AT A GLANCE | Japan

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The Bank of Japan May Advance Policy Revisions

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Long-Term Interest Rates Rise After Ueda Interview

At the monetary policy meeting held on September 21, the Bank of Japan's (BOJ) Policy Board kept its overall stance on hold. No critical changes were outlined in the bank's statement and the message provided by the post-meeting press conference by Governor Kazuo Ueda, in effect brushing off market speculation that the BOJ is set to raise its overnight lending rate from negative levels by year-end and emphasizing that the 2% inflation target is still not in sight.

Meanwhile, long-term interest rates have been rising in the markets since the September 9 interview with Governor Ueda was reported. The content of the article seems to have gone a step further than before, focusing on statements such as, "[w]e will do it if we deem it possible to achieve the price target even after the lifting of negative interest rates," and "[t]here is a possibility that sufficient information and data will be available by the end of the year." Regarding the lifting of negative interest rates, Deputy Governor Shinichi Uchida said in an interview in July that "judging from the current economic price situation, there is a great distance between the two countries" [referring to Japan and the U.S.], and Governor Ueda only said at a press conference in April that it was not necessarily the case that the decision on the timing of the policy change had to be made until the next year, but there was no mention of a specific timing. Compared to these, the latest statement seems to go a step further.

However, it is important to note that in the past, when discussing the outlook for the future, Governor Ueda has often referred to risks in both directions in order to achieve a balance, or to the possibility of policy revisions depending on the economic environment. Again, we believe it's important to note that such statements may have been a little too focused in the article. In fact, subsequent reports seem to suggest that there is a "gap between what (Governor Ueda) said and market interpretation within the BOJ." For this reason, it seems (in our view) that he did not intend to revise the policy early next January. In this report, we would like to explain the reasons why we think that the BOJ will not actively consider bringing forward the policy revisions.

Four Conditions to Overcome Deflation Will Be Achieved

Some readers will note that the high inflation rate and the recent upturn in the economic environment make a policy revision next January very likely. In fact, among the government's four conditions to overcome deflation, consumer prices have already exceeded 2% for 16 months, and the GDP deflator has already been positive for three quarters. In addition, "unit labor cost" has been positive recently, excluding January-March 2023 (up 1.0% year over year in April-June 2023). The remaining "GDP gap" also rose into positive territory, according to the Cabinet Office's estimate released on September 1. To be sure, these at least indicate that the current situation is not deflationary. It is a plausible scenario that the government issues a declaration to end deflation and the Bank of Japan moves to change its policy accordingly.

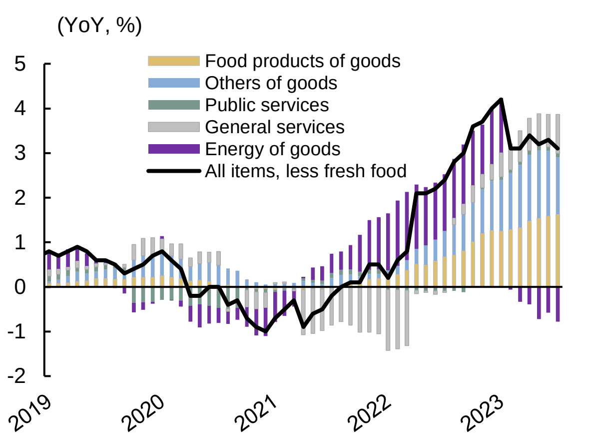
At present, however, there is no indication that the government will actively consider issuing a declaration to end deflation. The Cabinet Office's Economic and Fiscal Policy Report, released on August 29, also notes that a "GDP deflator, GDP gap and unit labor cost all need to be validated for sustainability" in response to the question of "[g]iven that the core of the consumer price index is rising at its fastest rate in nearly 40 years, is it impossible to say that our country has overcome deflation?" and that "[i]t is difficult to show a univocal criterion that deflation has been overcome if certain indicators meet certain criteria, which requires careful consideration." As far as these descriptions are concerned, it seems overly optimistic to think that the government will issue a declaration to end deflation based only on the improvement of the indicators.

