

No change at April's Bank of Japan meeting

We do not expect the Bank of Japan (BoJ) to introduce policy changes at its April meeting, but recent macroeconomic conditions mean the BoJ has paved the way for policy normalisation as early as June



Bank of Japan governor
Kazuo Ueda

The Bank of Japan will hold policy action at next meeting

We expect the Bank of Japan to hold its policy action at its April meeting, as it is just too early for the incoming governor Kazuo Ueda to make policy adjustments and there is no indication at this point that policy normalisation is urgent. At his confirmation hearings in parliament, Ueda also said that he would prioritise communication with financial markets and clarifying his rationale for policy decisions. We believe that he will lay out his views on the current macro perspective and the BoJ's current policy status in April. If pushed, he could hint at the possibility of coordinating forward guidance at the next meeting but we don't think he will comment on the yield curve policy (YCC) itself, because he believes that any implication on YCC change could diminish the expected policy effect.

Given recent data results and labour market conditions, we believe that the BoJ could change its forward guidance and adjust its YCC policy as early as June. We do not expect another YCC adjustment of the upper limit widening as it did last December, but it will try to anchor the shorter-

term tenor 5Y Japanese government bond (JGB) at 0.0% and set the bandwidth tighter than the current +/- 0.5%. Ten-year JGBs already run below 0.5% and recent global financial market uncertainties will likely support the 10Y JGB to stay below the current limit for the time being, thus shortening the YCC would be more effective to move towards policy normalisation. We still expect that the first rate hike will come only in 2024.

Macro conditions signal Japan's recovery

Based on various data releases, we believe that the Japanese economy is on track for recovery. Although recent positive service sector data contrasted with sluggish manufacturing activity, the service sector makes up a larger share of the economy, so overall growth conditions will remain positive.

Industrial production and retail sales data improved between the fourth quarter of last year and the first quarter of 2023, and forward-looking PMI and Tankan survey data provide a positive outlook for the current quarter. Both surveys foresee that the service sector will outperform manufacturing, which is a reasonable view as global demand conditions are expected to deteriorate, while Japan is expected to enjoy the reopening boost from both domestic and overseas travellers.

For inflation, Tokyo CPI, a leading indicator of nationwide inflation, continued to slow in March thanks to the government's energy subsidy programme. But, inflationary pressures seem to be expanding as other prices excluding utilities gradually rise. We believe that the second-round effect of previous high energy prices still remains while the reopening of the economy is partially adding to demand-side pressures. As the BoJ looks for demand-driven inflation, this is a good sign that inflation will stay at a sustained level.

Services will lead Japan's recovery



Source: CEIC

Wage growth is expected to beat the BoJ's expectations this year

The labour union's biggest wage increase in decades has recently sparked market speculation about the BoJ's policy normalisation. According to the news media, key labour unions and their employers have tentatively agreed to raise overall wages by 3.8%, the largest gain since 1993, with a 2.33% increase in the base wage. In addition, several large companies have announced plans for a higher-than-usual pay increase. However, SMEs won't be able to keep up with this trend, so the final wage growth should be lower than current estimates. But, so far, the results have been higher than the 3% sustained wage growth suggested by the BoJ, which could support the central bank's policy normalisation in the coming months.

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