in Jun), we think companies are likely to continue with pay increases backed by the high earnings shown in the September survey, increasing the likelihood of a virtuous cycle of wages and prices in FY25.

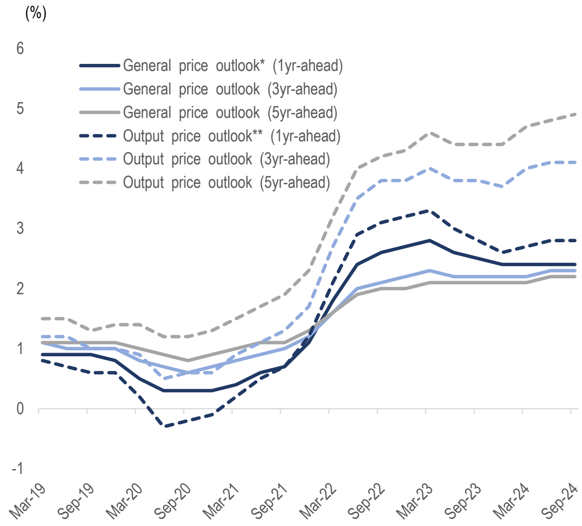
The September Tankan confirmed that changing conditions since August have yet to materially affect corporate activity. However, with companies revising down 2H recurring profit plans, further yen appreciation could squeeze earnings mainly at exporters and make firms unable to afford wage hikes. The recent JPY rally and decline in oil prices could also depress consumer prices and drive down expected inflation. We will continue to monitor factors including corporate earnings and the inflation outlook in the next Tankan (to be released on 13 Dec).

Chart 3: Input Price DI* - Output Price DI* (Pseudo Terms of Trade**)



Source: BOJ; compiled by Daiwa.
**Rise – fall, **Input price DI minus output price DI.*

Chart 4: Inflation Outlook of Enterprises



Source: BOJ; compiled by Daiwa.
**Indicates annual percent rate change, **shows rate of changes relative to the current level.*

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