Mizuho Market Comment

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MIZUHO

BoJ review – A more confident outlook

- **The BoJ hiked rates to 0.25% and aims to halve monthly JGB purchases by end FY25**
- **The Bank looks more confident on wages and concerned about the yen - key factors behind the hike**
- **Governor Ueda stressed that policy remains accommodative and more hikes are likely…**
- **…which alongside modest FOMC cuts will support a firmer JPY in coming quarters**

BoJ tightens policy
At today's policy meeting the BoJ raised the policy rate to 0.25% and said it would reduce its JGB buying by ~¥400bn/quarter until the figure hits ~¥3trn/month around end FY25, which is around half the current rate of purchases. The policy rate decision was a "surprise" in terms of timing with ~2/3 of the Bloomberg pre-meeting poll respondents seeing it coming in autumn rather than today but a hike was, nonetheless, expected at some time in the near future. The announcement on JGB purchases was on the dovish side, as it had been expected that there would be an initial large reduction followed by smaller reductions over time. However, the end point of ~¥3trn/month was in line with expectations. The initial fx market reaction to the policy announcement was somewhat muted, in part due to the media reports late in the London session yesterday, which saw USD/JPY drop ahead of the decision.

BoJ seems more confident in the outlook, especially on wages…
"*In the household sector, private consumption has been resilient despite the impact of price rises and other factors. On the wage side, moves to raise wages not only have been seen for large firms, which achieved wage increases that were significantly higher than those seen in the previous year in this year's annual spring labor-management wage negotiations, but also have been spreading across regions, industries, and firm sizes*". So said the BoJ statement released alongside today's policy decision. The first sentence on private consumption is debatable, especially given that it has made negative contributions to GDP in each of the last four quarters. The economy watchers' survey and consumer confidence data do not suggest a major turnaround any time soon. With regard to the wage data, real wages remain negative and the wage data since the June BoJ meeting have improved but not significantly. Nonetheless, the statement clearly suggests that the BoJ now believes its wage hurdle has been overcome. The statement also noted "*The year-on-year rate of change in import prices has turned positive again, and upside risks to prices require attention*". The accompanying Outlook Report also contained a few sentences that suggested increased concerns about the impact of a weak yen. It noted that the risks to prices in FY24 and FY25 were skewed to the upside.

…and will raise rates further if its optimistic outlook is realised
The policy statement went on to note that real rates were still stimulative and that "*if the outlook for economic activity and prices presented in the July Outlook Report will be realized, the Bank will accordingly continue to raise the policy interest rate and adjust the degree of monetary accommodation*". Ueda said it was best to hike bit-by-bit early rather than to undertake large hikes at a later date. He also that there was still some distance to go to neutral. There is little doubt that the BoJ expects to hike again, probably in the not too distant future. We would not be surprised if the BoJ hikes again around year end and again in spring. For now we continue to see the hiking cycle peaking out around the 1.0% level next summer, as inflation settles somewhat below the 2% level in H2-25.

It is worth comparing the BoJ's outlook with the consensus. The BoJ's FY24 GDP forecast is 0.8% vs a current consensus of 0.44%. The FY25 forecasts are closer at 1.0% vs 1.07% for the consensus. We use the JCER monthly survey of Japan economic forecasts, last published on 9 July, as the consensus view. The BoJ is upbeat on the economic outlook vs the consensus, especially in the near term. On the inflation outlook, the BoJ sees the core (ex fresh food) CPI at 2.8% in FY24 and 1.9% in FY25. The JCER consensus forecasts are 2.52% for FY24 and 1.89% for FY25. The fact that the BoJ's activity forecasts are more optimistic vs the consensus suggests downside risks to the policy outlook, although the gap is not huge.

Other considerations – politics, public pressure, Powell, positioning

The BoJ's mandate is an inflation mandate but we view politicians as more likely to try to interfere in the policy process if growth is weak and/or a weak currency is weighing on the Cabinet's approval rating, as it clearly is at the moment. In today's press conference Governor Ueda noted that the weak currency was one factor behind the decision to hike. It is certainly possible that political pressure is at least partially behind today's decision and the BoJ's more optimistic view on wages and increased concern about the currency.