Signs of a Peak in Consumer Prices

In July, the national Consumer Price Index (CPI) for core items (i.e., excluding fresh food) was up 3.1% from the previous year (up 3.3% from the previous month), the positive range for core items (excluding fresh food and energy) was up 4.3% from the previous year (up 4.2% from the previous month), and the underlying inflation rate has remained high (Figure 1). However, the Nikkei CPINow index, which uses point-of-sale data from supermarkets that can be viewed on a daily basis, shows a gradual decline in the rate of increase for nearly three weeks (Figure 2). This is the first time since November 2021 that prices have continued to decline for such a long period of time, and it is a movement that has not been seen since 2022, when inflation began to rise in earnest.

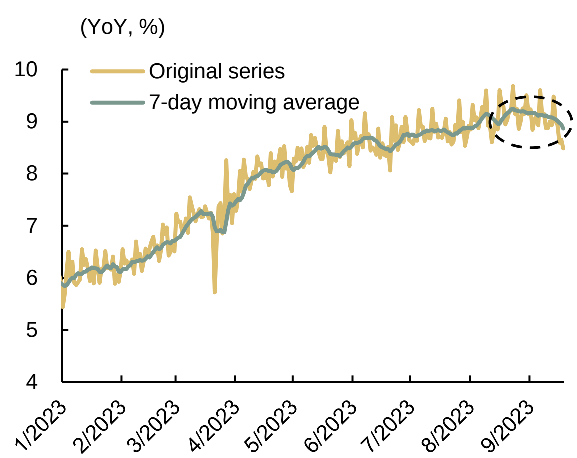
If it is confirmed that the CPI will actually peak out in the future, the BOJ will have less urgency to revise its policy. If consumer prices start peaking out in September, they might want to wait a little longer in January, when data from October to December, when the rate of increase gradually declines, is confirmed.

Figure 1: Year-Over-Year Core CPI and Breakdown Contribution



Source: Ministry of Internal Affairs and Communications

Figure 2: Nikkei CPINow (Until September 18)



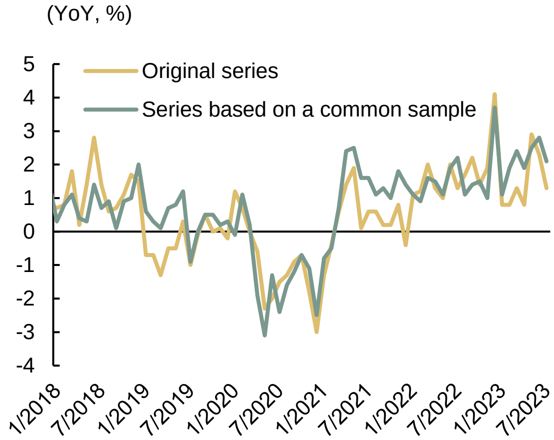
Source: Nowcast Co., Ltd.

Solid Wage Situation

Wage movements are also strong but weak. In July, the monthly labor statistics showed that nominal wages rose 1.3% from a year earlier, less than 2%. However, the year-over-year rate of increase in wages on a "common office basis" for the same sample was +2.1%, or more than 2%, indicating that the increase in wages does not seem to have collapsed (Figure 3). What was particularly striking was the movement in the on-time salaries (based on common establishments) of ordinary workers, excluding part-time workers (Figure 4). The increase has been intensified by the acceleration of wage increases in the spring wage negotiation cycle, with the increase exceeding 2% to +2.3% in July, but the 2% increase was the first since 1997. Wage movements are expected to be strong enough to allow inflation of around 2%.

