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Economic Commentary

BOJ Himino's speech; rate hike talks after Trump's inauguration speech likely

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- BOJ may revise upward core-core CPI forecast in Jan *Outlook Report*
- Himino's speech; BOJ to discuss Jan rate hike, but expect cautious decision
  Focus on risk of falling "behind the curve"
  BOJ to assess Trump's 20 Jan inauguration speech and subsequent market trends

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Long-term JGB yield rise originating from US continues, new catalysts include LA wildfires, rising crude oil price

Two weeks have already passed since the start of 2025. The minutes for the December FOMC meeting, released on the 8 January, show that the December interest rate cut was a close-call decision. The US employment statistics for December, released on 10 January, were stronger than the market expected. This caused expectations for another US interest rate cut to recede rapidly[1]. The 10-year UST yield briefly rose to the 4.8% level. The US economy remains resilient and, if Trump 2.0's inflationary policies are implemented in the future, higher UST yields would be natural. In addition to Trump's inauguration, two new market catalysts have emerged. The first is the worst-ever Los Angeles wildfires (since 7 Jan). Even now, there is still no prospect of when these fires will be brought under control. The cause is unknown and, while theories of administrative responsibility are flying around, losses could reach the equivalent of Y30tn. It is impossible to tell at this juncture to what extent the wildfires will impact the US economy and whether or not it will lead to fiscal stimulus measures. The second catalyst is the rising price of crude oil. On 10 January, the US Treasury Department announced that it had added a major Russian oil company to the list of targets for economic sanctions, with the aim of cutting off funds for the invasion of Ukraine. On 13 January, WTI briefly rose to the $79/bbl level. We probably need to determine whether or not this trend, as well as the relationship between the US and Russia, is only a passing phase.

In step with US trends and amid persistent expectations for a BOJ interest rate hike, the 10-year JGB yield briefly rose to 1.250% on 14 January. If the 10-year UST yield were to rise to around 5.0%, we would expect the 10-year JGB yield to likewise rise to around 1.3%. However, this could potentially be viewed as the upside ceiling in the absence of resumed US interest rate hikes. At that level, the BOJ will probably just sit back and monitor conditions.

BOJ may revise upward core-core CPI forecast in Jan *Outlook Report*

According to a 10 January Bloomberg report, there is a strong possibility that the outlook for the y/y rate of change in CPI excluding fresh food and energy (core-core CPI) will be revised upwards from the previous forecast of +2.0% for FY24 and +1.9% for FY25 in the BOJ's January *Outlook Report* (due out on 24 Jan). The main reason is the upward trend for food prices, especially rice. Yen depreciation and rising crude oil prices are also said to be contributing factors. The January *Outlook Report* will factor in the impact of the government's economic measures. However, the measures to counter rising prices, which had a temporary downward effect on the FY24 core CPI, will provide a reactionary boost for the FY25 core CPI. If these readings are averaged out, there is the view that core and core-core CPI will remain at around 2% towards FY26. At the 9 January BOJ branch managers' meeting, the key word in regards to wage hikes was "spreading" and there was a glimpse of confidence in the sustainability of wage hikes and the ability to pass on higher costs to higher prices. Conditions in Japan are moving in line with forecasts and supporting catalysts are gradually coming together. Right up until its January meeting, the BOJ wants to assess the content of Trump's inauguration speech on 20 January, as well as any new market trends following that speech. Based on that, the BOJ will make a careful decision regarding an interest rate hike.

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[1] The time at which the first US interest rate cut for 2025 is fully factored in by market has been pushed back from Jun to Sep, as of 13 Jan.

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Himino's speech; BOJ to discuss Jan rate hike, but expect cautious decision

On 14 January, BOJ Deputy Governor Ryozo Himino delivered a speech in Yokohama, his first such speech in five months. This was an important opportunity for the BOJ to communicate with the market just ahead of its 23-24 January Monetary Policy Meeting. This speech was closely monitored for any hints on the possible timing for an interest rate hike. Also, at his press conference following the BOJ's December meeting, BOJ Governor Kazuo Ueda stated that he needed a little more information to assess wages and conditions in the US. His comments on the Bank's assessment of these matters also attracted attention.

During his speech and press conference, Himino said that the Bank will examine the information it has obtained as of the January meeting and then make a judgment on an interest rate hike after considering the overall picture of the economic price outlook. He also indicated that the January meeting will include a "comprehensive judgment." Still, comments from the hawkish camp stressing that the domestic economy, including wages, is "on track" with the Bank's outlooks, stood out. In particular, the important points made in his speech were probably (1) expectations for wage hikes, (2) Trump's inauguration speech, and (3) discussing a January interest rate hike.

During his speech, Himino touched on wages. He said, "I hope to see strong wage hikes in fiscal 2025 as we did in fiscal 2024, given the high ratio of firms reporting favorable business conditions, strong corporate profits, low labor share ratio, accelerating labor shortages, employees searching and changing jobs increasingly actively." At his press conference, Himino said, "The main scenario based on the information we have so far is that the wage increase in 2025 will be as strong as in 2024." That said, the BOJ branch managers' meeting report (9 Jan) stated both sides of the argument regarding pay hikes and also included cautious opinions regarding the severity of earnings conditions, particularly among small and medium-sized enterprises. However, this speech mainly covered positive aspects. We can surmise that this content points to the BOJ's strengthening confidence in (expectations for) higher wages.

