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RATIONAL EXPECTATIONS: BOJ'S DEPARTURE FROM UNCONVENTIONAL MONETARY POLICIES SIGNAL THE END OF KURODANOMICS AS SHUNTO WAGE REALISATIONS TRUMP THE MARKETS FOR SECOND YEAR IN A ROW.....

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The BoJ board led by *Kazuo Ueda*, the academic turned BoJ governor since April, 2023 signaled a complete departure from the unconventional monetary policy pursued for long often dubbed as Kurodanomics/Abenomics that, of late, appeared little in sync with changing realms of the deglobalizing world post pandemic, with economic and technological might of Japan waning and the currency undergoing a tailspin with leveraged bets rising against the yen to big time highs.

The BoJ raised its short-term interest rates to around 0% to 0.1% from -0.1%, ending Japan's negative rates regime in place since 2016. The BoJ also announced the abolition of its radical yield curve control (YCC) policy for 10-year Japanese government bonds, which the central bank has employed to target longer-term interest rates by buying and selling bonds as necessary in a fight to boost persistently low inflation. In the roughly 8 trillion dollar JGB market, BoJ has had an overwhelming share (47.1% as on June'2023 against 43.7% pre-pandemic in Dec'19).

The pivot of the Central Bank from the YCC departure, as also applying brakes on ETF/J-REITS purchase was well communicated to markets and in fact major sections of the markets had an expectation inbuilt of the ensuing shift now (rather than April when corporate mood results from Tankan survey would be out), thus cushioning it from the volatility in the Fx markets that goes by the moniker of "widow maker".

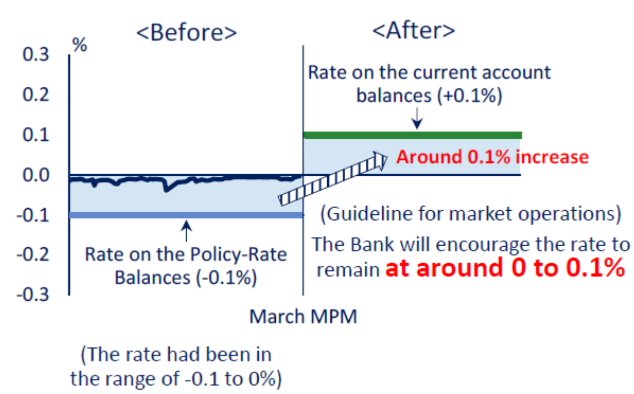
The volatility in yen witnessed since 2021 has earned the local currency an epithet of weak currency, dampening the image of the third largest economy even as its investments in recent years have incrementally been channeled towards Australia/ neighboring Asian economies. Additionally, the holdings of BoJ in US treasury at ~$1.14 trillion may find some way back home to benefit from the expected rise in benchmark yields, though not of materially significant levels as of now with constantly sliding yen ensuring carry trades by leveraged funds have peaked, their bets against the yen rising to the most in six years. **That way, the yen could witness strengthening in days to come even if it hampers the Japanese export competitiveness and gives less say/stake in the rejigged supply chains with the global economy accentuated by AI led innovations.**

Interestingly, the BoJ leaned with the early signs of the SHUNTO wage negotiations that in preliminary rounds has delivered a staggering 33-years high of 5.28% hike secured from major firms (building further upon 3.8% hike announced last year) which paves the way for setting benchmark for smaller firms/PSUs. The vibrancy in the Japanese economy needs to be a sustainable one as it finally departs from the deflationary concerns and stigma of the earlier lost decades, paving the way for Kazuo Ueda to work around the mandate of price stability in the range of 2% and keeping Japan relevant to the world.

JAPAN: THE END OF NEGATIVE INTEREST RATE ERA

- Japan's central bank (BoJ) raised interest rates today for the first time since 2007, ending the world's last negative rates regime on early signs of robust wage gains (SHUNTO) this year.
- The BoJ raised its short-term interest rates to around 0% to 0.1% from -0.1% (though not unanimously as two members voted against the action). Japan's negative rates regime had been in place since 2016.
- The BoJ also announced the abolition of its radical yield curve control (YCC) policy for 10-year Japanese government bonds, which the central bank has employed to target longer-term interest rates by buying and selling bonds as necessary.