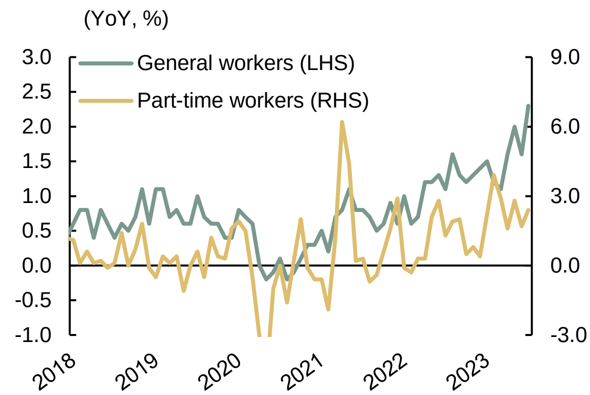
However, it is hard to imagine that wages will rise to 3% or 4% over the current fiscal year, considering that the outcome of the spring wage offensive in this year's wage negotiations was 2.12% (the final figure of the coalition). This is because, as is often pointed out, the Japanese labor market does not review wages frequently, and only regular employees (in many cases) have annual spring negotiations. In addition, it is difficult to hope for a rapid wage increase because the practice of assuming lifetime employment has taken root and labor mobility is small. If this is the case, it will be difficult for the BOJ to continue to raise prices above and beyond wage increases as consumer purchasing power declines, so there is not necessarily much need for the BOJ to quickly ease monetary policy out of fear of the risk that prices will continue to rise.

Figure 3: Nominal Wages (monthly labor statistics)



Source: Ministry of Health, Labor and Welfare

Figure 4: Salary on a Predetermined Basis (common location basis)



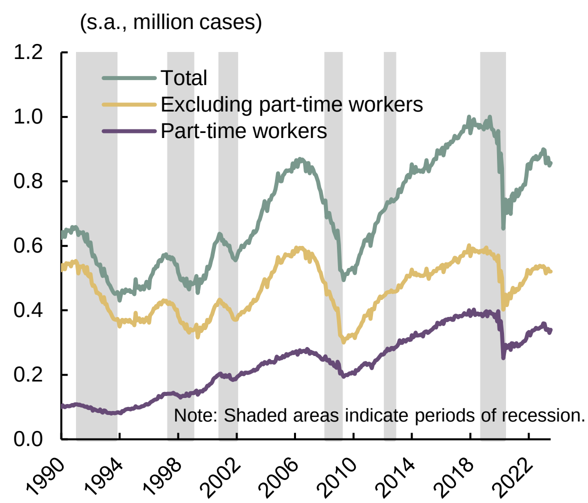
Source: Ministry of Health, Labor and Welfare

Leading Economic Indicators Are Also Weak

In addition, some leading indicators of the economy have recently faded. For example, the number of new job openings is on the decline. This is a worrisome development since the number of new job openings decreased before previous economic downturns (Figure 5). Japan's economy is experiencing a growing labor shortage, as evidenced by the fact that the GDP gap estimated by the Cabinet Office in September rose to +0.1%. While the unemployment rate remains low and the economy is unlikely to be in a recession any time soon, economic watchers say that "sluggish overseas consumption and rising domestic electricity, fuel and raw material prices, combined with reduced labor costs, have had an impact on the number of job openings" and "the sharp increase in the minimum wage has led some companies to curb labor costs and refrain from hiring employees." If the number of companies unable to withstand such high costs increases, this could be a drag on the domestic economy.

