

Economic Commentary

Speech from BOJ Policy Board member Tamura: Desire for policy normalization unchanged

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Hawkish Tamura corrected unintended impression of his March speech

On 12 September, BOJ Monetary Policy Board member Naoki Tamura gave his first speech and press conference in roughly six months. The last time Tamura spoke was on 27 March. At that time, he was the first policy board member to speak after the BOJ's decision to change its monetary policy framework (ended negative rates, abolished yield curve control) on 19 March. Even after ending the negative interest rate policy that had been in place for eight years, Tamura, who is seen as a hawkish member of the board, emphatically stated that the ultimate goals of monetary policy normalization are "return interest rates to a level where they can perform their functions" and "recover the hurdle rate function and signaling effects." However, the market fixated on the "deliberately" wording used by Tamura in his "Proceed 'deliberately' but steadily with monetary policy normalization" comment. This wording was perceived as overly cautious for a BOJ hawk and the yen immediately responded by depreciating. Tamura's true intention was to clearly indicate that the goals were still far off, but he did not correctly convey that intention and so probably felt uneasy.

Wants monetary policy normalization, neutral interest rate of at least 1.0%

One feature of Tamura's most-recent speech was the effort to clarify his thoughts on the neutral interest rate, which he did not elaborate on when questioned during the last press conference. His specific comments included: (1) "I think it will be at least 1%," (2) "Short-term interest rates should be raised to at least 1% in the second half of the projection period," and (3) "The Bank will raise short-term interest rates in stages as the probability of achieving its price stability target increases, while confirming the responses for economic activity and prices, and searching for an appropriate short-term interest rate level." The exact same wording appeared in the Summary of Opinions for the July Monetary Policy Board meeting. Furthermore, it was revealed that those words came from Tamura. The market momentarily reacted to the hawkish comments in Tamura's latest speech in the form of yen appreciation, which, in a sense, offset for some of the unintended yen depreciation following his speech in March.

Once again, an important point is that, even though this is a personal opinion held by Tamura, the aspiration for normalization "should initially be at the level of at least 1%." This is consistent with the level that former BOJ Governor Toshihiko Fukui was aiming for when he lifted quantitative easing in March 2006. Compared to that time, the level of inflation expectations in Japan has changed with the structural changes for the global economy and, theoretically, it is expected to be higher. However, as Monetary Policy Board member Hajime Takata pointed out on 5 September, the lesson from the past is "Since shocks originating overseas have repeatedly served as a constraint, we need to pay close attention to trends for overseas economies and markets." First of all, a soft landing for the US economy is desirable. We must also pay attention to the Chinese economy considering the current prices for crude oil, copper, and other resources. It should also be noted that markets tend to overreact when bad things coincide.

Intends to proceed with gradual 25bp rate hikes by second half of projection period

Next, Tamura indicated that the timing for reaching the BOJ's 1% price target is the second half of the projection period and, given the risk of higher-than-expected inflation, he assumes that this level will be reached by the end of FY25. On top of that, this time the phrase "likely to raise short-term interest rates gradually" replaced the "proceed deliberately but steadily" phrase used in Tamura's March speech. With the decision to again raise interest rates by 25bp in July, we can interpret that the Bank intends to continue gradually raising interest rates by 25bp while confirming that its economic and price forecasts are on track. Meanwhile, as for reducing the amount of JGBs purchased by the BOJ (reduce monthly purchases to Y3.0tn over the course of a year and a half), Tamura indicated that the Bank considers the scale of reductions to be appropriate in order to avoid market turmoil. He also expressed his perception that "functioning of JGB market has improved somewhat, but is still at a low level." Tamura has suggested that the road (to normalizing the BOJ's balance sheet) is still long when he said, "The side effects of the Bank's large-scale holdings of JGBs will remain for some time."

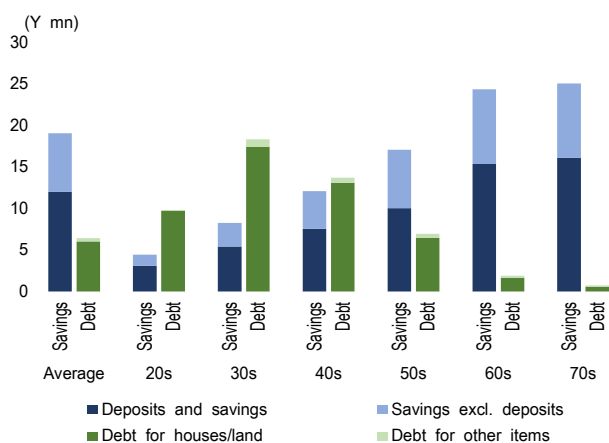
Considering impact of short-term rate hikes on households

The impact of short-term interest rate hikes on each economic entity was also discussed in the speech given by BOJ Deputy Governor Ryozo Himino in December 2023. This time, Tamura used the savings/debt situation of households and the financial situation of companies to explain his points.

