Notes on Financial Markets Vol.254

Press conference by Governor Ueda—Defense of normalization

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Introduction

The BOJ decided to maintain its policy rate at April/May MPM as widely expected. Governor Ueda presented the outlook of deceleration in economic growth and inflation due to the obvious reason. However, he maintained the fundamental strategy of policy normalization.

Assessment of economy

At the beginning of the press conference, Governor Ueda confirmed that there were substantial uncertainties about trade policy overseas. He also explained that, in compiling the outlook, the members of the MPM assumed additional tax would remain to some extent after 90days grace period, but there would not be disruption in global supply chains.

Based on such conditions, Governor Ueda expressed the view that higher tariffs would decelerate global economy, and as a result, corporate profits would decrease and sentiment of firms and households would deteriorate.

New outlook of real GDP growth rate for FY 2025 to FY2027 is +0.5%→+0.7%→+1.0%. In comparison with the previous outlook (as of January), there were large downward revisions for FY2025 and FY2026 by 0.6pp and 0.3pp respectively. Furthermore, the members of the MPM assessed that the risks of economic outlook tilted downwards.

During the Q&A session, many reporters raised the plausibility of the revised outlook.

Governor Ueda insisted that there remained substantial uncertainties about the outlook, and the BOJ would update it as the evolutions of economy.

With this respect, readers may like to note some facts. First, it was natural for the BOJ not to take account of economic stimulus measures currently discussed in the parliament. It is highly probable that they would support the growth rate at least for FY 2025 when they are launched.

Second, Governor Ueda suggested some factors of upside risks. While a benign scenario of trade conflicts may be too optimistic, potential improvement of real income of households due to large upward revision of annual wages and deceleration in inflation rate appeared to be reasonable.

Assessment of prices

Interestingly, Governor Ueda maintained the view that existing upward drivers of inflation including rise in import prices in the past and rise in food prices recently would gradually diminish. On top of these, slowdown of economic activities would further decelerate in inflation rate.

New outlook of core CPI inflation rate for FY 2025 to FY2027 is +2.2%→+1.7%→+1.9%. In comparison with the previous outlook (as of January), there were large downward revisions for FY2025 and FY2026 by 0.2pp and 0.3pp respectively. Furthermore, the members of the MPM assessed that the risks of inflation outlook also tilted downwards.

There are some caveats for inflation outlook as well. First, if economic policy measures by the government include reduction in retail energy/gasoline prices, it would have negative impacts on inflation at least for FY2025.

Second, foreign exchange rate would not have the upward impact on domestic inflation any more, especially in light of recent trend of JPY rate. In other word, domestic factors could only be the upward drivers for inflation.

Management of policy rate

As the BOJ's decision to maintain its policy rate at 0.5% was widely expected, the focus of attention was the management of policy rate in the context of policy normalization.

Most of the press reporters appeared to consider that the BOJ would either suspend its policy rate hike for the time being, or decelerate the pace of its policy rate hike further, due to considerable downside revision of outlook.

In particular, some of the reporters focused that the BOJ effectively postpone the expected time of achieving inflation target by a year; ie, from between later FY2025 to FY2026 to between later FY2026 to FY2027.

It should be noted, however, that the summary text of the outlook maintained the fundamental strategy of policy normalization, with some cautiousness about high uncertainties about the outlook and needs of careful monitor of economy and prices.

Key concept to understand the strategy is underlying inflation. Governor Ueda explained that its upward movement may stagnate as economic activity decelerates. Nevertheless, he expressed the view that improvement of underlying inflation would resume as economy recovers.

Governor Ueda further argued that even when underlying inflation stagnates, the BOJ could raise policy rate as long as it has confidence in the prospects of improvement of underlying inflation in some accelerated manner.

From the viewpoint of communication, it seems to be difficult to share the understanding of the BOJ's strategy with the reporters. One important reason is it remained uncertain whether core inflation rate expected to converge to the target between later FY2026 to FY2027 and evolution of underlying inflation rate is the same or not.

More important issue is whether the change in corporate behavior towards wages and prices could sustain under worse economic conditions. While the BOJ dose not indicate the estimates of underlying inflation precisely, they suggested that it is closely linked with inflation expectation and associated behavior towards wages and prices.

Although many press reporters expressed skepticism about its sustainability, Governor Ueda expressed the view that structural labor shortages would remain intact, which would make corporate behavior towards wages and prices more proactive, once our economy return to the original track.

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