

FX Pulse

BOJ board member appointments

- Nominees need not be reflationists

FICC Research Dept.

Kenta Tadaide81-3-5555-8466
kenta.tadaide@daiwa.co.jp**Asuka Ichikawa**81-3-5555-8761
asuka.ichikawa@daiwa.co.jp

Daiwa Securities Co. Ltd.

Focus shifts to assessing commitment to fiscal discipline

In her 20 February policy address, Prime Minister Sanae Takaichi argued for a shift toward "responsible, proactive fiscal policy" with the aim of strengthening Japan's comprehensive national power. Noting that Japan's potential growth rate lags behind other major advanced economies despite comparable technological innovation and labor efficiency, she stated that "what is overwhelmingly lacking is domestic investment, and we will carry out a thorough overhaul." She stated that this is the purpose of the "responsible, proactive fiscal policy," which she said would "break the cycle of excessive austerity and underinvestment in the future that has persisted for years."

In the speech, Takaichi explained that "crisis management and growth investment will be managed under a separate multi-year budget framework designed to bring down the government debt-to-GDP ratio." However, she stressed that "this is not a reckless fiscal policy," pledging to "ensure that government debt grows more slowly than GDP and steadily bring down the government debt-to-GDP ratio" and to "ensure fiscal sustainability and secure market confidence," adding that it will "clearly define specific indicators."

We think Takaichi is correct to say that more domestic investment is needed, and she declared her intention to "press the growth switch again and again and again." However, the government "taking the lead" will not necessarily translate directly into more vigorous private-sector investment. If the market perceives the government as overestimating GDP growth and tax revenue gains from increased fiscal spending, fiscal concerns will resurface. In the current environment of rising prices, the Takaichi administration's economic policies will also be unable to dispel concerns about demand-driven inflation from fiscal expansion. Having exited deflation, what Japan needs now is not demand stimulus but a growth strategy, and the government also needs to advance deregulation in a balanced manner, including labor market reform.

Elsewhere, the government intends to limit its proposed suspension of the consumption tax on food to two years and not issue deficit-financing bonds. However, questions remain about how it will fund the cut, and there are also concerns about its ability to restore the original 8% rate after cutting it to zero. The market will also be closely watching how the government plans to fund the large fiscal outlays for defense spending, crisis management investment, and growth investment.

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We will be monitoring fiscal policy as discussions progress. Minister of Finance Satsuki Katayama indicated that the government aims to present an interim report on the consumption tax cut "before summer, in June" and that "the system needs to be in place by then." We will also need to assess its Basic Policy on Economic and Fiscal Management and Reform (basic policy), which will similarly be drawn up in June.

On monetary policy, Takaichi met with Bank of Japan (BOJ) Governor Kazuo Ueda at the prime minister's official residence on 16 February for around 15 minutes. After the meeting, Governor Ueda described it as "a general exchange of views on the economy and financial conditions," stating that "while I cannot discuss specifics, we met for regular, general discussions." When reporters asked if he had secured the prime minister's understanding of the BOJ's stance on monetary policy and rate hikes, he said he had "nothing specific to share," and when asked if the prime minister had made any requests, he responded that "there were none in particular."

The government is expected to submit candidates for new BOJ policy board members to the Diet this week (25 Feb). It will reportedly present proposed successors both for Asahi Noguchi, whose term expires at the end of March, and Junko Nakagawa, who serves through end-June.

The market is watching how much of a reflationist skew the two candidates have. Kyoto University adjunct professor Etsuro Honda, who is seen as one of Takaichi's economic advisers, told Reuters in a 13 February interview that "Ms. Takaichi understands that with deflation behind us and growth strategy now the priority, the Japanese economy has moved on from the deflationary Abe era." On the new BOJ board member candidates, his view was that "they do not need to be reflationists who favour strong monetary easing."

If both nominees are reflationists, this would likely trigger more JPY selling, while if neither is, JPY would likely strengthen. The tricky scenario is if one is a reflationist and the other is not. A January Bloomberg survey found that around 60% of BOJ watchers expect Noguchi's successor to be a "strong reflationist." We therefore think the market already prices in to some extent the possibility of one reflationist nominee, but it could still react to that scenario by selling the yen.

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