Regarding households, Tamura said, "Households headed by those in their 40s and younger have more debt than savings, while households headed by those in their 50s and older have more savings than debt." This means that interest rate hikes would produce larger burdens for households headed by those in their 40s and younger and larger positives for households headed by those in their 50s and older. If we break down the 40s and younger age group into smaller age groups, the burden on those in their 20s and 30s is particularly heavy, but these younger age groups are benefiting from higher wage hike rates. This means that increased burdens due to rising interest rates will be offset to a certain extent. On this point, Tamura also noted that "It is necessary to take into account that many households with mortgages are working households, which includes households that have benefited from wage hikes."

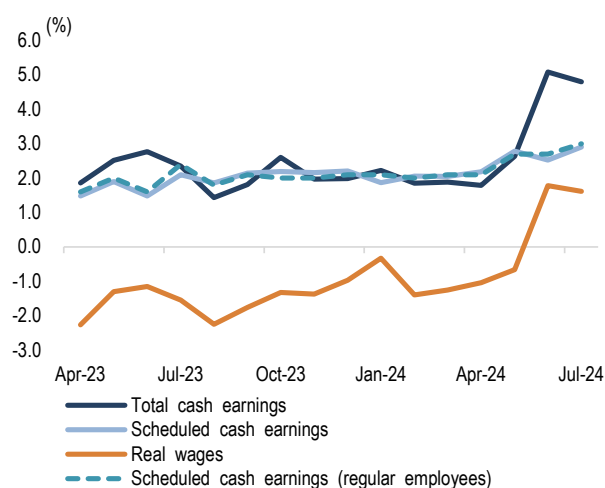
Conversely, this means that the benefits of higher wages for young people will be offset by higher interest rates. Also, the rate of increase for pension payments to the elderly in FY24 was 2.7%, which was lower than the growth rate for wages according to the Monthly Labour Survey. We must also take into account that households more likely to be positively affected by rising interest rates are unlikely to benefit much from wage hikes. Overall, the impact of rising interest rates on households will require careful analysis.

Chart 1: Household Savings and Debt



Source: Statistics Bureau, Ministry of Internal Affairs and Communications; compiled by Daiwa.

Chart 2: Wage Growth Rates (common data set series, y/y)



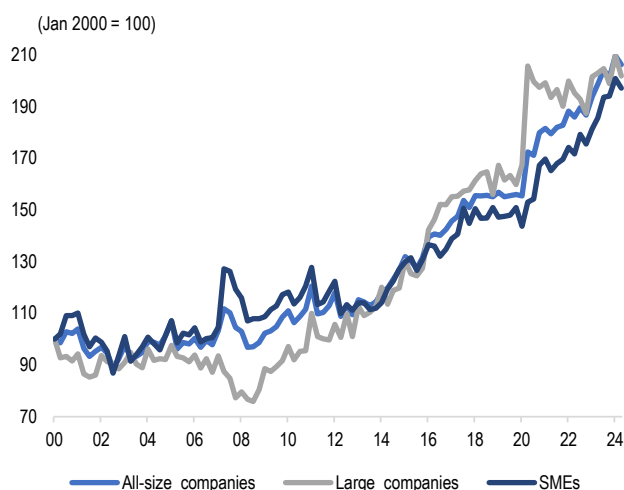
Source: Ministry of Health, Labour and Welfare; compiled by Daiwa.

Better productivity for firms by encouraging economic metabolism via higher interest rates

Turning to companies, Tamura pointed out that, “There has been a savings surplus for a long time and the percentage of debt-free companies has been increasing, which means that Japanese companies now have a high tolerance for the effects of interest rate hikes.” Tamura also indicated the acceleration of economic metabolism (business start-up and exit rates) and increased productivity. Actually, corporate cash and deposits have been increasing since the introduction of Abenomics in 2013 and it is thought that both large companies and SMEs have sufficient financial reserves (stock aspect). Furthermore, even when looking at the flow aspect, the level of recurring profit is high and corporate resistance to shocks is certainly increasing.

