Daiwa's View

September BOJ meeting: Focus on dissenting votes and government representatives

➢ Reading the administration's true position from the voting outcome

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Media reports that the "BOJ is set to raise rates to 1.25% this month" point to prior coordination

At the BOJ's Monetary Policy Meeting (MPM) on 17-18 September, the policy rate is highly likely to be raised from the current level of around 1.0% to around 1.25%. On 8 September, Kyodo News and the *Sankei Shimbun* reported that the BOJ intended to decide on a rate hike at its September meeting and had informed the government of this policy. A notable feature of the two reports is that, with around 10 days remaining before the meeting, they stated definitively that the BOJ was "set to raise rates," rather than merely "considering a rate hike." They also explicitly identified the policy rate as around 1.25%, effectively ruling out some market speculation about a 50bp rate hike.

The market has already almost fully priced in a 25bp rate hike in September. The new information provided by Kyodo News and the *Sankei Shimbun* is that the BOJ's leadership has finalized its proposed rate hike and has already explained the plan to the government. Based on the normal policy decision-making process, the leadership is likely to have a reasonable sense that it has secured the support needed for the proposal to pass at the MPM. The *Sankei Shimbun* also reported that the BOJ had informed the government of its plan to raise rates. The government's acceptance of the move appears to have contributed to the definitive tone of these reports. At a minimum, the government has shown no intention of blocking this rate hike. A senior administration official's comment that "this is not a matter of supporting or opposing the move" also suggests that the government is prepared to accept it.

The views of BOJ sources, as reported by Reuters on 8 September, is also consistent with the 25bp rate-hike scenario presented by Kyodo News and the *Sankei Shimbun*. A widely held view within the BOJ is that prices have generally moved in line with its outlook and that neither inflationary pressures urgent enough to require rapid monetary tightening nor new upside risks have been identified. The Reuters report also noted the need to assess the cumulative impact of the rate hikes implemented to date on households and businesses. Accordingly, even if the BOJ decides to raise rates, the increase would likely be limited to the usual 25bp. The yen's rebound from around USD/JPY164 in late July to the 152 range has also reduced the need for a larger rate hike.

BOJ sources have also expressed the view that "**if around two additional rate hikes can be implemented by year-end, there is no need to raise rates by 50bp in a single move**," suggesting that a December rate hike remains an option following the September move. The BOJ continues to monitor developments in the Middle East, wage increases stemming from labor shortages, and rising import prices due to yen depreciation. It is also considering shortening the interval between rate hikes to roughly once per quarter. The emerging picture is that the BOJ will opt for a 25bp rate hike at its September meeting and then decide on additional rate increases in light of subsequent developments in inflation and forex rates.

What dissenting votes would reveal about the administration's position

With the recent reports making a 25bp rate hike an almost certain outcome, the significance of how the Policy Board members vote at the meeting has, if anything, increased. Particular attention will focus on whether Policy Board members Toichiro Asada and Ayano Sato vote against the rate hike.

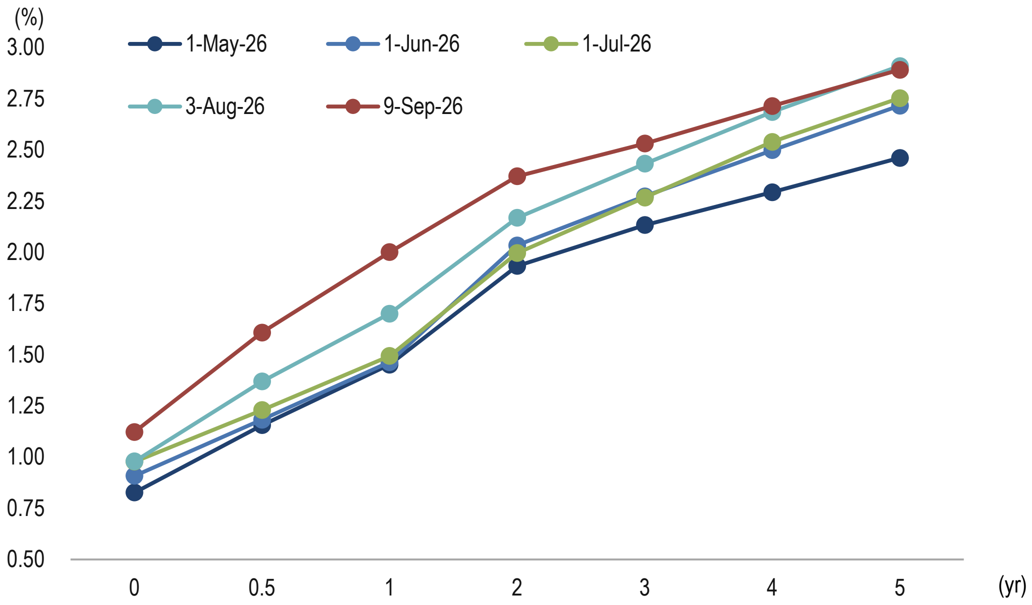
Both members are perceived by the market as holding monetary policy views similar to those of the current administration's policy advisers (economic advisers). If both were to dissent, even if the policy rate were raised to 1.25% as expected, the market could increasingly interpret their votes as a sign that the administration and its policy advisers remain cautious about accelerating the pace of rate hikes. The market's interpretation would likely differ depending on whether only one member dissented or both voted against the rate hike.

