

## Stable inflation supports Bank of Japan's policy normalisation

The Bank of Japan will continue on its path of policy normalisation, supported by sustained inflationary pressures and a recovery in economic activity



Japan is experiencing a period of political uncertainty and new prime minister Shigeru Ishiba's approval ratings have fallen sharply recently

### GDP is expected to moderate in the third quarter

Japan's automobile production disruptions in July and August started to normalise in September, but the mega-earthquake warning and typhoon in early September may have hindered a full recovery in economic activity. We foresee a solid recovery in manufacturing output from October onwards.

In the services sector, which makes up more than 60% of GDP, retail sales, tourism, and dining out have shown the most improvement. Consequently, services will continue to drive overall growth, bolstered by strong wage increases.

Meanwhile, the trade deficit is expected to narrow, contributing positively to growth, driven by weaker commodity prices and a gradual increase in exports. We expect GDP to decelerate from 2.9% (quarter-on-quarter seasonally adjusted annualised rate in the second quarter of 2024) to 1.2% in the third quarter, and then to grow at a faster pace of 2.4% in the fourth.

## **Inflation will remain above 2% until mid-2025**

The latest headline inflation logged 2.5% year-on-year in September and is expected to stay above 2% until mid-2025. Early Tokyo inflation in October confirmed that services prices rose firmly. This indicates that Japanese firms are passing on input cost increases to output prices more than before as households, supported by higher wage growth, can better afford these price hikes.

With the end of the summer energy subsidy programme in October, headline inflation is expected to reaccelerate in the near term, and service-led price increases are likely to continue.

## **Japan is going through an unusual period of political uncertainty**

The ruling Liberal Democratic Party coalition failed to secure a majority in the lower house for the first time since 2009, and new Prime Minister Shigeru Ishiba's approval ratings have fallen sharply recently. A special Parliament session is expected on 11 November, when parliaments convene to elect a prime minister seat. We believe Shigeru is likely to receive the most votes. His party has the largest presence, and the opposition parties' wide political spectrum makes it difficult for them to collaborate effectively.

Given that the LDP still lacks a majority in parliament, the new government will likely need to collaborate with minority parties in policymaking. We believe this local political uncertainty will not significantly impact the BoJ's policy decisions in the near future.

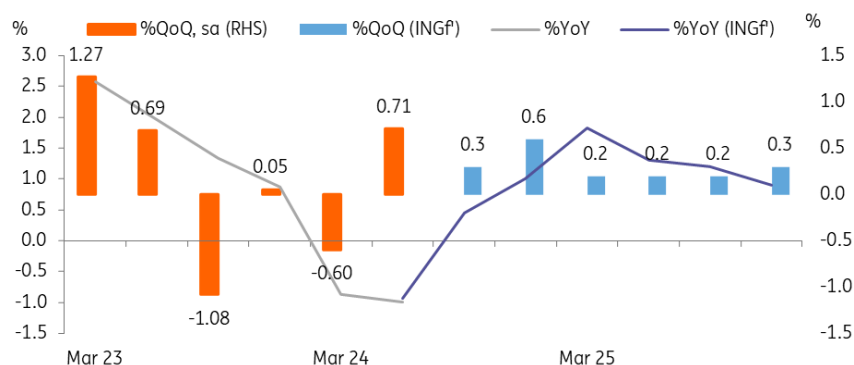
## **BoJ: rate hikes will come in 2025**

Looking back at the October BoJ meeting, we believe Governor Ueda's comments were hawkish. He didn't indicate when the next rate hike would be, but he also didn't completely rule out a hike in December, instead stating that every policy meeting from now on will be a live event.

Ueda reiterated that the economy is following the BoJ's projected path, and if this continues, the central bank will implement another rate hike. His overall tone on growth and inflation was more positive compared to the previous meeting.

Between now and the BoJ's December meeting, US data, Tokyo's November inflation, and labour cash earnings will be closely watched. But, the most dominant factor in the BoJ's December move is likely to be FX. Even if the BoJ decides to extend its pause in December, we continue to believe that the BoJ will hike rates by 25bp each quarter until it reaches 1.0%.

## The market is quite dovish about the BoJ's rate path



Source: CEIC, ING estimates

### Author

**Min Joo Kang**

Senior Economist, South Korea and Japan

[min.joo.kang@asia.ing.com](mailto:min.joo.kang@asia.ing.com)

### Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).