Economic Research View

Bank of Japan Ends Negative Interest Rate Policy

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At the Bank of Japan's monetary policy meeting on March 18-19, a decision was made to begin the "exit" from its longstanding massive monetary easing policy. This decision aligns with the expectations of the financial market and the author, as the primary tool of policy will shift from quantitative and qualitative monetary easing with yield curve controls to short-term interest rates. The decision includes: 1. Encouraging the uncollateralized overnight call rate to move around 0-0.1% (providing 0.1% interest on excess reserves), 2. Continuing long-term government bond purchases at similar amounts as before and taking action with various operations in case of interest rate spikes, 3. Ending new purchases of ETFs and J-REITs, 4. Gradually reducing purchases of commercial paper and corporate bonds with the goal of concluding the practice within one year, 5. Removing the overshoot-type commitment regarding the policy of expanding the monetary base.

The Bank of Japan decides to begin the "exit" within the range of market expectations.

- **Summary of Policy Changes:** The Bank of Japan (BOJ) announced the abolition of the framework of its longstanding quantitative and qualitative monetary easing policy with yield curve controls and negative interest rates at today's Policy Board meeting, declaring that these policies have fulfilled their roles. They introduced a new monetary market adjustment policy, utilizing an interest rate of 0.1% on excess reserves to "encourage the uncollateralized overnight call rate to move around 0-0.1%". They plan to continue long-term government bond purchases at a similar amount as before (around 6 trillion yen) and have measures in place to handle any sudden increase in long-term interest rates with additional purchases or operations if necessary. New purchases of ETFs and J-REITs will be discontinued, while purchases of commercial paper and corporate bonds will be gradually reduced, with plans to end purchases in about a year. The overshoot-type commitment was deemed satisfied and thus removed from the policy statement.
- **Future Policy Management:** In the policy statement, under the 2% price stability target, the Bank of Japan stated that they will exercise monetary policy primarily through the management of short-term interest rates, based on the perspective of achieving sustainable and stable realization of their target. Given the current economic and price outlook, they believe that an accommodative monetary environment will continue for the time being and did not strongly suggest future rate hikes or maintaining interest rates at their current levels, indicating that such decisions will be dependent on economic fundamentals.
- **Background of Policy Changes:** For the sustainable and stable achievement of the 2% price stability target, the BOJ has emphasized the importance of the positive cycle between wages and prices. In the past, Governor Ueda has specifically mentioned that the results of the spring wage negotiations in 2024 and the transmission of wages to prices are crucial points (for example, during the press

conference following the October 2023 decision meeting). Although it is in line with Governor Ueda's previous statements that the policy change is likely to occur after the reassessment of the price outlook at the next meeting in April, considering the low approval ratings of the ruling Liberal Democratic Party and the potential of influential political events occurring, it is highly likely that attention was paid to avoid risks associated with postponing the decision.

■ Regarding the first point of spring wage negotiations, according to the first response compilation of the spring wage negotiations announced by the union on March 15, the average wage increase rate was at 5.28%, significantly exceeding the forecasts from the ESP Forecast Survey in February (which predicted an average total of 3.88% and an average of 4.15% from 8 institutions). In smaller unions, the wage increase rate was at 4.42%, and for fixed-term, part-time, contract workers, the hourly wage rate was 6.47%, and the monthly wage increase was 6.75%, indicating broad wage increases were confirmed. Although the wage increase rate is expected to see downward revisions with each new response, it is likely to stabilize around 5%. Against this backdrop, there is a high possibility that real income could turn positive compared to the previous year in the latter part of the year. With the expected improvement in the real income environment, there will be fixed tax cuts in June. As the momentum of the economy improves towards the summer, the BOJ's decision in March may be regarded as appropriate.

