Daiwa Securities

Daiwa's View

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Cherry blossoms blooming: BOJ prepares to end NIRP

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Environment for policy normalization in place after BOJ confirms big wage hikes

According to the first tally of wage negotiation responses by Japanese Trade Union Confederation (Rengo) as of 15 March, its member unions have won an average wage hike of 5.28% (3.80% hike last year). This was the first hike of more than 5% in 33 years and much stronger than expected. This year RENGO targeted an average wage hike of "5% or more." Considering this high level from the initial tally, that goal now seems likely even if there are some modest downward revisions ahead of the final tally due out in early July. Also, the base salary increase portion, which is clearly known, exceeded 3% to hit 3.70% (2.33% last year). The BOJ previously indicated that achieving its 2% price stability target would require at least 3% nominal wage growth. That goal was successfully cleared. A virtuous cycle between wages and prices is starting to turn. All told, we can probably say that the environment is ripe for the BOJ to now start normalizing policy (the cherry blossoms are blooming).

Such results on the wage front sparked a slew of media reports about the BOJ's next likely move. Just after 4:00 p.m. on 15 March, Jiji Press ran an article entitled "BOJ in Final Stages of Talks to End Negative Rate Policy (after confirming large wage hikes)." Then, just after 10:00 p.m. on that day, Kyodo News ran an article in which it said the BOJ has decided to end negative interest rates at its 19 March Monetary Policy Board meeting, in what would be the first hike in 17 years, and start normalizing its large-scale monetary easing (after realizing virtuous cycle for wage growth and price hikes). Then at 2:00 a.m. on 16 March, the *Nikkei* online edition ran an article entitled "BOJ to End Negative Rates, Marking First Hike in 17 Years (amid rising wages)." There is a growing consensus within the government that ending the BOJ's negative interest rate policy (NIRP) in March is acceptable. The 16 March morning edition of the *Yomiuri Shimbun* reported that the BOJ is considering major changes to monetary policy and may end NIRP. However, we should note that the article ended with the proviso that the "BOJ may postpone its consideration of the policy shift until it meets on April 25-26 (if policy board concludes that information and data are not sufficient)." Ultimately, the decision lies with BOJ Governor Kazuo Ueda and that is the point that seems hard to read. In any event, the adjustment for ending NIRP began on the 15 March and the result (cherry blossom) will be revealed on the 19 March.

NIRP, which the BOJ introduced on 29 January 2016, has now been in place for more than eight years. At long last, the curtain now appears to be falling on NIRP. The author was opposed to NIRP when it was enacted eight years ago[1]. At that time, the author wrote in a report, "(as a long-time BOJ watcher) I have a sense of disappointment about the introduction of negative interest rates, which feels like the final word was given for a never-ending monetary policy journey (exit quite far away and steep)." Since 2020, there was global compound inflation (structural changes in global economy) brought about by the coronavirus outbreak. Even in Japan, a virtuous cycle of higher wages and prices seems to have started turning. Changes in firms' wage and pricing behavior were brought about by external inflationary pressures and wages rose due to adaptive expectations from higher prices. This, combined with a labor shortage due to a declining working population, has led to a widespread increase in service prices as well. Such changes have taken much longer than in other countries, but now is the time for Japan to move toward monetary policy normalization.

Five questions to answer at BOJ's March meeting

On 17 March, the *Nikkei* online edition ran an article entitled, "BOJ to Focus on Discussing Monetary Easing Revisions? Interest in YCC/ETFs." This article presented five key questions to be answered during the Bank's March meeting. Specifically, the five questions are: (1) What will happen to policy rate after ending NIRP? (2) What will happen to YCC? (3) What will happen to ETF purchases? (4) What is the outlook for interest rates? and (5) Will the yen depreciation trend change?

