

Daiwa's Economic View

BOJ's future outlook (as of autumn 2024) ~ Signs BOJ monitoring conditions

- Changes over past three months; start of US interest rate cuts not leading to further yen appreciation; Japan's economy saw weak production and consumption in Jul-Sep, but moderate growth is likely to continue
- Growth rate forecast likely unchanged overall in BOJ Oct *Outlook Report*; Outlook for underlying inflation to remain around 2%, but upside and downside risks
- BOJ board members differ on timeline for normalizing policy; Time to monitor conditions with BOJ's Oct meeting after Japan election, before US election

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Changes over past three months; start of US interest rate cuts not leading to further yen appreciation

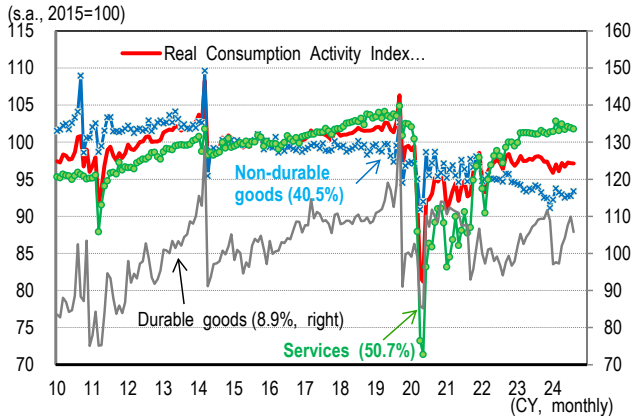
Around two and a half months have passed since the BOJ released its last *Outlook for Economic Activity and Prices* report (*Outlook Report*) on 31 July¹. Since then, external circumstances have changed in that (1) the US started rate cuts (initially 50bp) in September, (2) there was an accompanying correction towards yen appreciation (with the USD/JPY rate falling below Y140 at one point), and (3) the risk of an uptrend in prices in Japan declined. This gave the BOJ some leeway to make policy decisions at the September Monetary Policy Meeting (MPM). On the evening of 2 October, Prime Minister Shigeru Ishiba said that "Japan is not in an environment that requires an additional rate hike," pushing up the USD/JPY rate to the Y146 level. On 4 October, the rate jumped to Y149 in response to the stronger-than expected US jobs report for September. 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 to correct for excessive conditions. During such a process, it would be difficult to imagine a continuation of rapid yen appreciation. With there being significant uncertainty during the short term, we should carefully monitor developments in Japan's Lower House election on 27 October and the US Presidential election on 5 November.

Japan's economy saw weak production and consumption in Jul-Sep, but moderate growth is likely to continue

Despite Japan's weak consumer spending, Japanese companies remain strong. The Consumption Activity Index (Real) weakened to an average of +0.1% q/q in Jul-Aug, from +0.8% in Apr-Jun (Chart 1), due to the influence of heat waves and typhoons during Jul-Sep, in addition to inflation. However, there has been a pause in the downtrend in consumer sentiment indicators, and levels are still high (Chart 2). From October onwards, while some consumers will trend towards frugality, overall consumption is expected to remain solid due to the absence of weather factors and an increase in household income driven by wage hikes.

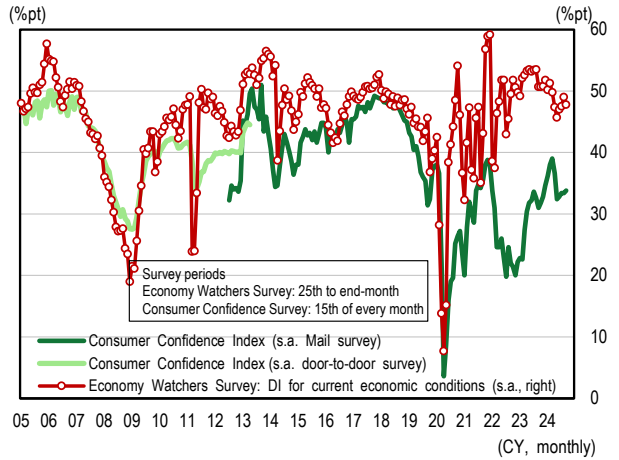
¹ [Iwashita's Economic & Market Watch: BOJ decides to further raise interest rates without delay \(31 Jul 2024\)](#).

Chart 1: Japan's Real Consumption Activity Index



Source: BOJ; compiled by Daiwa.
Note: Figures in parentheses show weights in index.