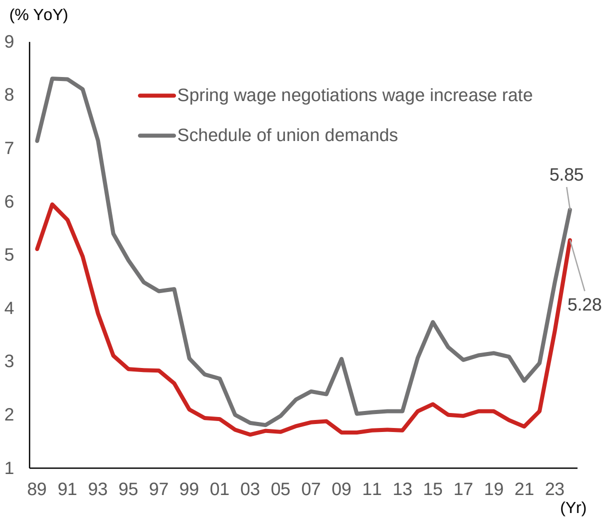
■ Regarding the second point, the subsequent transmission of wages to prices, positive evaluations have been made based on the Bank of Japan staff analysis suggesting that there are indications of a gradual spread of the movement to reflect wage increases in sales prices. The vigorous rise in general service prices, which are easily influenced by labor costs, is also seen as positive news (however, this has been mainly led by dining and accommodation expenses, and assuming certain conditions, the growth might slowdown in the latter part of the year in the author's personal view).

Monetary Policy and Environment Outlook

■ In terms of future policy interest rates, the possibility of implementing further rate hikes beyond 25 or 50 basis points by the end of 2025 is considered challenging. From a fundamental standpoint, due to the prevailing norm in Japan of "interest rates will not rise," the impact of rate hikes may be more significant compared to countries like the United States. The presence of a considerable portion of floating-rate mortgages means that an increase in short-term interest rates affecting mortgage rates could significantly deter household sentiment. Consequently, the BOJ is expected to carefully evaluate the repercussions of any rate hikes and make cautious decisions. Additionally, taking into account the implications on the BOJ's financial standing and the financial markets, prioritizing "balance sheet reduction" over "steep increases in short-term interest rates" is likely to be favored in a scenario with minimal risks of wage-price spirals. A crucial aspect would be the significance of boosting interest on excess reserves to guide policy interest rates, with the BOJ's threshold for potential deficits possibly lying around 50 basis points.

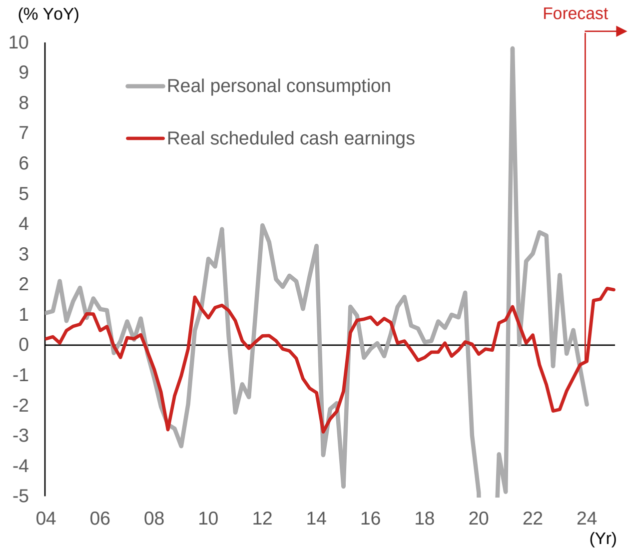
■ Support for the so called "stealth quantitative tightening"?: As mentioned earlier, the author has speculated that the BOJ may desire a form of "Stealth QT", where balance sheet reduction progresses without an explicit announcement. In today's policy statement, it was noted that long-term government bond purchases will be maintained at approximately the same level as before, which aligns almost proportionately with the redemption of government bonds held by the BOJ in 2024-2025. However, the statement also includes a note that the actual purchases will be conducted with flexibility, with some room for adjustment based on market conditions and government bond supply and demand. During phases of stable interest rates, it is conceivable that offers may be made closer to the lower end of the range indicated for government bond purchases. In the quarterly schedule for long-term government bond purchases announced today, the upper limit of the range for each offering had been lowered. The offerings in February were within this range, maintaining the pace at around 6 trillion yen annually. The removal of the overshoot-type commitment, the flexibility mentioned in the statement regarding government bond purchases, and the quarterly schedule range adjustments all seem to support the author's view on the "Stealth QT".

Figure 1. Spring Wage Negotiation - Wage Increase Rate and Union Demands



Note: Nomura Asset Management based on RENGO (Japanese Trade Union Confederation) data.

Figure 2. Real Income and Personal Consumption



Note: The forecast value of the real scheduled cash earnings is calculated from the projected value of the spring wage negotiation increase rate, i.e. the nominal scheduled cash earnings forecast minus inflation rate forecast by Nomura Asset Management.
Source: Nomura Asset Management based on the RENGO, the Bank of Japan, and CEIC data.

*This commentary is based on personal views of the author and does not necessarily represent Nomura Asset Management house view.

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