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JAPAN

Bank of Japan won't alter its policy normalisation path

After a Japanese newspaper highlighted PM Sanae Takaichi's tougher tone on future rate hikes, and following today's announcement of two dovish-leaning Bank of Japan board nominees, the yen fell against the US dollar. However, we do not expect this to prompt the BoJ to alter its gradual approach to policy normalisation



The Bank of Japan headquarters in Tokyo

The Bank of Japan will base its rate hike decision on data, despite dovish tilt on board and government pressures

Despite ongoing concerns regarding the Bank of Japan's independence from government influence, the BoJ unanimously decided to raise rates in December. The Board consists of nine members: the governor, two deputy governors, and six others. With the appointment of two new members, a broader range of perspectives will be brought to monetary policy discussions, but no single view is expected to dominate decisions. Looking ahead, increased complexity in rate decisions and more divided votes are anticipated. Nevertheless, the board will continue to base its decisions on economic data.

Two new academic candidates with “reflationist” views were nominated by the government

today to replace board members Asahi Noguchi and Junko Nakagawa, who are retiring in March and June. The market appears to anticipate that these two members (pending approval) – Ayano Sato, an Aoyama Gakuin University professor and Toichiro Asada, a Chuo University professor – will serve as strong opponents to monetary tightening, thereby establishing a consistent bloc likely to dissent against any prospective rate increases.

However, in our view, the overall dove-hawk balance on board is likely to be tilted slightly toward the dovish side but unlikely to change significantly from its current state because Noguchi is already the most dovish member and Nakagawa tends to be neutral or dovish among current board members.

If upcoming growth and inflation figures are consistent with the Bank of Japan's projections, the process of policy normalisation is expected to proceed. Nevertheless, the introduction of two dovish members may result in the adoption of stricter criteria for rate decisions and an increase in divided votes. Meanwhile, the most hawkish members – Hajime Takata and Naoki Tamura – consistently advocate for additional interest rate hikes.

Furthermore, although Takaichi favours maintaining easing monetary conditions, should data indicate the necessity to adjust the easiness – evidenced by strong spring wage negotiations and sticky inflation data – the Bank of Japan is likely to proceed with rate hikes.

We continue to believe the Bank of Japan will hike in June

In this sense, we judge that an interest rate hike during the first half of the year, when inflation is expected to slow sharply, is unlikely. On Friday, Tokyo CPI data will be released, and the market expects core inflation excluding fresh food to decelerate to 1.7% YoY (ING 1.6%) in February from 2.0% in January. Energy subsidies and a stabilisation in food prices are the main reasons for further deceleration.

The weak JPY should be a concern for the BoJ as it may push up inflation, but the BoJ is not likely to target JPY stabilisation with rate hikes. The BoJ should examine financial conditions more carefully and determine whether recent market rate movements have tightened liquidity and credit conditions or not. The Bank of Japan is expected to adjust the pace of its bond purchases for the fiscal year 2027, with an announcement likely at the April meeting.

We continue to believe it is more probable that a rate hike will occur in June rather than in April, following confirmation of the Spring Wage Negotiations securing above 5% growth and April inflation data.

Also, worth noting, that previously there have been instances where government nominees were rejected by parliament. With the LDP holding a supermajority in the lower house, the opposition in the upper house plays a crucial role. Thus, the confirmation process of the two candidates will be closely watched by market participants.

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