

## Bank of Japan opens the door to ending negative rates, but timing uncertainty remains

The Bank of Japan stood pat on monetary policy today as widely expected. But the market is now paying attention to a more positive tone on the wage and inflation outlook, as well as an upgrade to the FY2024 inflation outlook which lays the groundwork for policy normalisation. We still see a slightly higher chance of a first hike taking place in June than in April



Kazuo Ueda, Governor of the Bank of Japan

### No surprise that the BoJ kept its policy rate and 10-year yield target unchanged

We think the Bank of Japan's modest change in its view on inflation hints that policy normalisation is approaching. The BoJ assessed its statement that the likelihood of achieving the price goal has "continued to gradually rise." Governor Kazuo Ueda's comments on wages and inflation were also more positive than in previous meetings, signalling that a path to policy normalisation could be underway. Markets were likely pleased to hear that the central bank would consider whether

negative rates should remain if the price goal is in sight and that it can make policy decisions without all small firm wage data.

## Quarterly outlook report

Aside from the policy decision itself, the BoJ's quarterly outlook report was closely watched by market participants. As we expected, the BoJ lowered its core inflation outlook for FY 2024 from 2.8% to 2.4% while upgrading the outlook for FY 2025 from 1.7% to 1.8%. The government's efforts to curb inflation and the recent weaker-than-expected global commodity prices will likely drag down the price for early 2024, but the BoJ still sees underlying inflation pressures remaining through FY 2025, induced by solid wage growth. This tells us that a rate hike is only a matter of time – but with the BoJ reconfirming its patient easing stance, the timing remains uncertain.

## BoJ outlook

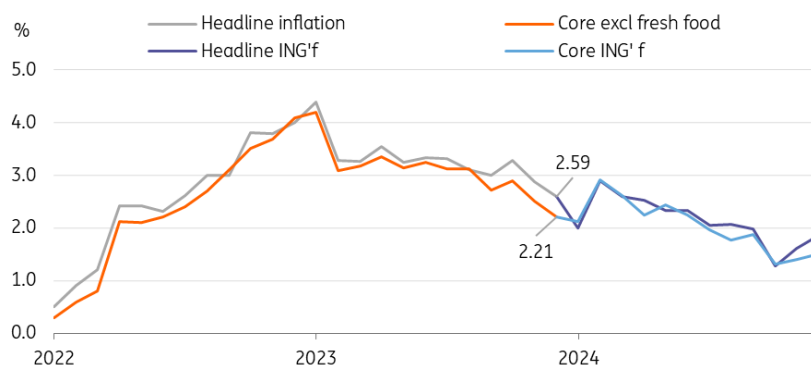
Market bets on an April rate hike increased sharply after today's decision, but for now, we retain our long-standing view of the first rate hike materialising in June. Of course, this could change depending on upcoming inflation trends and growth conditions.

There was no change in the forward guidance from today's statement, and we don't think the BoJ will deliver any policy changes at its next meeting in March. We also don't expect it to make any noise by delivering a surprise policy change at the end of the fiscal year. Governor Ueda has stated that more information will be available ahead of the April meeting than in March, so we're inclined to think that the latter is probably off the table.

There are several areas to follow to gauge the precise timing of the BoJ's policy change, but inflation should be considered the most important of them all. In our view, the inflation path up until April will be quite bumpy, exacerbated by the government's energy subsidy programmes. Consumer inflation has slowed over the past two months as the government renewed some of the subsidy programmes from last November, combined with softening oil prices. We expect inflation to move even lower in January (vs 2.2% in December) but pick up quite sharply again in February.

April CPI is a key piece of data for judging the inflation trend, but by the time the April meeting is held, the nationwide CPI report won't yet be available. April is also in the middle of the wage-negotiating Shunto season. While Governor Ueda mentioned that there isn't any need to wait to gather all data from small firms, we believe that the BoJ will wait a couple of more months to see if the wage growth could actually lead to sustain inflationary pressure – particularly in service prices. The BoJ will take orderly steps, including forward guidance being revised before any action is taken. We think that this revision will likely happen in April. Taking these factors into consideration, we still expect the Bank of Japan to announce its first rate hike in June for now.

## Choppy inflation is expected at least for 1Q24



Source: CEIC and ING estimate

## FX: Not hawkish enough

USD/JPY held pretty steady after the release of the BoJ decision but dropped around 0.7% as Governor Ueda hinted that wages and prices were heading in the direction of price stability. The same thing occurred in the JGB market, with 10-year JGB yields edging about 3-4bps higher around the same time as USD/JPY sold off.

As above, market expectations of a shift in BoJ policy will now roll on to the 26 April meeting, when the next set of CPI forecasts will be released. Today's price action, where the yen is now handing back its short-term gains, suggests the market will be happy to park the BoJ policy normalisation story until April.

Given further upside risks to US rates over the next month – including the risk of higher Treasury yields next week, should the US quarterly refunding announcement shine a light on the US fiscal deficit – USD/JPY can probably continue to trade around this 147/148 area. And BoJ intervention remains a threat should USD/JPY trade over 150 again.

We currently have USD/JPY forecasts at 140 for the end of March and 135 for the end of June. We certainly like that direction of travel – particularly if the short-end of the US curve starts to break lower ahead of the first Fed hike, which we forecast in May. The risk is that mixed market sentiment and low volatility keep interest in the carry trade and keep the yen softer than our end-of-first quarter target.

However, we suspect carry trade investors will be increasingly turning to the Swiss franc as their preferred funding currency. The Swiss National Bank wants a weaker currency and may be the first to ease. The BoJ wants a stronger currency and will now be the only G10 central bank to hike.

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