Regarding the impact of the policies of the new US administration, Himino said, "The inauguration speech next week will give us an idea on the broad direction of policies the new administration will pursue." Specifically, during his post-speech press conference, Himino said that the Bank will be listening to Trump's inauguration speech for hints about his likely policies in terms of striking the right balance, schedule progress, and any new policies that have not been presented before. At the very least, the Bank probably assumes that the uncertainty surrounding US economic policy is likely to decrease following Trump's inauguration speech on 20 January. Meanwhile, Himino also touched on the US economy, saying, "Many expect the US economy to continue performing strong over the coming period, which seems to be in contrast with the outlook entertained around August last year when downside risks were the focus." We share the view that the US economy is resilient. With the downside risks to the US economy easing due to the results of the US employment statistics for December (released on 10 Jan), we assume that the BOJ will continue assessing the US economic policies.

In addition, Himino stated in his speech that, "The board will have discussion to decide whether or not to raise the policy rate (in January)." Since after the post-meeting press conference in December, the BOJ often said that it was "cautiously considering" a rate hike. However, this time around Himino said that the BOJ will, "have discussions" about a rate hike. This wording seems to suggest that progress has been made toward a decision to hike rates again in January. However, it is important to note that, at present, this is just the discussion stage and an interest rate hike in January has not been confirmed. We believe that the decision on whether to hike interest rates in January will be made with caution, taking into account Trump's inauguration speech and subsequent market trends.

Changes since Dec meeting: positive wage trends, stronger USD after Fed's rate cut expectations receded

We were left with the impression that the BOJ was not in a hurry to raise interest rates based on the statements it made after the post-meeting conference in December. However, the background factors to the hawkish stance at Himino's press conference this time is thought to be (1) positive talk about wages and (2) growing risk of falling behind the curve.

In particular, the background factors for this risk of falling "behind the curve" are (1) the retreat in expectations for a US interest rate cut due to the strength of the US economy and (2) the accompanying rise in UST yields and the strength of the US dollar. Himino indicated during his press conference that the m/m rate of change in import prices in yen terms was quite high in

October and November 2024 and the Bank will closely monitor the impact on prices. It seems to us that the risk of upward price fluctuations due to exchange rates is increasing as compared to when Ueda said at his December post-meeting press conference, “When looking at the on-year change in import prices, the situation is relatively calm.”

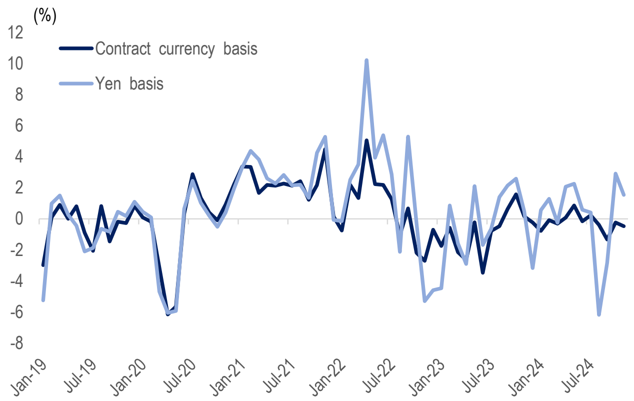
In this regard, the m/m rate of change in import prices (total average, yen basis) turned positive in October (+2.9%) and November (+1.5%). Given that the m/m rate of change in import prices (total average, contract currency basis) was -0.2% in October and -0.5% in November, it can be said that the recent rise in import prices is due to the exchange rate (Chart 1).

Also, the yen depreciation since December has continued in January and crude oil prices have also been rising recently. There is also likely to be upward pressure on import prices announced in the future. Furthermore, given the resilience of the US economy and UST yields stuck at high levels due to the “Trump 2.0” inflationary policies, the possibility of a strong dollar is increasing. The fact that the dollar is unlikely to fall vs the yen will also contribute to keeping import prices at high levels.

Recently, there has been a delay in the positive turnaround for real wages, reflecting the unexpectedly high rate of price increases, particularly food prices (Chart 2). In order to ensure that the economy does not significantly deviate from the forecast, we also need to be aware of the risk that rising prices could cause a delay for a domestic demand recovery. However, as mentioned earlier, the BOJ will still make a “comprehensive judgment” before determining whether it will raise interest rates in January. The period up until the January meeting will likely be a time for the BOJ to assess Trump’s inauguration speech on 20 January and any subsequent changes to market trends.

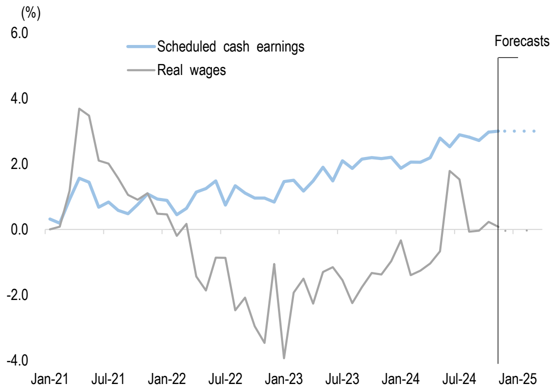
Minister of State for Economic and Fiscal Policy Ryosei Akazawa said at a press conference following the 14 January cabinet meeting, “We are working well with the Bank of Japan. We are entrusting all the specific monetary policy methods to the Bank.” In this manner, the government has indicated that it will leave any decision on hiking rates in the hands of the BOJ. At this juncture, there seems to be little chance that the government decisions will hinder a possible January interest rate hike.

Chart 1: Import Price Index (m/m)



Source: BOJ; compiled by Daiwa.

Chart 2: Forecasts for Real Wages



Source: Ministry of Health, Labour and Welfare (MHLW); compiled by Daiwa.

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