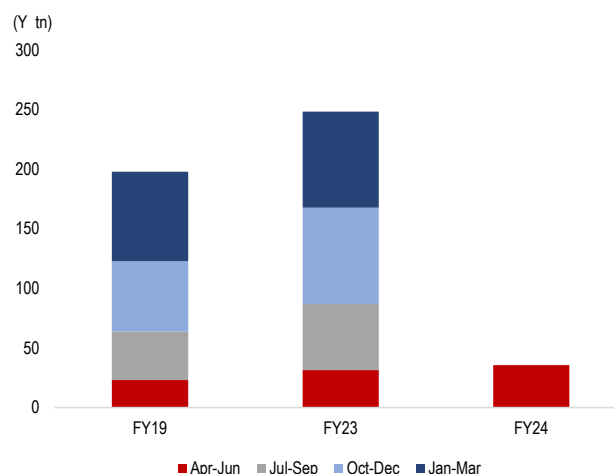
Also, according to general economic theory, companies will invest in a business/project if the return on that investment is higher than the cost. Rising interest rates lead to higher costs, forcing companies to reduce their costs and improve productivity through efficient capital allocation. Companies with low productivity that are unable to do so could be forced to exit the market. This kind of economic metabolism (periodic turnover) has the potential to improve productivity for the overall economy.

Chart 3: Cash and Deposits at Companies (by size)



Source: MOF; compiled by Daiwa.

Chart 4: Recurring Profit at Companies (all sizes, all industries)



Source: MOF; compiled by Daiwa.

Chart 5: Side Effects Relating to Interest Rate Functions in a State Without Meaningful Interest Rates

(1) Weakening of the hurdle rate function of interest rates

The hurdle rate function acts to urge firms to concentrate their business resources to businesses with high added value that generate profitability that is higher than borrowing interest rates, thereby stimulating business metabolism.

⇒ In a state without meaningful interest rates, it is likely that the channeling of funds into businesses with relatively low productivity has impeded advances in business metabolism.

(2) Weakening of the signaling effects of interest rates

The level of long-term yields on JGBs and how it changes provide a signal for how the market sees factors such as the future state of economic activity and prices and the government's fiscal condition.

⇒ The signaling effects have not been fully exerted.

Source: Excerpted from materials for BOJ policy board member Naoki Tamura's speech at meeting with local leaders in Aomori (27 Mar 2024).

BOJ's challenge is better communication with market

This latest speech positioned Tamura as the “final runner” in the marathon leading up to the September meeting, following the decision to again raise interest rates on 31 July. He will be the “fifth runner” (speaker) since August, following speeches by BOJ deputy governors Shinichi Uchida and Ryozi Himino, as well as by Monetary Policy Board members Hajime Takata and Junko Nakagawa. While there has recently been a slew of speeches, no speeches were given between the June and July meetings. It must be said that the BOJ's speech schedule seems skewed and unbalanced. In the US, immediately after the August employment statistics, which attracted considerable attention, Fed Governor Christopher J. Waller gave a speech in which he suggested the possibility of a 25bp interest rate cut at the September FOMC meeting. Here, it appears as if he played a role in guiding the market. In order to improve its communication with the market, the BOJ must first ensure that someone will always deliver a speech between meetings. If that is not possible, then efforts should be made to continuously disseminate information through interviews and other channels.

While the BOJ continues to look for the right time to raise interest rates, Asahi Noguchi is scheduled to deliver a speech on 3 October. Then there will probably be speeches before the end of this year by board members Seiji Adachi and Toyooki Nakamura, whose terms in office will expire next year. Also, the BOJ Governor visits Osaka and Nagoya every year, so we expect that Governor Kazuo Ueda will, at the very least, give two speeches in these cities before the end of this year.

In order to confirm whether the outlooks for Japan's economy and prices are on track, over the near-term, the BOJ will need to examine the September Tankan survey (due out on 1 Oct) to gauge the state of corporate earnings, the passing on higher costs to prices, and fundraising. The Bank will also need to ascertain whether the wage increase level requested under the 2025 Spring Labor-Management Wage Negotiations Basic Plan (due out in mid Oct) and the high wage hike rates are reflected in the CPI for Tokyo (due out on 25 Oct), especially service prices. However, in Japan, the ruling LDP's presidential election set for 27 September (Diet could be dissolved for snap general election as early as 27 Oct or 10 Nov), while the US will hold its presidential election on 5 November. This means that market instability is likely to persist for the time being. We think the BOJ will spend the autumn season assessing these conditions.

Still, the number of factors to consider will increase considerably in December. These factors include the Bond Market Survey released at the beginning of the month and the Tankan survey for December due out on 13 December. The BOJ's assessments this year are likely to attract attention at the December meeting. If the US economy can make a soft landing (Fed only makes a corrective rate cut), the BOJ may again raise interest rates as early as December. If the Bank's focus is more on *Outlook for Economic Activity and Prices* reports and information from hearings, it could consider another rate hike in January 2025. At the December meeting, we expect an official announcement that the Review of Monetary Policy from a Broad Perspective will be concluded (matter for the Monetary Policy Board meeting to vote on).

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