Daiwa Securities

Economic Commentary

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Analyzing Governor Ueda's interview

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- Governor Ueda's *Nikkei* interview: Rate hike depends on "assessment of wages/US"; next rate hike approaching, does not want Dec hike seen as fait accompli; BOJ unable to pinpoint neutral rate of interest, but will initially aim for 1%
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BOJ communicating carefully ahead of December MPM

The 30 November *Nikkei* carried an exclusive interview with BOJ Governor Kazuo Ueda (the interview itself was conducted on the 28th). The BOJ will hold its last Monetary Policy Meeting (MPM) of 2024 on 18-19 December, less than 20 days away. We have a positive view of its efforts to communicate carefully during the period between Governor Ueda's 18 November speech in Nagoya and the upcoming MPM, during which only one official speaking engagement is scheduled (a speech by Policy Board member Toyoaki Nakamura on 5 Dec). Our impressions of the interview were that while the BOJ is preparing for another rate hike, it has yet to decide on the timing and will consider it while monitoring future conditions. After the interview was posted on the *Nikkei* website at 2am, the forex market reacted to the headline ("Governor Ueda sees major risk of weaker yen, will respond by changing policy"), with USD/JPY briefly falling below 149.50. Below, we briefly comment on Mr. Ueda's key answers in the interview regarding near-term policy conduct.

Governor Ueda's *Nikkei* interview: Next hike approaching, does not want Dec hike seen as fait accompli

In response to a question about the possibility of additional rate hikes, Mr. Ueda stated that the BOJ would "adjust the degree of monetary easing at the appropriate timing if we become confident that underlying inflation is steadily accelerating toward 2%." He noted that "wage growth, the pass-through of wage hikes to prices, and the strength of consumption" are the BOJ's key checkpoints in deciding on whether to raise rates, and that "strong economic activity (particularly consumer spending) will be needed to support the pass-through of higher wages." In response to a question about whether the BOJ is close to raising rates again, he noted that "we can say that [a rate hike] is approaching in the sense that economic data are on track to meet our forecasts, but the outlook for US economic policy is a major question mark".

Mr. Ueda's responses indicate that the domestic data that will feed into the BOJ's decision on rate hikes is in line with its forecasts, with the upcoming October Monthly Labour Survey and December Tankan set to back this up. Given the analysis in the October *Outlook for Economic Activity and Prices* report (*Outlook Report*) indicating that domestic economic conditions are conducive to raising interest rates, we think the BOJ is beginning to lay the groundwork for another hike. However, it is less confident about US factors. Mr. Ueda also noted at his regular October press conference that "the election of a new president could cause new risks to emerge even if the US economy remains strong in the near term." While tariffs are making headlines, it will take time to gauge their impact. The BOJ has yet to decide whether to wait until the major question marks about the outlook become smaller question marks, or opt for market stability before new risks emerge. The BOJ is in no hurry to raise interest rates, and appears reluctant to create the impression that a December rate hike is a fait accompli. This is likely what the *Nikkei* article means by Mr. Ueda "emphasizing that the BOJ seeks to avoid making a hasty judgement."

Domestic focus is sustainability of wage hikes

Mr. Ueda explained that "the results of the 2024 spring labor negotiations are feeding into the Monthly Labour Survey data as expected. Growth in scheduled cash earnings is between 2.5-3%, broadly consistent with long-term consumer price index (CPI) inflation of 2%. The key point will be whether this continues"; and "if goods inflation slows a little further, real wages should pick up slightly, supporting consumer spending". Scheduled cash earnings (Chart 1) remain a key monthly metric. On the subject of the 2025 spring labor negotiations, Mr. Ueda also noted that "we want to see how much momentum comes out of them, and we will not be able to confirm that for a while, but it is not as if monetary policy decisions are on hold until then". Targets for the FY25 negotiations are "at least 5% (including regular pay increases) and at least 3% base pay hikes, in line with 2024", suggesting that wages are likely to continue rising (Chart 2).

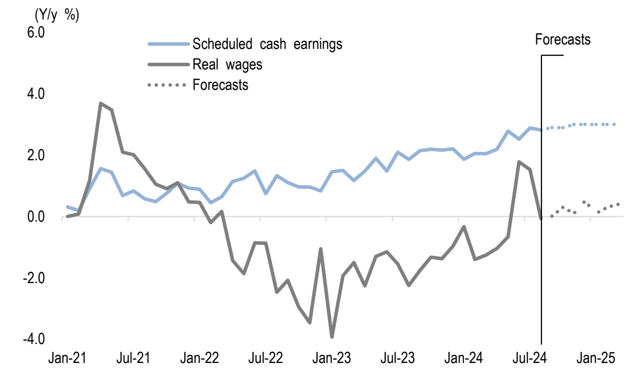
We doubt that waiting until the January MPM would give the BOJ much more information about domestic factors than it will have at the December meeting. However, it would gain more opportunities to communicate with the market via Mr. Ueda's year-end speech to Keidanren (Japan Business Federation) and the report from the BOJ's January branch manager meeting. If it continues to prioritize careful communication, a rate hike in January seems the likely option.

