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Thoughts on the BOJ you might not have heard, but should consider

From a long-time Japan watcher and global strategist

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22 February, 2023

Firstly, due to its importance, although few seem to be discussing it in the heat of the moment, Japan's inflation outlook, like the rest of the world, should greatly improve in the coming quarters, with consensus expecting January's headline CPI announced this week, or February's, likely to be the peak in year-on-year (YoY) terms, and then drop below 2% in the 3Q and to 1.4% in the 4Q. This would put, unlike in the US or Eurozone, inflation back below Japan's target, and, thus, will greatly relieve pressure on the new leadership at the BOJ and the Government overall. Also noteworthy is that Japan's western-style core CPI, which also excludes all food items, is only around 2% YoY now. No consensus forecasts are available for this latter figure, but it certainly seems that it should be significantly lower later this year.

Also crucially important to this topic is that Japan is likely the least inflationary country in the world, with workers hardly ever striking and rarely changing jobs for higher salary. Like current Governor Haruhiko Kuroda's stance, many in the BOJ will want to see more than just one round of substantial wage hikes before believing a virtuous cycle of disinflationary growth is sustainable. Indeed, many large companies are preferring to give special inflation bonuses rather than permanent, major wage hikes. Meanwhile, many SMEs apparently are not able to pay much more at all to labour this year, although minimum wage rates are rising. **Furthermore, clearly Japan's GDP has been sluggish for decades and partly due to demographics, should not greatly excel** after a quarter or two of acceleration due to increased tourism. Indeed, Japanese consumers currently are far from optimistic and have curtailed spending recently due to high inflation, with it likely requiring a sustained period of lower inflation before they become comfortable with spending more fully.

It is important to note the BOJ's historical context, as tightening just before recessions has been the bane of several BOJ Governors in the past, with 20/20- hindsight critics lambasting such as "mistakes". Indeed, Kuroda would very likely have been right in rejecting a broadening the YCC band, given the fact that China's economy was weakening under the zero-COVID Policy, and that the G-7 looked likely to enter recession, not to mention war uncertainties, but Xi Jinping's pivot to re-open and accelerate the economy, coupled with the resilience of the G-7 economies, forced a change in the BOJ's outlook, so it took action in December to broaden the band.

Clearly, the damage to many households and the government deficit would be quite large if official policy rate rises. The former have a very large portion of mortgages on a variable rate, and the monthly payments on such would greatly increase, thus harming the economy. Meanwhile, the Ministry of Finance (MOF) likely viewed the US Congressional Bureau Office's new fiscal budget projections on interest expenses with great concern given Japan's high debt to GDP ratio. No one except some wolfish hedge funds, wants Japan to experience a crisis, as such would likely have very negative global implications, with Japan likely selling large amounts of US Treasuries and other bonds, even after last year's major sales, to bolster its domestic markets. Lastly in this regard, it bears noting that fears of a JGB crisis have existed for two decades, but Japan's economic circumstances and domestic considerations have long confounded the JGB sceptics.

New BOJ leadership and team effort

The process for choosing the BOJ's leadership was confusing, as political developments in Japan often are, but optimists are calling the result a "dream team" and the nominees are all certainly highly qualified and capable.

Shinichi Uchida, the Deputy Governor nominee basically in charge of internally-sourced advice and implementation of monetary policy, was an architect of the YCC policy and the negative interest rate policy (NIRP) as a senior BOJ Director since 2012. He will be a source of tremendous knowledge of the benefits and difficulties of both these and other policies, such that no BOJ decisions will be erroneously based and each will be implemented effectively.

Ryozo Himino, the other Deputy Governor nominee, most recently headed MOF's Financial Services Bureau and held leadership posts there in its international division from 2016. He also was secretary-general of the Basel Committee on Banking Supervision and chaired the Financial Stability Board's Standing Committee on Supervisory and Regulatory Cooperation, **which are amongst the highest posts in the international financial system**. Thus, he is well known and respected domestically and internationally, and should easily be able to deal with all financial sector developments.

Rather quiet and professorial, Governor-nominee **Kazuo Ueda** is greatly respected domestically, and given his academic credentials, a PhD under Stanley Fischer at MIT and a Tokyo University professor for many of the top BOJ and MOF staff over several decades, as well as serving on the BOJ board for seven years two decades ago, he should quickly garner international respect. Indeed, his academic qualifications are more robust than most G-7 central bankers.

In public, he is likely to be somewhat arcane and highly technical in his explanations, a bit like Alan Greenspan was, when faced with questions in the Diet and by reporters. Press conferences might be rather short, not abounding in new information and somewhat inconclusive, partly due to his style but also because the BOJ and everyone else is waiting to see how this unique global situation develops in the next few months before making any momentous decisions. In the meantime, economists have been perusing Ueda's past comments and most of such have been quite dovish during the last few decades, but he has shown greater concern than Kuroda regarding the market distortions caused by some BOJ policies. However, once taking the mantle of responsibility, leaders often do not follow their ideals so strictly, especially when faced with a complex and critically important situation. This is especially applicable given that he is often called much more of a pragmatist than an ideologue, which should also affect the style and speed of policy. Lastly in this regard, the **BOJ's future will be a team effort**, including the Deputy Governors, the rest of the policy board and inputs from the public and private sector, so one should not place too much importance or criticism on one person. All central bank leaders rely heavily upon their professional staff, and success is never easy, especially in today's circumstances, so one should consider the capability of the entire team, which in Japan's case, seems very strong, well-balanced and likely very well coordinated.

Outlook

Currently, there is a wide variety of predictions for the BOJ's actions, with some expecting imminent hawkish decisions based upon some of Ueda's "anti-distortion" comments, but changes are more likely to be gradual and tentative assuming the global economy continues improving. However, if the global economy actually remains very sluggish, coupled with declining inflation, the BOJ may not need to change much at all. If there are any changes, it may first tinker with NIRP to make it less burdensome to the few institutions that are affected by it. This would conform with Ueda's desire to remove market distortions and also with the global trend away from negative rates. Further broadening the YCC band is possible this year, but not assured. Meanwhile, it doesn't seem that just shifting the target to 5-years from 10-years conforms with Ueda's "anti-distortion" preference.

Conclusion

Investors can be patient regarding predictions of the BOJ's actions over the coming months, while also analysing how the global economy transpires as a major factor in its deliberations. They can have confidence that skilled persons lead the effort and that Japan's circumstances will lead to substantially lower inflation, and, thus, reduced worries about BOJ policy and Japan's financial markets.

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