Let's start with question (1) What will happen to policy rate after ending NIRP? After 10:00 p.m. on 14 March, Jiji Press released an article entitled "BOJ in Final Stages of Talks to End Negative Rate Policy" in which the uncollateralized overnight call rate, as the new policy rate, will be guided to 0.0%~0.1%. The author thought that if the yield curve control (YCC) framework remained in place, a range for the uncollateralized overnight call rate would be offered as a short-term interest rate reference rate, not as a guidance. However, if YCC is eliminated, it seems natural to return to the pre-YCC approach. Even in his 8 February speech, BOJ Deputy Governor Shinichi Uchida mentioned raising the policy interest rate by 0.1% if there is a return to conditions before the introduction of NIRP. Here, we can assume the policy rate is an uncollateralized overnight call rate range and not the 0.1% interest rate attached to excess reserves in current accounts held by financial institutions at the Bank (Chart 1).

As for (2) What will happen to YCC, we looked at the 29 February speech by BOJ Policy Board member Hajime Takata. In this speech, the expression "terminating the yield curve control framework" appeared before the expression "terminating the negative interest rate policy." Takata seems to have provided a hint based on that ordering.

[1] I advocated side effects of NIRP at the *Nikkei* New Year economic seminar held on 15 Jan 2016, two weeks before BOJ decided to introduce NIRP.

Chart 1: Considerations Pertaining to Revision of BOJ's Large-Scale Easing (as of 18 Mar 2024)

Considerations	Content	Market Impact
Ending YCC, NIRP	BOJ eliminates YCC on grounds that achieving 2% price stability target in sustained and stable manner is now expected. Also ends NIRP. Explanation that accommodative conditions to continue even after ending YCC, NIRP. 10yr JGB yield target abolished. While largely left to the market, BOJ will clearly indicate that measures to prevent temporary sharp rises in long-term yields through fixed-rate JGB purchase operations will continue.	Market persistently anticipating that NIRP will end by this spring, which is within expectations. No major disruptions if market recognizes that there is considerable distance to go before next rate hike. Market believes ending 10yr JGB yield target will not lead to yield spikes, even if yields rise for a time, as the BOJ demonstrates it is ready to prevent yield spikes.
Tiered current account structure	After ending NIRP, it is highly likely that the rate on excess reserves will be set at +0.1%, with the BOJ changing from a three-tiered to a single-tiered structure, based on expectations that the release of funds will be considerably reduced.	Some disadvantages for intermediary functions, but advantages for asset management side. Brokers will need to generate revenue elsewhere.
Policy interest rate / Guidelines for money market operations	Regarding short-term rate, uncollateralized O/N call rate is set as new policy interest rate and guided in the "0.0% to 0.1%" range.	No major market upheaval, as expected. Likely to land around 0.07%, slightly below 0.1%.
JGB purchases	Until the next rate hike, quantitative indicators will be used to control yields. BOJ indicates continued purchases (just under Y6tn per month) for time being to avoid discontinuity.	If JGB purchasing pace continues for time being, unlikely to see sudden change in yield levels.
ETF and REIT purchases	To terminate new purchases of ETFs and REITs. Need to consider measures to separate balances held from BOJ's balance sheet in the future.	No significant impact as new purchases already suspended.
Overshoot commitment	Core CPI has already held above 2% for about 18 months and the overshoot commitment will be removed as soon as negative interest rates are ended.	Despite an impression that the commitment to "amount" will be lost, BOJ expected to handle JGB purchases in a manner that avoids discontinuity, so no significant impact.
Rate hiking path	New guidelines will depend on the economic and price situation. Checks to be conducted every three months and, with a moderate economic recovery, one more rate hike (+0.25%) before the end of year is possible if there are upside price risks. Declaration by government that deflation is over would be an endorsement.	After negative rates are ended, the market will enter a period of groping for when the next rate hike will occur. Here, the main point of interest is the possibility that, in addition to Japan's economic and price trends, the forex rate level may also have an impact (changes prompted by forex rate level).

Source: Compiled by Daiwa based on various information.
Note: Content and market impact are author's opinion.