The question for investors is will the political pressure ease now that USD/JPY is closer to 150 than 160? It likely will but not significantly. The USD/JPY move to date will not likely impact prices/sentiment at the retail level. We still see much of corporate Japan as uncomfortable at current levels and hoping for additional currency strength. However, at USD/JPY 150 any threat of intervention is significantly reduced.

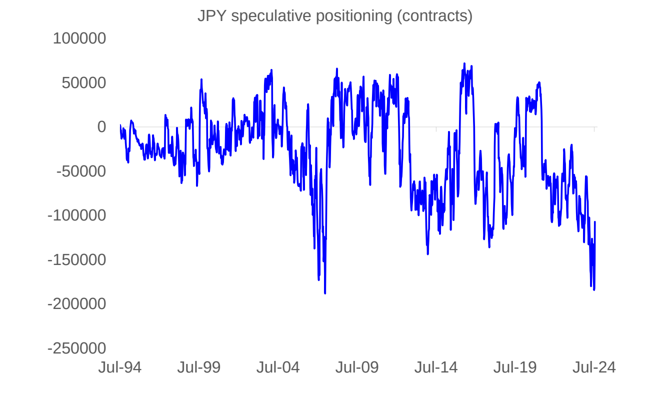
Is the BoJ worried that its window for tighter policy is closing? We suspect that this was not a big driver of today's decision. The global outlook remains reasonable and overseas central banks are only lowering rates slowly.

Later today the FOMC meets. Dec-24 FOMC pricing now sees around 2.5 x 25bp Fed cuts by year end, up from around 1.5 x 25bp at the start of July. The weak CPI report on 11 July helped boost expectations of US rate cuts. In addition, Biden bowing out of the presidential race has lessened the chances of Trump being President and there has been a sharp reversal of Trump Trades of which the firm US dollar is one. Although Powell may hint at rate cuts later this year at the 31 July FOMC meeting, he will not likely make any promises. We suspect that market pricing of the Fed for Dec-24 looks a little aggressive. As these expectations of cuts get priced out it should help the greenback to remain firm in coming months.

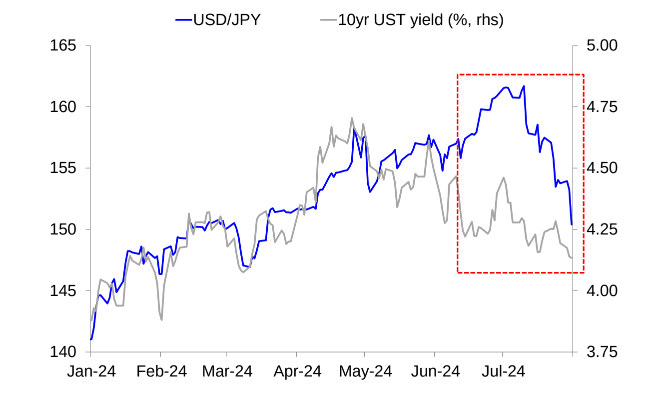
Finally, USD/JPY has moved a long way in a short space of time. A lot of this has been driven by the closing out of short JPY positions. Obviously, the change in the underlying fundamentals has been a driver of the changes in positioning but nonetheless the move in USD/JPY has been sizable and rapid. At the start of the month, speculative short JPY positioning was at multi-decade extremes. These positions have been sharply trimmed through the month. Our macro forecasts do not imply a huge reversal as in 2007/8 (which would likely happen if the US economy plunged into recession, as it did in 2008) but we think investors will continue to trim JPY shorts, albeit much more modestly in coming months. We suspect that going forward, moves in USD/JPY will be more much modest than they have been over the past month.

In the short run, we can see scope for a higher USD/JPY in August driven by 1) the fact that near-term positive surprises on the yen side seem unlikely to materialise given the hike is now in the rear view mirror and b) disappointment on the expected pace of FOMC cuts. We note that the USD/JPY RSI is below 25 which usually suggests exhaustion is setting in. However, the big picture remains one of a narrowing UST/JGB yield spread which will push USD/JPY lower in the medium term. We expect USD/JPY to drop towards the 140 level on a 12m horizon.

Short positioning has been trimmed sharply…



…against a backdrop of falling UST yields



Source: Bloomberg

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