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UEDA SPEAKS: ARE YOU LISTENING?

Market wisdom in the United States is “don’t fight the Fed”. The Japanese equivalent is “don’t buck the BoJ”.

In his testimony to the Diet on Friday, Professor Kazuo Ueda, the next Governor of the Bank of Japan, proved a smooth operator, dealing easily with the questions from the politicians, including the sometimes heated rhetoric of the opposition parties.

Crucially, he stated that the BoJ’s current policy stance was “appropriate” and continuing to ease was “necessary”. Furthermore, he validated the “compact” concluded between then-Prime Minister Shinzo Abe and the BoJ ten years ago, declaring he wanted to reach the 2% inflation target “as soon as possible”.

That is particularly important because Ueda also intimated that inflation in Japan was peaking out. As it happens, the CPI report released earlier in the day showed how weak Japan’s inflation dynamic really is, despite the hysterical headlines. Using the U.S. definition, core inflation came in at 1.9% YoY and at 0.1% MoM. The absolute level of the index itself is still below where it was in 2019.

No wonder inflation expectations in Japan are so low, with the 5-year breakeven at 1.16% and the 10-year at 0.69%. On that basis, the Bank of Japan is still nowhere near meeting its target of sustainable inflation of 2%, indicating that accommodative monetary policy will be around for a good while yet.

What about wages, you ask? Indeed, the labour market is tightening and there is good possibility that wages may rise into the medium term. But, as of now, the Economy Watchers’ Index of Employment Conditions is bang on its average reading for the past 22 years and the job-to-applicant ratio is rising nicely, but still well off its highs.

Prime Minister Kishida is successfully pressuring blue chip companies into granting higher wages, though in many cases half the hike is in the form of one-off payments that can be stopped when the cost of living squeeze abates. As for the 85% of Japanese workers who are not employed by blue chip companies, they will enjoy no such boost.

Ueda is not some kind of hard money hitman who was suddenly drafted into the job after the favoured candidate turned it down at the last minute. That narrative appears to have been a diversion created by one Japanese newspaper which got the story badly wrong. More likely are the reports that Ueda had always been Kishida’s preferred choice. The Prime Minister wanted someone who was a good communicator in English and had strong connections with other central bank officials. Ueda was the perfect fit.

Unsaid, but equally vital, would be the capacity to navigate the complicated politics. That requires placating the banking lobby up-to-a-point while avoiding a badly timed monetary tightening, a blunder that the BoJ has committed twice this century. So there may be some action on yield curve control, either a widening of the band or outright abolition, but Ueda’s BoJ will keep easy money in place “until conditions change.”

When will that be? Later rather than sooner, in my view. Meanwhile, Kishida’s support rating is experiencing a rare bounce thanks to Ueda’s assured performance in the Diet. If inflation does fade away as predicted, expect much less angst about Japanese monetary policy in the media and markets.

Disclaimer

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