Until then, the author had believed that the YCC framework would remain in place in order to avoid a sharp rise in 10-year JGB yields. If the YCC policy is eliminated, the BOJ could still maintain market stability by continuing to purchase JGBs. We expect the BOJ to carefully respond in terms of the scale of its JGB purchases so that there is no discontinuity before and after the policy revision, and so that 10-year JGB yields do not rise sharply. As for the scale of JGB purchases, the points of interest are whether the Bank provides any specific numbers, whether the current pace remains unchanged, and whether such information is included in the body of the statement, a footnote, or on a separate page?

As for (3) What will happen to ETF purchases, in the abovementioned 8 February speech, Uchida said, "Once the Bank revises the large-scale monetary easing, it would be natural to discontinue these purchases." Soon after that, TOPIX fell by more than 2% on 11 March, but the BOJ did not step in to purchase ETFs, which became a topic on the market. However, given the market's current high level, there was no need to support the market through the purchase of ETFs. Here, the BOJ was probably able to simply rely on the market's price formation.

Market's main concern is future of interest rates (= rate hiking path)

With the ending of NIRP now seen as almost a certainty, "(4) What is the outlook for interest rates = rate hike path (rate hiking pace)" is probably the market's main concern right now. In regards to this question, a "good student" of monetary policy would answer that if the realization of the 2% price stability target is in sight, then a subsequent rate hike should likewise be in view. However, the pace seems uncertain and slow. The only previous example is during the 2006-2007 period under then-BOJ Governor Toshihiko Fukui. Quantitative easing was ended in March 2006, the short-term interest rate was raised to 0.25% four months later in July 2006, and then to 0.5% seven months later in February 2007, at which time the rate-hiking phase was ended. This time the BOJ is likely to follow the same approach as in 2006. Specifically, even if interest rates are raised, the environment will remain accommodative (lower than neutral rate of interest) and that adjustments will be made in response to economic and price conditions. Normally, conditions would be examined every three months, just as the *Outlook Report* is released each quarter.

In this case, if NIRP is ended in March, conditions would be examined three months later in June. Production and consumption have turned sluggish in the current Jan-Mar quarter. Whether production and consumption pick up in the Apr-Jun quarter and whether prices do not rise more than expected going forward are two important points to confirm. In June, the government will execute income tax cut refunds, but the effects will not be seen as of June. In terms of prices, free high school tuition will start in April, but the spread of service price increases should be checked at the start of the new fiscal year. By May, a decision will be made on whether or not to extend the government's current measures to offset higher prices (electricity, gas prices). In any event, the price growth rate will be easier to control, on the surface, and an accelerated rise in prices during the Apr-Jun quarter seems unlikely. Meanwhile, we will need to wait a little longer to see the effect of the JFTC's guidelines on price negotiations aimed at enabling SMEs to pass on the increases in labor costs to their prices when conducting business with large companies.

Meanwhile, by June we will have a better idea of the timing for the start of interest rate cuts in the US and Europe, as well as the distance between them. If the US economy remains resilient and inflation remains tenacious, the view that the start of rate cuts will be delayed and that the pace of rate cuts will likely slow would probably strengthen. If the US only makes a corrective rate cut, the BOJ could potentially make an additional rate hike. At that time, a declaration by the government that deflation is over would be an endorsement. At this juncture, the author expects the next rate hike (to 0.25%), if any, to occur six months from now, around September or October. In that case, as well, the speech by Uchida, slated for around August (after July *Outlook Report*), will likely provide some major hints.

USD appreciation (US-side factors), JPY depreciation (Japan-side factors) to continue