Chart 2: Japan's Consumer Sentiment Indicators



Source: Cabinet Office; compiled by Daiwa.

However, the Ministry of Economy, Trade and Industry's (METI's) adjusted industrial production data for September (+0.3% m/m) suggests a return to negative growth, with growth -0.8% q/q in Jul-Sep (growth in Apr-Jun was $+2.7\%$ q/q). This is partly due to temporary weakness following suspension of plant operations caused by typhoons in August. Also, shipments of capital goods (excl. transportation equipment) fell sharply, with the Jul-Aug average down 2.6% vs. Apr-Jun (which was up 0.5% q/q). Nevertheless, the BOJ's Real Export Index in Jul-Aug increased to an average of $+2.4\%$ q/q, from $+0.5\%$ in Apr-Jun. Inbound demand also remains firm. Given the above, with exports gaining momentum, despite the weakness of consumer spending and capex compared to the previous quarter, we expect Jul-Sep real GDP (to be announced on 15 Nov) to show annualized growth of around 1.5% (annualized growth in Apr-Jun was $+2.9\%$). We expect moderate GDP growth to continue in Oct-Dec, driven by the solid US economy and rebounding Chinese economy.

Growth rate forecast in BOJ's Oct Outlook Report to be largely unchanged

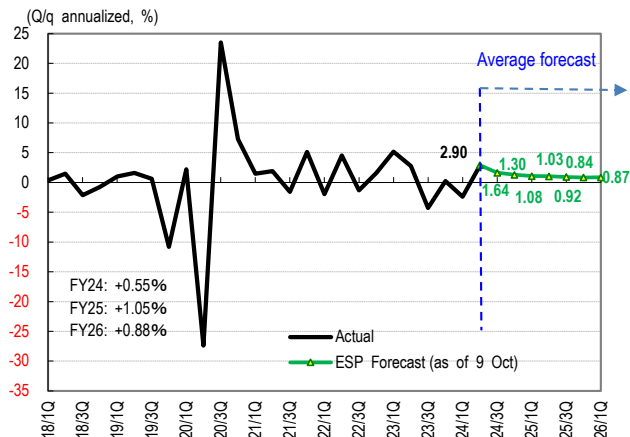
These are the circumstances in which the BOJ is set to release its October *Outlook Report* on 31 October. With regard to the growth rate forecast (median of majority of policy board members' forecasts), the Jul-Sep real GDP figures are unlikely to gain momentum partly due to weather factors, although Apr-Jun figures (released since Aug) were stronger than expected. While there was a temporary increase in concern about a US recession, there is some uncertainty about this. The FY24 GDP growth forecast is expected to remain unchanged from the previous July report, at $+0.6\%$, in part due to the fact that the details of economic measures have not yet been decided (Chart 3). The BOJ is likely to continue to see the upside and downside risks to the economy as being largely balanced, and expect moderate growth (of around 1%) to continue in FY25 onwards. We expect the BOJ's forecast to be close to private-sector forecasts (the *ESP Forecast* survey includes quarterly forecasts through FY25; Chart 4).

Chart 3: BOJ Policy Board Members' Projections (median, y/y %)

	Real GDP			Core CPI			Core core CPI		
	Jul 2024*	Oct 2024**	Our forecasts	Jul 2024*	Oct 2024**	Our forecasts	Jul 2024*	Oct 2024**	Our forecasts
FY24	+0.6 %	+0.6 %	+0.5 %	+2.5 %	+2.5 %	+2.5 %	+1.9 %	+1.9 %	+1.9 %
FY25	+1.0 %	+1.0 %	+1.0 %	+2.1 %	+2.1 %	+2.0 %	+1.9 %	+1.9 %	+1.8 %
FY26	+1.0 %	+1.0 %	+1.0 %	+1.9 %	+1.9 %	+1.8 %	+2.1 %	+2.1 %	+2.0 %

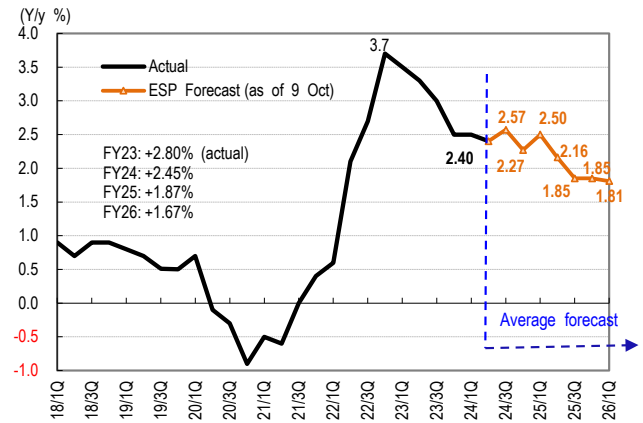
Source: BOJ, various materials; compiled by Daiwa Securities.
*BOJ projections. **Our estimates for policy board member projections (highlighted in light blue).