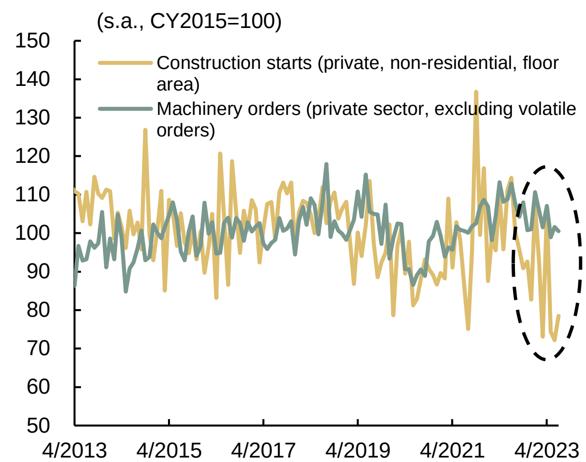
Leading indicators of capital investment also show a decline. Indicators such as construction floor area and machine order statistics have fallen recently (Figure 6), and comments such as "[d]ue to the fact that price shifting cannot keep up with the increase in purchasing costs and the difficult profit situation, the policy is to keep the capital investment for this fiscal year to the minimum necessary maintenance and renewal," and "[d]ue to the increase in building costs, the payback period has been prolonged, raising the bar for opening new stores" have been heard in the Bank of Japan's Sakura Report. On the other hand, firms' interest in capital investment, as confirmed by the Tankan (the short-term economic survey of enterprises), continues to be strong, so it is probably too early to judge that the trend of increasing capital investment has broken down, but downside risks may also exist.

Figure 5: Number of New Job Openings



Source: Ministry of Health, Labor and Welfare

Figure 6: Leading Indicators of Capital Investment



Sources: Cabinet Office, Ministry of Land, Infrastructure, Transport and Tourism

In light of the above, it seems unlikely that the Bank of Japan will rush to revise its policy without waiting for the results of the spring wage offensive next year. However, if the yen continues to weaken or if prices continue to rise more than expected, the risk of an early policy correction will of course increase. Let us conclude by saying that the situation will likely continue to be unpredictable.

Economic Outlook: 2023-2024 Forecast

Figure 1: Forecasts for Economic Growth, Inflation, and Unemployment Rates

		2022			2023				2024				2021	2022	2023	2024
		Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
US	Real GDP	−0.6	3.2	2.6	2.0	2.1	2.5	1.2	0.6	1.0	1.2	1.7	6.0	2.1	2.1	1.2
	Inflation	5.0	5.0	4.8	4.7	4.4	4.0	3.6	3.0	2.7	2.6	2.5	3.3	5.0	4.2	2.7
	Unemployment	3.6	3.6	3.6	3.5	3.6	3.7	3.9	4.2	4.4	4.4	4.5	5.4	3.7	3.7	4.4
Euro Area	Real GDP	0.8	0.3	−0.1	0.1	0.1	0.0	0.1	0.2	0.3	0.3	0.4	5.6	3.4	0.5	0.8
	Inflation	8.0	9.3	10.0	8.0	6.2	5.1	3.2	3.3	3.2	3.0	2.8	2.6	8.4	5.6	3.1
	Unemployment	6.7	6.7	6.7	6.6	6.4	6.5	6.6	6.7	6.8	6.8	6.8	7.7	6.7	6.5	6.8
Japan	Real GDP	5.3	−1.2	0.2	3.2	4.8	0.9	0.8	0.9	0.9	1.1	1.1	2.2	1.0	1.5	1.0
	Inflation	2.1	2.7	3.8	3.5	3.2	2.9	2.5	2.9	2.8	2.5	2.1	−0.2	2.3	3.0	2.6
	Unemployment	2.6	2.5	2.5	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.8	2.6	2.4	2.3
China	Real GDP	0.4	3.9	2.9	4.5	6.3	4.4	4.8	3.7	4.1	4.6	5.0	8.4	3.0	5.0	4.4
	Inflation	2.2	2.8	1.8	1.3	0.2	0.0	0.6	1.1	1.5	1.8	2.0	0.8	1.7	0.5	1.6
	Unemployment	5.8	5.4	5.6	5.5	5.2	5.3	5.2	5.1	5.0	5.0	5.0	5.1	5.1	5.3	5.0

Real GDP growth is in QoQ annualized for U.S. and Japan, QoQ for euro area and YoY for China and India. Inflation rate is in YoY%. Inflation rate is YoY, % of core index (ex. fresh food) for Japan, YoY % of PCE deflator for U.S., and total YoY% for the rest.

