The Bank of Japan could be just months away from more policy normalisation

The Bank of Japan ended its negative interest rate and yield curve control in March, hoping strong wage growth would boost inflation and consumption. It won't hesitate to take further action if upcoming data confirms a recovery in real wages and consumption

Looking up! The Bank of Japan Governor, Kazuo Ueda, is mulling another rate hike

Expect front-loaded rate hikes in the second half of the year

We expect the Bank of Japan to raise its target rate to 1.0% by the end of 2025. But even if we slowly get there, overall monetary conditions will remain accommodative as real interest rates will remain in negative territory. Don't expect any sudden shock! A 25bp hike in most quarters should be sufficient for the economy to digest the rate increases.

In addition, should inflation fall below the 2% target range, the BoJ needs enough room to react. So we expect the Bank to raise its policy rate target to a range of 0.15-0.25% in July and 0.40-0.50% in October, followed by two more 25bp hikes in the first half of next year.

But what happens in the near term will depend on inflation's path, earnings, and consumption data between now and July. The BoJ's Quarterly Outlook Report will also be closely watched as it could give a hint as to the Bank's future policy decision. If we are right about inflation staying above 2% and cash earnings rising above 5% from May, the BoJ is likely to hike as early as July.

The surge in wages could be seen in payrolls as early as May

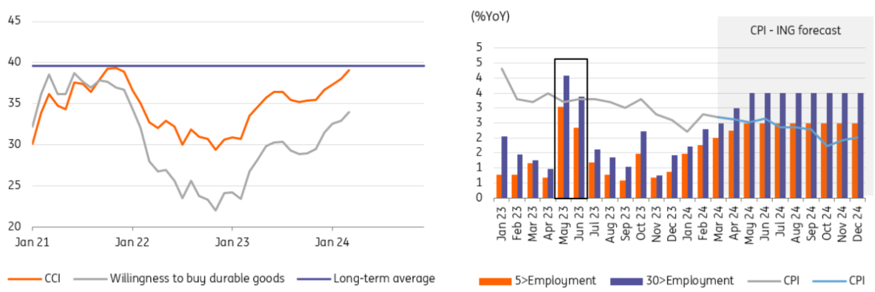
Last year's wage negotiations resulted in a relatively solid 3.6% YoY increase, but consumer prices rose by 3.3%, resulting in no real wage growth at all. However, in 2024, wage growth is expected to exceed 5%, while consumer prices are expected to slow to 2.3%, turning real wage growth positive. History tells us that newly agreed wage increases usually kick in from May onwards. Data on that will be released in early July, just a few weeks before the July Bank of Japan meeting. Also, given the strong corporate earnings this year, we expect larger-than-normal bonus payments to be made, so strong wage growth should pave the way for that BoJ rate hike.

Household consumption has been picking up despite some distractions

After a large dip in the fourth quarter of 2023, retail sales in Japan finally rose on a monthly basis in the first two months of this year despite car sales dropping for the past three months and the major earthquake at the beginning of January. We expect a technical payback in car sales from March as a distinctive factor related to a car safety scandal issue fades.

Given that's a major component of total household spending, it suggests retail sales are set to improve more meaningfully in the second quarter, supported by stronger wage growth and associated consumption. In addition, a leading indicator for household consumption, the consumer confidence index, has been rising for the past six months. Consumers' willingness to buy durable goods has advanced meaningfully as well, suggesting a consumption recovery is ahead of us.

Consumer confidence advanced for six months while real cash earnings is likely to turn positive from May



Source: CEIC, ING estimates

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