Chart 4: Japan's Real GDP Growth Rate Forecasts



Source: Cabinet Office, Japan Center for Economic Research; compiled by Daiwa.

Chart 5: Japan's Core CPI Forecasts



Source: Ministry of Internal Affairs and Communications (MIC), Japan Center for Economic Research; compiled by Daiwa.

Increasing probability of virtuous wage, price cycle

There are many factors indicating that price trends are as strong as the projections in July. The wage increase rate from the annual spring labor-management wage negotiations (5.10% according to Rengo's final response tally) reached the highest level in 33 years. While the BOJ waits for this to be reflected, the Monthly Labour Survey showed that the on-year change in scheduled cash earnings (full-time employees) for data continuously collected from same establishments was +2.7% in June, +3.0% in July, and +2.9% in August. We think that growth for scheduled cash earnings will remain around 3% even after September, reflecting the high wage increase rate from the 2024 spring labor-management wage negotiations.

The October BOJ branch managers' report² confirmed that wage increases are spreading to small and medium-sized enterprises (SMEs). It is clear that the BOJ not only waits for data to be released, but also proactively uses information from its own hearings to grasp (emphasize) changing situations. As for the 2025 wage increase rate target, it was reported on 16 October that "The policy is to increase wages by at least 5% including regular wage increases, and at least 3% for basic salary, the same level as that from the 2024 spring labor-management wage talks." So, the probability of continued wage increases ahead of the 2025 spring labor-management wage negotiations is also increasing.

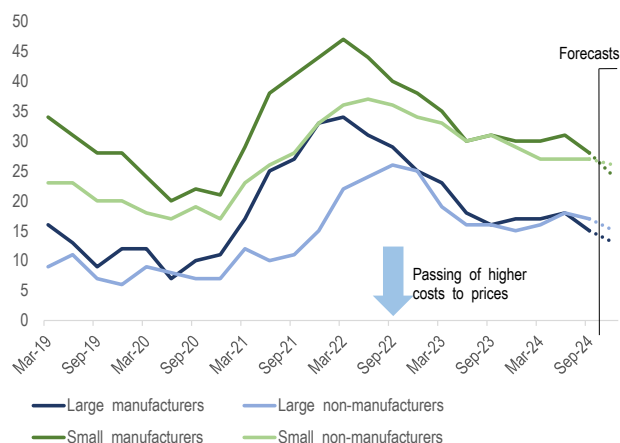
The BOJ's September Tankan survey confirmed that the sense of labor shortages driving higher wages has persisted, with the employment conditions DI pointing to increasingly "insufficient employment." Meanwhile, one feature this time is that the price DI was strong, not only for large companies, but for small companies as well. The output prices DI for small companies continues to rise, and the outlook is particularly bullish, with the passing of higher costs to prices (Chart 6). In addition, the corporate price outlook in the Bank's Tankan survey remains above 2% (Chart 7). That is a desirable state for the BOJ, which wants to anchor inflation expectations at 2%, as in the US and Europe.

Outlook for underlying inflation to remain around 2%, but upside and downside risks

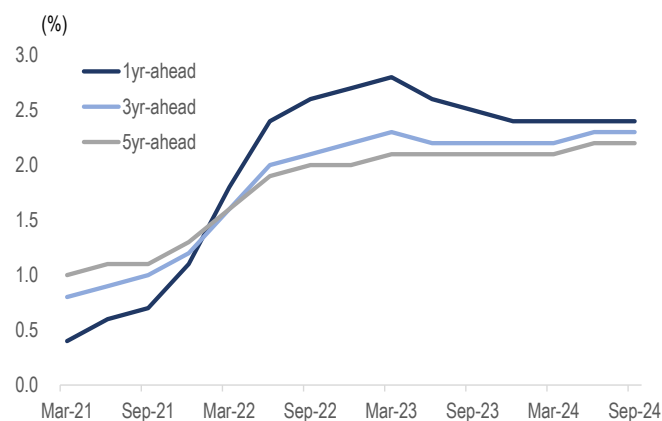
The forecast for core-core CPI, the underlying price trend that the BOJ emphasizes, is likely to remain at around 2% from FY24 to FY26, unchanged from the previous forecast (Chart 3). This is a figure that can achieve the 2% price stability target on the premise that a virtuous cycle of wages and prices is turning. With yen depreciation (beyond USD/JPY150) currently pausing, the BOJ is likely to conclude that the risk of higher-than-expected prices in the future has eased compared to before.