Japan Short-term interest rate (uncollateralized overnight call rate)



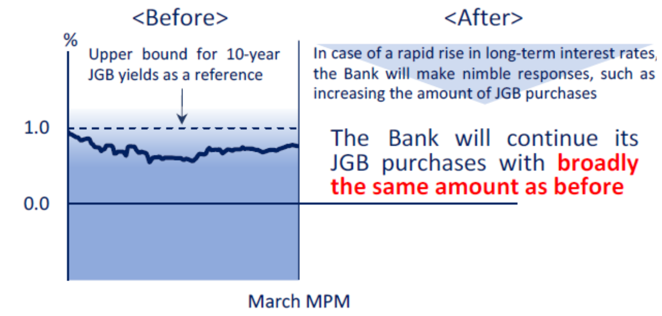
Source: BoJ; SBI Research

- On the price front, the negative contribution of energy prices to the year-on-year rate of increase in the consumer price index (CPI, all items less fresh food) has been relatively large, partly due to the government's economic measures. That said, the rate of increase in the CPI has been at around 2% recently, mainly on the back of the fact that, despite waning, the effects of a pass-through to consumer prices of cost increases led by the past rise in import prices have remained, and services prices have increased moderately. Inflation expectations have risen moderately thus.
- The BoJ had barely budged from its ultra-loose monetary policy posture despite 'core core inflation' exceeding its 2% target for more than a year, because policymakers viewed price increases were largely imported. However, there are signs of price growth that are more organic and sustainable.
- The BoJ said it would stop purchases of exchange-traded funds and Japan real estate investment trusts (J-REITS) and will slowly reduce its purchases of corporate bonds, and aims to stop this practice in about a year.
- The BoJ though will continue its purchases of Japanese government bonds with broadly the same amount as before. This represents the sharpest pull back in its decades-old radical policy tinkering in the form of asset purchases and quantitative easing to reflate the world's fourth-largest economy.

KEY FEATURES OF POLICY TWEAK

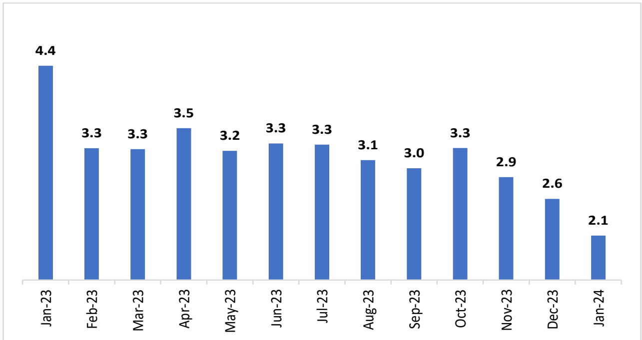
- The Bank will encourage the uncollateralized overnight call rate to remain at around 0 to 0.1% (In order to achieve this guideline, the BoJ will apply an interest rate of 0.1% to current account balances held by financial institutions at the Bank (excluding required reserve balances). The new guideline for market operations and the new interest rate on the current account balances will be effective from March 21, 2024).
- The Bank will continue its JGB purchases with broadly the same amount as before (current monthly JGB purchases are around 6 trillion JPY). In case of a rapid rise in long-term interest rates, it will make nimble responses by, for example, increasing the amount of JGB purchases and conducting fixed-rate purchase -- operations of JGBs -- both of which can be done so regardless of the monthly schedule of JGB purchases and the Funds-Supplying Operations against pooled collateral.

Japan Long-term interest rates



Source: BoJ; SBI Research

Japan CPI Inflation (% y-o-y)



Source: BoJ; SBI Research

Quarterly Schedule of Outright Purchases of Japanese Government Bonds (Apr-Jun 2024)

	Residual maturity	Purchase size per auction (100 million yen)	Frequency of auction
JGBs with coupons	Up to 1 year	1500	Once a month
	1-3 years	3000-4500	Four times a month
	3-5 years	3500-5000	Four times a month
	5-10 years	4000-5500	Four times a month
	10-25 years	1000-2000	Three times a month
	More than 25 years	500-1000	Twice a month
Inflation-indexed bonds		600	Once a month