Figure 2: Forecast for Rates

Interest rate		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
US	Policy rate	4.25 ~ 4.50	4.75 ~ 5.00	5.00 ~ 5.25	5.25 ~ 5.50	5.25 ~ 5.50	5.25 ~ 5.50	5.00 ~ 5.25	5.00 ~ 5.25	4.75 ~ 5.00	4.25 ~ 4.50	5.25 ~ 5.50	4.75 ~ 5.00
	2yr	4.43	4.03	4.90	5.00	5.00	5.00	4.75	4.75	4.75	4.43	5.00	4.75
	10yr	3.87	3.47	3.84	4.50	4.20	4.00	3.90	4.00	4.00	3.87	4.20	4.00
Germany	Policy rate	2.50	3.50	4.00	4.50	4.50	4.50	4.50	4.25	4.00	2.50	4.50	4.00
	Deposit rate	2.00	3.00	3.50	4.00	4.00	4.00	4.00	3.75	3.50	2.00	4.00	3.50
	2yr	2.50	2.68	3.20	3.20	3.00	2.80	2.60	2.40	2.30	2.50	3.00	2.30
	10yr	2.20	2.29	2.39	2.30	2.30	2.30	2.20	2.10	2.10	2.20	2.30	2.10
Japan	Policy rate	−0.10	−0.10	−0.10	−0.10	−0.10	−0.10	0.10	0.10	0.10	−0.10	−0.10	0.10
	2yr	0.04	−0.06	−0.07	0.10	0.15	0.20	0.30	0.30	0.30	0.04	0.15	0.30
	10yr	0.42	0.35	0.40	0.65	0.75	0.80	0.90	0.90	0.90	0.42	0.75	0.90
China	Policy rate	2.75	2.75	2.65	2.50	2.40	2.40	2.40	2.40	2.40	2.75	2.40	2.40
	2yr	2.39	2.41	2.11	2.05	2.00	2.08	2.15	2.25	2.35	2.39	2.00	2.35
	10yr	2.83	2.85	2.64	2.50	2.45	2.50	2.55	2.60	2.65	2.83	2.45	2.65

Figure 3: Forecast for FX and Oil Price

		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
USD/JPY	Range	130.58 ~ 151.95	127.23 ~ 137.91	130.64 ~ 145.07	137.25 ~ 152.00	133.00 ~ 147.00	131.00 ~ 145.00	126.00 ~ 140.00	128.00 ~ 142.00	128.00 ~ 142.00	113.47 ~ 151.95	127.23 ~ 152.00	126.00 ~ 145.00
	End of quarter	131.12	132.86	144.31	145.00	140.00	138.00	133.00	135.00	135.00	131.12	140.00	135.00
EUR/USD	Range	0.9633 ~ 1.0735	1.0806 ~ 1.1033	1.0635 ~ 1.1095	1.0300 ~ 1.1300	1.0200 ~ 1.1200	1.0100 ~ 1.1100	1.0000 ~ 1.1000	1.0100 ~ 1.1100	1.0100 ~ 1.1100	0.9536 ~ 1.1495	1.0200 ~ 1.1300	1.0000 ~ 1.1100
	End of quarter	1.0705	1.0839	1.0909	1.0700	1.0600	1.0500	1.0500	1.0600	1.0600	1.0705	1.0600	1.0600
EUR/JPY	Range	138.81 ~ 148.40	124.40 ~ 145.67	142.55 ~ 158.00	149.00 ~ 163.00	144.00 ~ 158.00	138.00 ~ 152.00	133.00 ~ 147.00	136.00 ~ 150.00	136.00 ~ 150.00	124.40 ~ 150.00	137.39 ~ 163.00	133.00 ~ 152.00
	End of quarter	140.41	144.01	157.43	155.15	148.40	144.90	139.65	143.10	143.10	140.41	148.40	143.10
Crude Oil Prices (WTI)		82.64	75.99	73.67	80.00	82.00	82.00	76.00	77.00	78.00	98.74	77.92	78.25

※ Crude oil prices are averages for each period. Source: SMBC.

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