² [Economic Commentary: BOJ branch managers report / Further yen weakening ahead of US/Japan elections \(8 Oct 2024\)](#).

Meanwhile, the BOJ's price forecast entails both upside and downside risks. Specifically, there is the risk of higher-than expected prices due to bigger-than-expected wage increases driven by worsening labor shortages, along with the risk of lower-than-expected prices due to downward pressure on prices, especially prices for goods, caused by the ongoing yen appreciation.

Chart 6: Input Price DI – Output Price DI


Source: BOJ; compiled by Daiwa.

Chart 7: Inflation Outlook of Enterprises in BOJ Tankan


Source: BOJ; compiled by Daiwa.

BOJ board members differ on timeline for normalizing policy

Based on comments from speeches made by BOJ Governor Kazuo Ueda, board member Asahi Noguchi, BOJ Deputy Governor Ryoza Himino, and board member Seiji Adachi following the September meeting, it is clear that board members have different stances on the key points for normalizing monetary policy.

During a speech delivered on 24 September, Ueda said, “The Bank will need to carefully monitor factors such as developments in financial and capital markets at home and abroad, as well as the situation for overseas economies underlying these developments. We have enough time to do so³.” Here, Ueda repeated what he had said at his post-meeting press conference on 20 September. Next, on 3 October, Noguchi said during a speech, “Using this ample time, we need to determine whether or not consumer sentiment can withstand higher prices.” As such, he has not changed his dovish position.

On 10 October, BOJ Deputy Governor Himino added China’s consumption as a point to watch in the future. From Himino’s speech, we can infer that, when looking at the global economy, he is watching not only the US economy, but China’s economy as well. Also, messages each time have conveyed the importance of timing when making policy decisions. Finally, during his speech on 16 October, Adachi said “There are some points that require attention in regards to future price trends, such as the downward pressure on consumer prices (especially prices for goods), due to the correction of yen depreciation, and the uncertainty of wage increases next year.” In this manner, he expressed caution about future price outlooks.

Board member Adachi’s term in office will end on 25 March 2025, so this was likely his last speech as a board member. While it will be interesting to see whether the Ishiba administration can put its own stamp on things after the Lower House election, it will also be significant for the government to decide on its two nominees for the BOJ’s Monetary Policy Board (appointments subject to Diet approval) before the Upper House election in July 2025.

³ [Economic Commentary: BOJ Governor’s speech, future focus points \(25 Sep 2024\).](#)

Time to monitor conditions with BOJ's Oct meeting after Japan election, before US election

The next MPM (30-31 Oct) is now just two weeks away. In terms of the economy, there are concerns over whether the US economy can make a soft landing and whether the Chinese economy can recover. Turning to Japan, based on the BOJ's September Tankan survey and its October BOJ branch managers' report, there will be discussions on whether the virtuous cycle of higher wages and higher prices is progressing and whether the probability of achieving the 2% price stability target is increasing. This time, as well, it seems that there is no change to the recognition that the outlook for the economy and prices will remain "on track," but the uncertainties surrounding overseas economies and the instability of market trends must be carefully monitored. Even though the BOJ is "on track," it is not in a hurry to raise interest rates and there is ample time to monitor conditions. Also, this time for monitoring conditions will likely continue as the BOJ's next meeting comes just after Japan's Lower House election (27 Oct) and just before the US presidential election (5 Nov).

Forex is one of the BOJ's policy reaction functions. This means that if the yen continues to weaken beyond the USD/JPY150 level, it is quite possible that speculation about the Bank making additional interest rate hikes could again flare up. We need to keep in mind that the tense situation in the Middle East, the outcome of the US presidential election, and the trends for crude oil prices and exchange rates could also impact Japan's price outlook. In October, the BOJ will adopt a wait-and-see stance. Then, after the elections in Japan and the US, we expect the focus to again shift to the US economy.

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