

Japanese core inflation data supports May rate hike

Headline Japanese inflation eased in February amid lower fresh food and energy costs. But upward pressure on services and solid wage growth support a Bank of Japan rate hike in May



3.7%

Consumer inflation (YoY)

First drop in three months

Higher than expected

Japan's consumer price index eased to 3.7% year-on-year in February from 4.0% in January

The February gain was above the market consensus of 3.5%. Most of the moderation reflected energy subsidy programmes -- utilities costs are down to 6.4% from the previous 11.2% -- and tamer fresh food prices -- down to 18.8% from the previous 21.9%. Yet underlying pressures still appear to be building. Core inflation, excluding fresh food and energy, is more closely watched by

the BoJ. It edged up to 2.6% in February, from 2.5% in January. While the rate was in line with market consensus, it marks the fifth straight monthly gain.

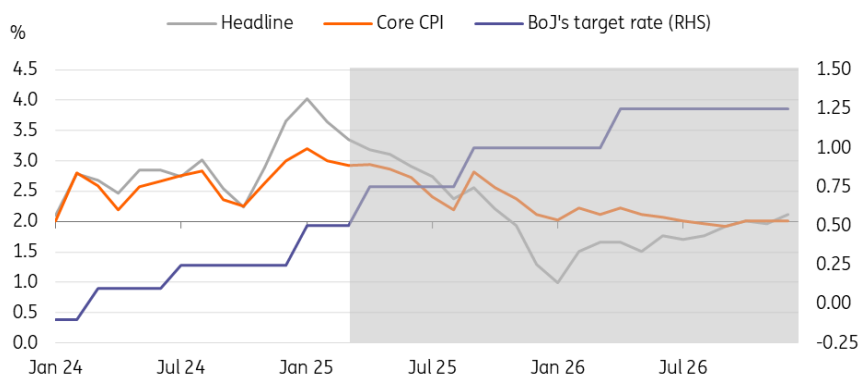
On a monthly basis, inflation fell by 0.1% month on month, seasonally adjusted, in February -- the first decline in five months. Goods prices fell by 0.5%, while services rose by 0.1%. We believe lower headline inflation is beneficial for households, indicating an easing of supply-side inflationary pressures. Given the steady rise in service prices, though, a BoJ rate hike could be justified.

BoJ watch

With this year's Shunto results likely to result in wage growth well above 5%, inflation and private consumption are worth watching. Today's inflation data shows that services prices continued to rise. The BoJ will want to see how companies pass on input price increases to retail prices. Typically, companies raise prices in the first month of their fiscal year -- April. Therefore, April data is key.

Tokyo's CPI data will be released a few days before the BoJ's April/May policy meeting. The BoJ will decide whether to hike in May or take a "wait and see" approach until June based on next month's figures. Although Governor Kazuo Ueda made much of the risks surrounding US trade policy on Wednesday, we think he's just hedging his bets -- considering it a risk factor. Therefore, if trade tensions don't escalate more than the market currently expects, they won't affect the BoJ's rate hike plans.

Core inflation is likely to stay above 2% for a considerable time



Source: CEIC, ING estimates

Author

Min Joo Kang

Senior Economist, South Korea and Japan

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.