JAPAN: Anticipating the Bank of Japan's next move

- Ahead of the last monetary policy meeting of 2023 on 18-19 December, speculation is rising again regarding the Bank of Japan (BOJ)'s next steps towards normalizing monetary policy.
- The key question now is whether and when the Bank will ditch what remains of yield curve control (YCC) entirely, and/or raise interest rates for the first time in over 15 years.
- Given recent data trends and the economic and political calendars for 2024, April still looks like the most logical date for an end to negative interest rates, with a decision on YCC harder to call.

Recent trends

Governor Kazuo Ueda has been relatively clear recently in telegraphing the factors he is focused on when considering an exit from negative interest rates—prices, wages, and domestic demand. The core consumer price index (excluding fresh food) has decelerated from above 4% earlier this year, likely to around 2.6% last month, in line with the Bank's forecast of an average of 2.8% in FY2023. The BOJ's target is for 2% inflation, pulled up by sustainable domestic demand rather than pushed up by external cost factors.

The outlook for wages and private demand is mixed. Despite nominal wages rising for 22 consecutive months, real wages have declined for 19 months—falling by 2.3% on the year in October. Consequently, private demand has also slipped for the last six consecutive months, with household spending down 2.5% on the year in October. However, decelerating inflation in 2024 should help lift private demand, assuming nominal wage growth holds steady.

The economic growth outlook is also mixed. Third-quarter GDP data showed a 2.9% annualized contraction, but preliminary data pointed to an uptick in October, while the Bank of Japan's quarterly *Tankan* survey this week found net business sentiment positive and rising among larger firms in both manufacturing and non-manufacturing sectors, while net sentiment among SMEs turned positive for the first time in almost five years. The BOJ's latest median forecasts are for 2.0% GDP growth in FY2023, and around 1% in both FY2024 and FY2025.

Parsing the calendar

While Ueda said in September that data before year-end could point to the realization of a virtuous wage-price cycle, it is hard to interpret recent trends as evidence that such a cycle has already been achieved. Deputy Governor Ryozo Himino said on 6 December that the Bank has no specific schedule or sequence in mind for an exit from negative rates, but the BOJ's own annual calendar sets some parameters.

The Bank's two-day monetary policy meetings in 2024 will finish on 23 January, 19 February, 26 April, 14 June, 31 July, 20 September, 31 October, and 19 December. However, a major policy shift would surely coincide with a change in the Bank's economic outlook. In that respect, the dates on which the Bank publishes its quarterly Outlook Reports after policy meetings would seem to be the most important—23 January, 26 April, 31 July, and 31 October.

Another consideration is the Bank's ongoing review of the last quarter-century of unconventional monetary policy interventions. When that review was launched in April 2023, Deputy Governor Shinichi Uchida indicated that it could take up to eighteen months. The Bank hosted a first workshop as part of that review on 4 December, with a second scheduled for May 2024. Summer 2024 would seem to be a likely publication window for the final report.

Externally, collective wage bargaining between labor unions and large employers should conclude in mid-March, though actual wage increases won't show up in the data until June or July. A further consideration might be the course of monetary policy in the United States. On 13 December, the Federal Reserve indicated that it would hold rates steady through March and then cut rates incrementally thereafter.

Finally, domestic politics might also be an indirect consideration, insofar as Ueda would not want to be seen to taking economic decisions that caused political headwinds before an election period. Here, the [corruption scandal facing the ruling LDP] makes predictions more difficult, but presumably Prime Minister Fumio Kishida would not want to call a snap general election in the wake of a massive scandal, meaning that the political calendar from the BOJ's perspective would look good through at least H1 2024, and quite possibly H2 too.

Best guesses

Ueda's comments on 7 December—that monetary policy conditions would become more challenging heading into next year—were interpreted by some as suggesting a policy shift as soon as next week. But a major move would be hard to imagine considering current economic data, and not one of 26 economists in a recent Reuters survey anticipated a change to negative interest rates in December. About 80% in that poll thought the BOJ would end negative rates sometime in 2024, while almost half thought the change would be made in April.

An April end to negative short-term rates would indeed seem to be the most intuitive date. By then, the BOJ would have a fuller sense of the ongoing deceleration of consumer price inflation, a clearer idea of the findings of its long-term policy review, a preview of FY2024 wage increases, and a fresh economic outlook report with which to justify any major policy change. A rapid improvement in economic fundamentals that would catalyze a January move is hard to envisage, though economic headwinds like a growth slowdown could conceivably push the rates decision date back to July.

The decision around ending the remains of YCC is even harder to anticipate. YCC was introduced in September 2016 following the completion of a previous policy review, and there would be a certain logic to ending it concurrent with the publication of at least a new Outlook Report. If Ueda wanted to end YCC as a precursor to raising interest rates, that might point to a January YCC decision ahead of an April rate rise. However, the BOJ's three unexpected tweaks to progressively loosen YCC in the past 12 months makes it hard to guess how the Bank would implement the decision to finally end it.

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