BOJ unable to pinpoint neutral rate of interest, but will initially aim for 1%

On the subject of the neutral rate of interest, which is the ceiling for rate hikes, Mr. Ueda noted that "the range is very wide and we have not been able to narrow it down; if underlying inflation remains at around 2% from the middle to second half of the period through FY26, we would expect [the policy rate] to approach the neutral rate around then," and that "our internal estimates of the natural rate of interest are between –1% and +0.5%, but it is difficult to be definitive about current levels based on parameters calculated from historical data, given that these parameters may have changed; virtually no global central banks have an accurate idea of the neutral rate. The process will likely be of making gradual adjustments as we see how the economy reacts to changes in interest rates."

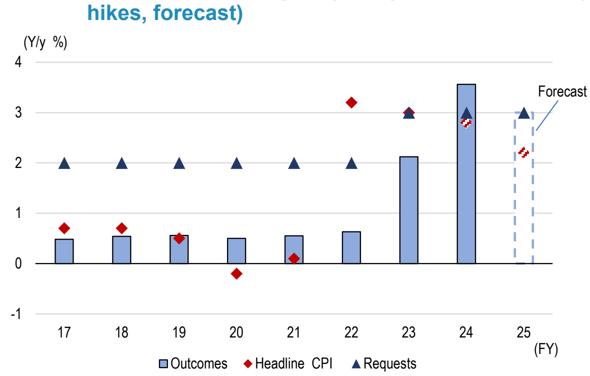
The *Nikkei*'s commentary states that the policy rate could settle between 1.0 and 2.5% if the natural rate of interest is in line with the BOJ's assumption of –1.0 to +0.5% and inflation is at 2%. We think the BOJ will gradually raise interest rates with the initial aim of achieving 1.0%. By "gradually", we mean one 25bp hike every six months or so.

Chart 1: Nominal Wages, Real Wages



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

Chart 2: Outcomes of Spring Wage Negotiations (base pay hikes, forecast)



Source: Japanese Trade Union Confederation, Ministry of Internal Affairs and Communications, Cabinet Office; compiled by Daiwa.
Note: FY24 and FY25 headline CPI figures based on mid-FY24 Cabinet Office simulation.

BOJ to publish broad-based review in Dec; no fixed relationship between forex and policy

We think Mr. Ueda also used the *Nikkei* interview to advertise the "Review of Monetary Policy from a Broad Perspective" the BOJ plans to publish after the December MPM. Mr. Ueda stated his ambitions for the report: "we want to quantify as far as possible how the variety of easing measures over the past 30 years or so worked, or failed to work; we want to publish an overall assessment of the side effects they may have had on the functioning of the market and on financial institutions' earnings."

When asked if a weaker yen was one major side effect, Mr. Ueda responded that, "for example, the yen strengthened in the early 2010s, a deflationary period when a stronger yen would have been problematic; in contrast, a weaker yen when inflation is beginning to exceed 2% is a major risk for a central bank, to which it could need to respond depending on the circumstances." The market reacted to the second half of this statement. Later in the interview, Mr. Ueda stated that "there is no fixed relationship between forex and policy, but there is a relationship between the inflation outlook and monetary policy; forex rates have a different impact at any given point".

A global consensus has emerged at international conferences since October on the strength of the US economy, and the market is also beginning to expect a slower pace of US rate cuts in 2025. From what we have heard, Mr. Ueda appears to concur with Fed Chair Jerome Powell's view. The BOJ may therefore not be as cautious about the US economy as we feared. However, the key point will be how the market reacts to the November US employment and CPI data that will be released in December. The BOJ will make its monetary policy decisions on 19 December, the second and final day of its December MPM. The results of the December FOMC (Summary of Economic Projections, dot plot) are due early the same day. It is entirely possible that the BOJ will brace for a USD rally in the market.

Hopes for economic momentum under 2% inflation regime

Finally, when asked from a long-term perspective whether a rise in inflation from 0% to 2% would boost the Japanese economy's growth potential, Mr. Ueda first summarized his basic views on the BOJ's inflation target. He explained that "achieving the 2% inflation target would result in higher nominal interest rates than when inflation was at zero. This would create more room for monetary easing when the economy slows than if inflation were at zero. While unconventional monetary easing tools (such as quantitative easing, QE) are an option, they are not a perfect substitute for normal interest rate cuts. Ideally, we want the ability to cut rates should a recession result in lower inflation." Our sense is that Mr. Ueda was able to express himself in such bold terms precisely because the BOJ's eight years of negative interest rates is now over.

Mr. Ueda also noted that "if inflation remains at 0% and wages continue rising, the need for cost cuts would come to dominate the corporate mindset. This would not be conducive to positive moves to produce new innovations and then raise prices to reflect them. While there is no logical rationale for this, I am moderately hopeful that (2% inflation) will create a kind of economic momentum." We also hope to see positive changes in Japan's corporate wage and price-setting behavior continue. The BOJ's first task will be anchoring inflation expectations at 2%. It still has a way to go to normalize monetary policy.

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