The voting outcome alone would not reveal whether their dissent reflected each member's own assessment of the economy and prices or the extent to which it reflected the preferences of those close to the administration. Even so, the market is likely to use their votes as a signal of the distance between the administration and the BOJ. The voting outcome will therefore indicate whether the government's acceptance the rate hike, conveyed in the recent media reports, and the voting behavior of the Policy Board members point in the same direction.

The yen's rebound to date and the flattening of the yield curve have partly reflected renewed confidence that the BOJ will be able to implement the policies it considers necessary to achieve price stability. In addition to moves by the Japanese and US authorities since the end of July to correct excessive yen depreciation, this perception was reinforced by Policy Board member Hajime Takata's indication, albeit by the most hawkish member of the Board, that the BOJ could shift from its conventional approach of raising rates at fixed intervals to a more flexible approach based on economic and price conditions.

The future pace of rate hikes and the terminal rate will depend on developments in crude oil prices, forex rates, wages, AI-related demand, and other factors. Financial markets also lack a clear consensus on how quickly and how far the policy rate should be raised. The current appreciation of the yen and flattening of the yield curve reflect the market's view that the BOJ can take the policy action required as conditions change.

Market Expectations for Japan's Policy Interest Rate



Source: Bloomberg; compiled by Daiwa.

Accordingly, if both Policy Board members Asada and Sato were to dissent and the government subsequently made comments cautioning against a faster pace of rate hikes, the view that the BOJ's policy conduct remains subject to political constraints could gain traction. In that case, concerns that the BOJ is behind the curve, which have receded as markets have increasingly priced in rate hikes, could return to the fore. The underlying premise that has supported yen appreciation and yield curve flattening could also weaken.

If both members vote in favor of the rate hike, the market's interpretation would be different. The BOJ's prior communication of its policy stance to the government, the administration's acceptance of the move, and broad support within the Policy Board would then be seen as elements of a consistent policy process. The administration would likely be seen as accepting not only a 25bp rate hike in September but also the possibility of shorter intervals between rate hikes if upside risks to inflation persist.

Government representation and remarks

Who represents the government at the meeting will be another point to monitor alongside the voting outcome. Under the Takaichi administration, Minoru Kiuchi, Minister of State for Economic and Fiscal Policy, has attended MPMs, signaling the administration's intention to increase its involvement in monetary policy decisions. With a Cabinet reshuffle expected around the middle of next week, attention will focus on whether Minister Kiuchi attends this meeting as well and what the government representatives say. If the Minister of State for Economic and Fiscal Policy continues to attend MPMs, this will likely be seen as indicating that the administration is maintaining its established practice of emphasizing direct involvement in monetary policy.

The government representatives are unlikely to express clear opposition to this rate hike, given reports that the BOJ communicated its rate-hike policy in advance and that the government indicated its acceptance. Their remarks may instead focus on the subsequent pace of rate hikes, the impact on households and businesses, and the need to take economic conditions into consideration. It will be necessary to confirm from the "Summary of Opinions" and other materials released at a later date whether the government's prior stance of acceptance, as conveyed in the recent media reports, was maintained in its remarks at the meeting.

At the September meeting, the 25bp rate hike, dissenting votes, and government representatives need to be assessed together. A 25bp rate hike would demonstrate the BOJ leadership's judgment that it should continue responding to upside risks to inflation while also assessing the cumulative effects of previous rate increases. Dissenting votes would indicate the extent to which the administration and its policy advisers (economic advisers) accept an acceleration in the pace of rate hikes. The government representatives in attendance and their remarks would provide a direct indication of the administration's stance.

The reports by Kyodo News and the *Sankei Shimbun* suggest that prior coordination among the BOJ's leadership, the Policy Board, and the government may be progressing ahead of a September rate hike. If the vote and the remarks by the government representatives on the day of the meeting confirm this picture, the market is likely to maintain its view that the BOJ can continue raising rates flexibly in response to price developments. If dissenting votes and government comments instead signal a strongly cautious stance, political constraints surrounding the BOJ's next move will remain a market focus even after the September rate hike.

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