



BOJ stands pat on policy but paves way for future rate hikes

Bank sees risks to prices leaning towards the upside

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As widely expected, the Bank of Japan (BOJ) has kept interest rates on hold at 0-0.1%. The decision was unanimous. The notable change this time is the BOJ's higher headline CPI forecast of 2.8% year-on-year (y/y), compared to the previous figure of 2.4% y/y. In line with this forecast, the BOJ commented that risks to prices were leaning towards the upside.

The forecast, which is definitively in the upper 2% range, paves the way for future rate hikes, provided that the "virtuous circle" of reflation stays intact. We will be closely watching the wage data for April, which should reflect the wage rises reported by the Japanese Trade Union Confederation (Rengo) of over 5%. We will also keep a close eye on any follow-up announcements regarding subsequent wage releases. The key to the "virtuous circle" remains positive real wages; however, higher-than-expected inflation rates could disrupt this virtuous circle. The BOJ is currently monitoring data—particularly wages—to gauge when it could withdraw further accommodation. The most opportune situation for the BOJ, in our view, would be for the central bank to continue hiking rates as wage growth can absorb higher prices and also provide a surplus for additional consumption or investment.

As expected, BOJ Governor Kazuo Ueda indicated that while the yen's current level is not yet having a large impact on underlying prices, the currency's weakness was one factor that led to the upward revision in the inflation outlook. This is consistent with the idea that yen weakness could be a concern if it is persistent enough to impact household purchasing power over an extended period, even in the face of wage increases.

Meanwhile, we must remember that the dollar-yen exchange rate has also been shaped by US data and its implications for the Federal Reserve's policy outlook. Currently, it seems that many of the Fed's rate cuts initially expected for 2024 have been ruled out. However, there are sectors in the US economy where underlying inflation is slowing down. Therefore, if US inflation unexpectedly drops back to a level that suggests rate cuts, it could make dollar-yen susceptible to a correction.

The BOJ also dropped its previous wording about maintaining the same level of bond purchases. This is significant as it implies a potential reduction of stimulus with the BOJ decreasing its bond purchases even as the bonds it currently holds reach maturity.

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