

## JAPAN

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## BANK OF JAPAN: MOVEMENT BY JUNE?

With alarming inflation across the country, the new governor of the Bank of Japan (BoJ), Kazuo Ueda, will have a baptism of fire when he takes up his role. Even though price increases are expected to slow down during Q1 2023 thanks to government energy subsidies, core inflation has continued to rise this winter. Price dynamics are posing a major challenge and may force the BoJ into making changes to its interest rate control policy, despite bond yields falling off as a result of the recent US bank failures. The Japanese economy stagnated in Q4 2022, buoyed by foreign trade and private consumption during Q4 2022, but slowed by public and private investment. We expect growth to continue in 2023 (1.2%) at a similar pace to 2022 (1.1%), before a more sluggish growth takes hold in 2024 (0.8%).

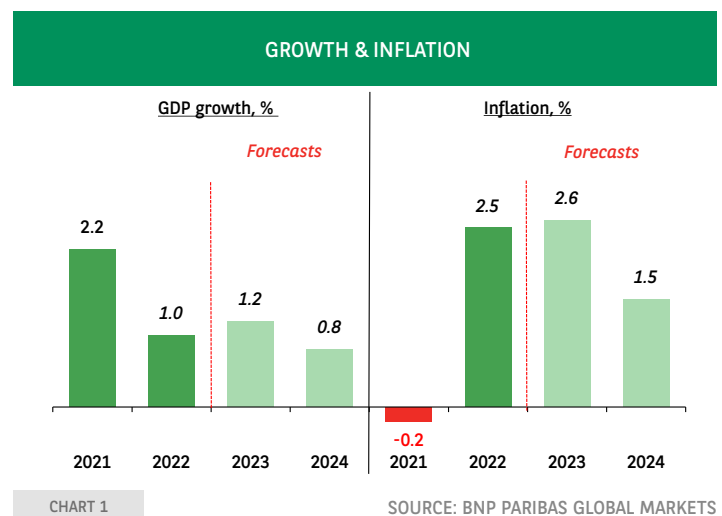
Inflation fell in February (3.3% y/y), thanks to the energy subsidies introduced by the government. However, inflation could prove to be more persistent than expected in 2023 and put the BoJ's current monetary policy under increasing pressure. Firstly, core inflation (excluding fresh food and energy) continued to rise (3.6% y/y in February following an increase of 3.3% in January). Secondly, inflation became noticeably more widespread during Q4 2022: the BoJ's inflation spread index stood at 69.3 points in February, close to December record at 69.5. Finally, services inflation also grew more quickly (1.3% y/y in February compared to 0.8% in December). These factors, combined with major future wage increases, should keep inflation at close to 3% in 2023, with a return to the 2% target not expected before 2024.

Therefore, the new BoJ Governor, Kazuo Ueda, will be under pressure as soon as he takes up his position in April. While the BoJ should maintain an accommodating monetary policy, we expect Japan's yield curve control ceiling to be raised to 1% (10-year maturity) in the coming months (from its level of 0.5% today).

## A FALTERING RECOVERY

Japan has reopened to tourists, but the number of foreign visitors arriving in January was still at around half (44%) of its 2019 level. However, this did help the services sector to rebound and supported consumption growth by more than 0.25pt during Q4 2022. At the same time, there is still major catch-up potential, as spending among non-residents in Japan stood at one third of its pre-pandemic level at the end of 2022, and this should continue to help to boost the economy in 2023. Despite earnings falling in real terms for almost two years now, household consumption rose above its pre-pandemic level for the first time during Q4 2022.

The labour market tightened during Q4 2022 and is expected to remain under pressure throughout 2023. The unemployment rate is close to its historically low pre-pandemic level, standing at 2.6% in February. The number of new job openings has also matched its February 2020 level. Tight labour market conditions and persistent pressures on consumer prices may push wages up. According to the Japanese Ministry of Health, Labour and Welfare, nominal base wages rose 0.8% y/y in January 2023, down from the figures for the end of 2022 (+1.6% y/y in December). However, this rate should improve as a result of the annual Shunto wage negotiations, with final agreements expected in April. Prime Minister Fumio Kishida is in favour of a 3% wage increase, which is below the 5% rise being called for by the Rengo trade union (Japanese trade union). We believe that all sides will agree upon a 3.6% wage increase, which would just about offset the effects of inflation on purchasing power.



China easing its "zero-covid" policy is still only being felt moderately on the Japanese economy, but its effects should become more prominent by Q2 2023. Japanese industrial production, which is closely linked to exports to China and therefore to the Chinese economy, recovered by 4.5% y/y in February, after a 6.4% contraction in January, but is still 7.4% below its Q3 2019 levels. Car production, a major contributor to Japanese exports, was 11.2% below its pre-pandemic level in February. Exports to China, which had fallen in December and January, should continue their recovery which began in February (+20% m/m).

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