

## JAPAN

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## THE CALM AFTER THE STORM

The Bank of Japan is continuing with its incremental and cautious monetary tightening, with a single policy rate hike in Q3, which is expected to precede further movement in December, while the July decision has contributed to major financial market volatility. At the same time, the economy is recovering from a turbulent start to the year and inflation is still above the 2% target. In addition, the country has a new Prime Minister and early general elections are now scheduled for October 27th.

The Japanese economy rebounded significantly during Q2 2024, with GDP growth of +0.7% (in line with our forecasts), following the Q1 contraction (-0.6% q/q). Growth is expected to slow during the second half of the year, but will remain in positive territory (+0.2%-+0.3% q/q). Nevertheless, due to the negative carry-over effect for 2023 (-0.3 pp), in addition to Q1 data, 2024 is ultimately expected to see a negative average annual growth rate (-0.2%), i.e. a marked decline on 2023 (1.7%).

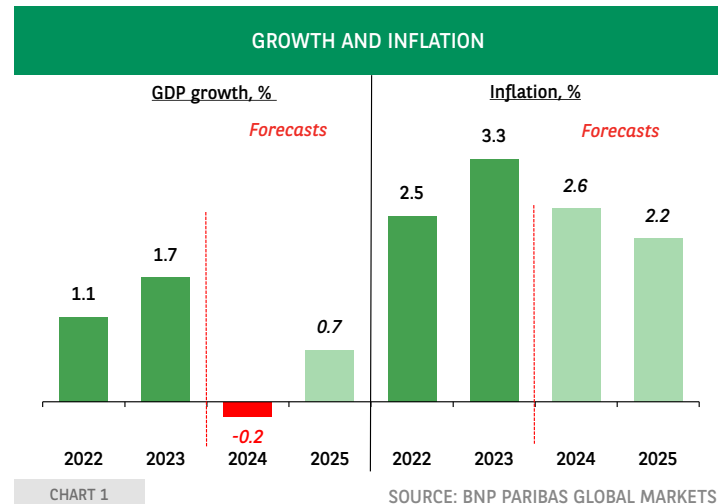
The growth in Q2 2024 is partly attributable to a technical rebound after the specific contingencies that disrupted activity at the start of the year, such as the earthquake on the Noto peninsula and disruptions to automotive production. However, the latter has still not caught up on its level at the end of 2023 (down -12.7% q/q in Q1 2024, before increasing +7.7% in Q2). Nevertheless, there are positive points to highlight, particularly in relation to private consumption, as its increase of +0.9% q/q has brought to an end four consecutive quarters of contraction. In addition, while foreign trade is once again making a negative contribution to growth, it is less important this time, with exports and imports increasing after their simultaneous declines during Q1. Therefore, although the relatively substantial variability of this GDP component (compared to domestic demand) should be noted, exports, which are Japan's principal growth driver, are recovering, while the increase in imports points to some kind of renewed demand.

Core inflation has been on the rise since the start of Q2, increasing from +2.2% to +2.8% y/y between April and August. Services prices slowed over the same period (from +1.7% to +1.4%), but have accelerated in month-on-month terms over the last two months. Nominal wages rose as the increases negotiated as part of the Shunto were implemented, helping real wages to post two consecutive months of year-on-year improvement in June and July 2024 for the first time since Q1 2022 (+1.1% and +0.4%), providing grounds for improved expectations around household consumption.

## THE MONETARY EXCEPTION

The Bank of Japan (BoJ) is continuing with its incremental monetary tightening in contrast to its G7 counterparts, after ending its negative interest rate policy at the start of the year. The detailed quantitative tightening plan, which involves almost halving the monthly Japanese Government Bond (JGB) purchase pace by Q1 2026, was presented during the July monetary policy meeting. The second hike in the key rate, the uncollateralised overnight call rate, to +0.25% (+0.15pp), also occurred during this meeting. This movement surprised observers and markets, contributing to renewed volatility on the markets at the start of August, illustrated by the VIX index soaring to its highest level since March 2020.

While the Governor of the BOJ, Kazuo Ueda, played down the relationship between the July decision and the financial market fluctuations in early August, officials (including Ueda) admitted that they should be taken into account in the tightening trajectory. Therefore, there were no changes



to the key rate during the September meeting. In addition, Kazuo Ueda reiterated the BoJ's intention to continue to hike its key rate and adjust the level of monetary policy easing. We anticipate a further rate hike during the December meeting (+0.25 pp), with the upward trajectory then gradually continuing towards neutral in 2025, i.e. three increases in the uncollateralised overnight call rate, taking it to +1.25% at the end of the year.

In addition, the yen has generally strengthened against the US dollar in recent weeks, with the USD/JPY falling from over 160 at the start of July to 143 on 23 September. As the interest rate spread with the Fed narrows, we expect the relative value of the JPY to improve further during the quarters ahead, with USD/JPY standing at 131 by Q4 2025.

## POLITICAL CHANGES

The outgoing Prime Minister, Fumio Kishida (who was in office since October 2021), announced that he would not seek re-election as leader of the Liberal Democratic Party (LDP), meaning that he would be standing down from his government role after the election on 27 September. Kishida came to this decision against a backdrop of declining popularity and scandals surrounding his party. The campaign to elect his successor has resulted in the appointment of Shigeru Ishiba (former Secretary General of the LDP), who beat Shinjiro Koizum (former Minister of the Environment) and Sanae Takaichi (current Minister for Economic Security). Soon after, Shigeru Ishiba announced the holding of new early elections to the House of Representatives, scheduled for October 27<sup>th</sup>.

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