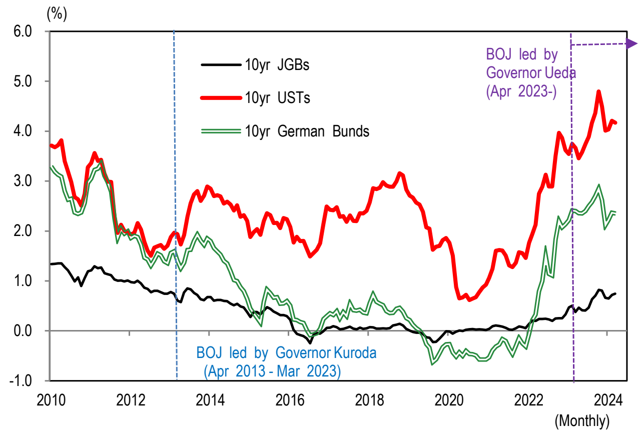
The fifth and final point for the March meeting is "Will the yen depreciation trend change." Factoring in the BOJ ending NIRP, the USD/JPY has already temporarily dipped below the USD/JPY147 line on 8, 11, and 12 March. However, the yen did not appreciate further, based on the perception that the pace of interest rate hikes after ending NIRP will be slow. Rather, stronger US price data lowered expectations of an early rate cut and the 10-year US Treasury yield rose to the 4.3% level on 15 March (Chart 2). The USD/JPY has been closely tied to these developments with the pair reaching the USD/JPY149 level (stronger USD. Weaker JPY) on 15 March (Chart 3). Exchange rate movements is one of the policy reaction functions adopted by the BOJ, and it is important to note that this forex trend will likely continue.

The FOMC will meet on 19-20 March, immediately after the BOJ's March meeting. In its Summary of Economic Projections (released every three months), the growth forecast for 2024 is expected to be revised sharply upward from +1.4% as of December 2023 to around +2.0%. For that reason, the sluggish pace for the 2024 price outlook will likewise probably ease. Furthermore, the policy rate outlook (dot chart) suggests that views for 2024 may remain divided. Nevertheless, if there is a strengthening view that the start of a US rate-cutting phase will be pushed back beyond June 2024, the US dollar would gradually appreciate. For the BOJ, which wants to curb higher prices, a rise for the USD/JPY (dollar appreciation) may prompt additional interest rate hikes. At the same time, if the US economy were to unexpectedly stall in the future and enter a phase of full-fledged interest rate cuts, or if the Chinese economy were to stagnate for a prolonged period, downward pressure on the Japanese economy would likely intensify. In that case, additional rate hikes by the BOJ would become more difficult.

Expect Ueda to provide some hints about future at post-meeting press conference

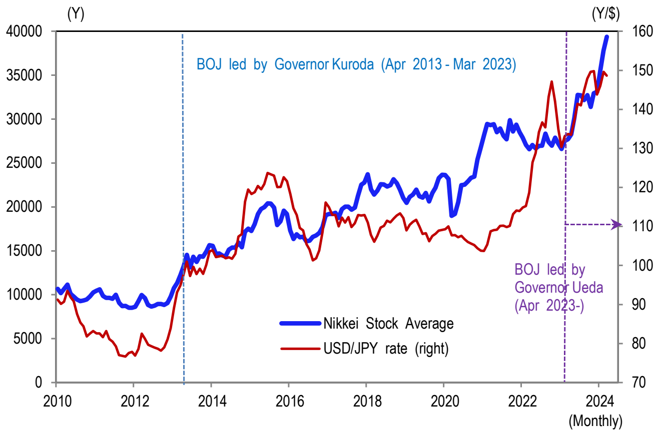
Based on the above, we expect the BOJ to not only end NIRP at its March meeting, but to also decide on a number of items to review regarding its large-scale monetary easing (Chart 1). The point of such a review would be "simple is best," with efforts made to switch to policies that are easier to understand (that said, we expect a larger number of appendices will be prepared for review, including legal changes). Under such circumstances, Ueda will need to provide careful explanations at his post-meeting press conference. At the same time, we also expect some hints about the future. This will be an opportunity to once again confirm Ueda's resolve for taking steps to normalize monetary policy.

Chart 2: Long-term Yields in Japan, US, Germany (from 2010)



Source: Bloomberg; compiled by Daiwa.
Note: Mar 2024 data uses average through the 15th.

Chart 3: Nikkei Stock Average, USD/JPY Rate (from 2010)



Source: Bloomberg; compiled by Daiwa.
Note: Mar 2024 data uses average through the 15th.

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