Source: BoJ; SBI Research

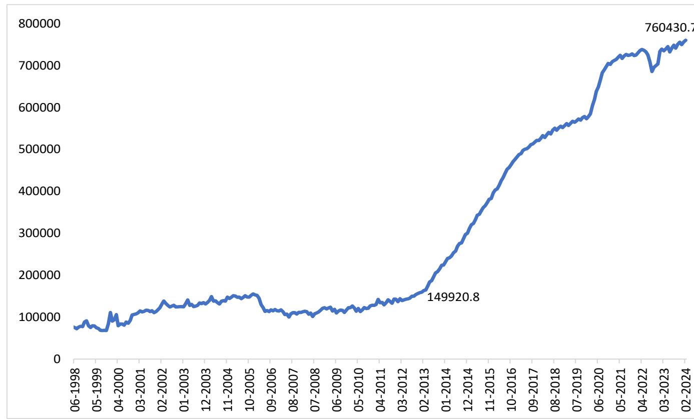
- Under asset purchases other than JGB purchases, the BoJ will discontinue purchases of ETFs and Japan-REITs. The BoJ will also gradually reduce the amount of purchases of CP and corporate bonds and will discontinue the purchases in about one year.
- The BoJ will provide loans under the Fund-Provisioning Measure to Stimulate Bank Lending, the Funds-Supplying Operation to Support Financial Institutions in Disaster Areas, and the Funds-Supplying Operations to Support Financing for Climate Change Responses with an interest rate of 0.1% and a duration of one year.

- *Kazuo Ueda*, the academic turned BoJ governor since April, 2023 at the helm of central bank's stormy affairs has successfully led the transition of BOJ from a somewhat orthodox (and a solitary figure of late as the bank continued with negative rate bias) monetary policy actions orientation cemented during famed decade of *Kurodanomics/Abenomics*, utilizing in part his long association with the Japan Economic Association as also his deep insights of the broader global markets anchored by Rational Expectations (Ueda completed his Ph. D. thesis from MIT under Stanley Fischer). **The pivot of the Bank from the YCC departure was well communicated to markets and in fact major sections of the markets had an expectation inbuilt of the ensuing shift now (rather than April), thus cushioning it from volatility in fx markets that goes by the moniker of "widow maker".**
- The volatility in yen witnessed since 2021 has earned the local currency an epithet of weak currency, dampening the image of the third largest economy (once synonymous with tech / industrial leadership across automation, heavy engineering and electronics) even as its investments in recent years have been incrementally been channeled towards Australia/ neighboring Asian economies. Additionally, the holdings of BoJ in US treasury at ~$1.14 trillion may find some way back home to benefit from the expected rise in yields, though not of materially significance as of now with constantly sliding yen ensuring carry trades by leveraged funds have peaked, their bets against the yen rising to the most in six years, basis Bloomberg. That way, the yen could witness strengthening in days to come even if it hampers the Japanese export competitiveness and less say in the rejigged supply chains.

SHUNTO NEGOTIATIONS

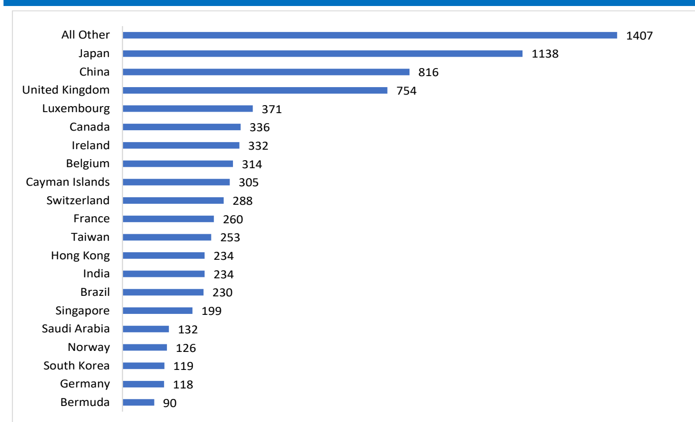
- **Interestingly, one of the critical cues taken by the BoJ board to firmly depart from the 8 years old YCC was clear indications of a vibrant wage settlement from the Japan's famous spring time wage settlements known as SHUNTO, in practice since 1955.** The spring wage offensive, a collective wage bargain led by labor/industrial unions every March that provides a framework surpassing internal individual corporate negotiations, rather creating a bargaining method whereby wage increases could be secured throughout the entire industry is keenly watched.

BOJ Total assets size (JPY bn)



Source: BoJ; SBI Research

Major holdings of US treasury in $ bn (Dec' 2023)



Source: US Department of the Treasury; SBI Research

- Policy makers use SHUNTO outcomes as proxy to gauge the state of the economy, purchasing parity and consumption trends of households and enterprises both. However, over the years, the ramifications of the SHUNTO settlements, dubbed the pattern setter, have fanned to small and medium enterprises as also the public sector.
- Ongoing negotiations trends reveal a bullish growth likely in wages, second year in a row, with Rengo, Japan's largest trade union group declaring a 5.28% wage hike this year secured from major firms, a 33 year high (and much higher than 3.80% hike announced last year which was the previous high). That should be the benchmark for smaller firms/ PSUs and explains why the BoJ did not wait till the results of Tankan survey that would be published in April, mirroring corporate economic sentiments.

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