

# MARKET COMMENTARY

## Bank of Japan ends the era of negative interest rate and yield curve control

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- The Bank of Japan has ended today its Negative Interest Policy (NIRP) as well as its Yield Curve Control (YCC) policy in a single move, one month earlier than we had expected. It will target the uncollateralized overnight call rate between 0% to 0.1 %. The bank also scrapped purchases of exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) and announced to gradually reduce the amount of purchases of CP and corporate bonds.
- However, the core of its buying policy remained in place. The BoJ will continue JGB purchases with broadly the same amount as before at around JPY 6 tr per month. It also clarified that in case of a rapid rise in long-term interest rates, it stands ready to intervene, regardless of monthly schedules.
- The BoJ sees an increased likelihood that its 2% inflation target can be achieved in a stable manner. While we agree with the outlook on higher inflation, we are sceptical that this will result in more material tightening any time soon. Especially, we see no key rate hike this year. Markets seem to agree as the Yen depreciated slightly against the US-dollar and 10y JGB yield even receded a bit. The Topix was up about 1%.

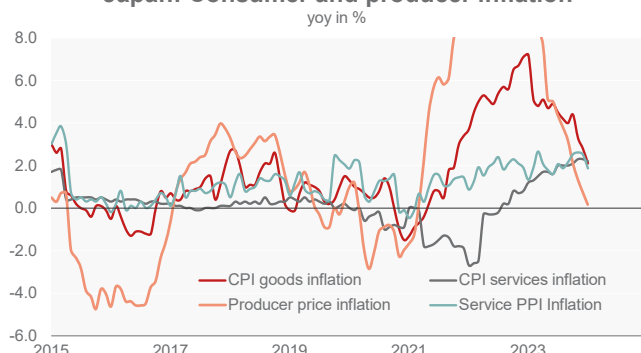
**One month earlier than we had expected**, the BoJ scrapped today its NIRP and YCC in a single move, together with ending purchases of ETFs, J-Reits and the announcement to reduce buying of CP and corporate bonds (to be discontinued in about one year). However, the bank will continue with the core of its policy unabated, i.e., government bond purchases with broadly the same amount as before (around JPY 6 tr per month) while it secured its freedom to act, in case of a rapid rise in long-term interest rates. It will also continue its “funding for lending” programme. So far, we interpret the BoJ’s decision to be in line with our outlook, which we discussed in more depth in a recent [Core Matter](#).

**The BoJ has become more convinced that the much-wanted virtuous wage-price cycle is indeed establishing.** Its [statement](#) reads that “[...] Bank judged it came in sight that the price stability target would be achieved in a sustainable and stable manner toward the end of the projection period.” The BoJ mentioned the positive influence of recent wage settlements of large enterprises which reached 5.28%, a 33y record high. However, medium- and smaller-sized firms will follow, which are not expected to agree to such high increases. Nevertheless, we also expect disposable income to rise this year on the three elements of rising wages, government fiscal support, and slowing inflation. This in turn should support private consumption, the second necessary part of a sustainably higher inflation.

**That said, we expect the BoJ to remain cautious in hiking its key interest rate.** The bank still needs to nurture the wage-price cycle, quite the opposite of other major central banks which fear high wage growth to complicate the return of inflation below

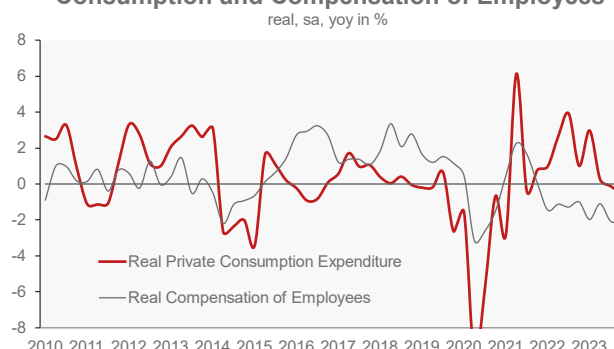
target. We expect the BoJ to stay accommodative, expanding its monetary base in line with the targeted nominal GDP growth (2% inflation target plus potential growth) of 2.5% - 3% over the next years.

**Japan: Consumer and producer inflation**



Source: Datastream, GenAM calculations

**Consumption and Compensation of Employees**



Source: Datastream, GenAM calculations

In the press conference, Ueda said “we will choose the appropriate level of short-term rates in line with our economic and price outlook. But in doing so, we need to be mindful that there is some distance for inflation expectations to reach 2%. When we focus on this gap, it’s necessary to maintain accommodative monetary conditions even under a normal monetary policy framework.” Accordingly, we see an interest hike not anytime soon, especially not this year. Models suggest that even with annual wage growth between 3% - 3.5% over the next years, Japan’s inflation will not advance above 1.8% within the forecast horizon. Only if the wage-growth dynamics would substantially accelerate, eliciting inflation above 2% on a sustained basis, we see the BoJ hike its interest rate. But this is not our forecast. Inflation peaked at 4.1% in Jan. 2023, and is on a downtrend, although it will be noisy over the next months. We expect headline inflation to jump up again in February to 2.8% (after 2.2% in January) on ending base effects. However, overall, we expect inflation at 1.9% this year and 1.6% in 2025. The latter is in line with the consensus forecast. If this came true, it would not allow the BoJ to argue an inflation overshoot.

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