

**31 July 2024**

## **Ueda pushes ahead as political climate shifts**

### **Key takeaways**

- The Bank of Japan (BOJ) announced a second interest rate hike as well as a plan to taper government bond purchases on Wednesday, 31 July.
- Through the BOJ's actions Wednesday and its openness to further rate hikes, Governor Ueda Kazuo decisively asserted the bank's independence and signaled that a new macroeconomic policy environment has arrived.
- This shift was enabled by a post-Abenomics shift in the Liberal Democratic Party (LDP) and will encourage further shifts within the party in favor of monetary and fiscal hawks.

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The Bank of Japan's (BOJ) policy board announced on Wednesday, 31 July that it would be raising its short-term policy rate from a range of 0-0.1% to 0.25% – their highest level since 2007 – in addition to tapering its monthly purchases of long-term Japanese government bonds from roughly JPY 6tn (USD 39.8bn) to JPY 3tn (USD 19.9bn). The impact of these decisions may ultimately be more significant than the March [decision](#) to end negative interest rates and yield curve control. Whereas that decision left significant questions unanswered about the direction of monetary policy, on Wednesday BOJ Governor Ueda Kazuo effectively answered those questions. By moving more boldly and more quickly to normalize than many observers expected, Ueda has placed the BOJ on a more hawkish footing, signaling that his BOJ will not be tentative in normalizing monetary policy.

### **Ueda leans forward**

In his remarks Wednesday, Ueda worked to resolve any lingering questions about his BOJ's approach and signal that he will not be timid about further interest rate hikes. He

insisted that with real interest rates still negative, the policy environment is still accommodative. He further argued that Japan is still not at its neutral rate, leaving the BOJ with room for additional hikes, adding that he does not recognize 0.50% as a barrier for interest rates. He stated that what the BOJ does next will depend on economic data, but the bank's quarterly outlook for economic activity and prices suggests that the policy board is more concerned about the risks that inflation could be above its 2% target than below, implying a bias in favor of further tightening, with another rate hike possible before the end of the year. He also stated that the yen's weakness was "not a major factor" behind this rate hike.

The BOJ's actions – announcing a rate hike at the same time as it announced its plan for tapering bond purchases, leaning into the possibility of additional rate hikes, and downplaying concerns about economic weakness – read as an assertion of the BOJ's independence. The bank can and will decide how to proceed in policy normalization.

### **Post-Abenomics politics**

Ueda's "declaration of independence" was possible in large part because the [political environment](#) largely favors Ueda's shift. Prime Minister Kishida Fumio celebrated the BOJ's policy announcements, taking the bank's decisions as a victory for his government's efforts to move Japan to a "new growth-oriented economy," particularly its vigorous incomes policy. The significant pay increases delivered by employers this year played a significant role in encouraging Ueda to move quickly, as he cited the increases as part of a virtuous cycle of wages and inflation, suggested that pay increases will soon translate into more robust consumption, and argued that the pay increases will enable households to manage some of the effects of higher interest rates on housing costs. To be sure, both Chief Cabinet Secretary Hayashi Yoshimasa and Finance Minister Suzuki Shunichi said the government will be closely monitoring the impact of higher interest rates on the economy, but this does not suggest discord between the Kishida government and the BOJ.

In the immediate term, the combination of Wednesday's rate hike, Ueda's forward-leaning stance on additional rate hikes, the tapering of JGB purchases, and the prospect of an interest rate cut by the Federal Reserve could reverse some of the yen's decline against the dollar and other major currencies this year, which may in turn ease the impact of yen weakness in the Liberal Democratic Party's (LDP) leadership election and the general election that could be held before the end of the year. After more than JPY 15tn (USD 99.6bn) in foreign exchange intervention this year – the finance ministry reported on Wednesday that in June and July it bought more than JPY 5.5tn (USD 36.5bn), surpassing the record of JPY 9.1tn (USD 60.4bn) in 2022 – the government can now step back and save intervention as a backstop, although it is unlikely to abandon its insistence that if necessary it can act at any time.

More broadly, with the BOJ's decisive move to normalize monetary policy, the LDP has truly arrived in a post-Abenomics era. The upshot of this shift is that the LDP will move in a more monetarily hawkish direction along with the BOJ; the consensus view among the likely candidates in the party's leadership election will be in favor of monetary policy normalization and BOJ independence. It will also shift the balance of power within the LDP further in favor of fiscal hawks, who have [already](#) used the prospect of higher interest rates to argue that it is increasingly essential to prioritize fiscal consolidation. (This shift will also be felt in the bureaucracy, as the Ministry of Finance will gain power at the expense of policy ministries like the Ministry of Economy, Trade, and Industry, which was in the driver's seat under Abenomics.) With the LDP's right wing still committed to easy monetary policy and deficit spending, the macroeconomic policy shift will further marginalize the party's right, which has seen its influence wane following the assassination of Abe Shinzō, the Unification Church scandal, and the kickbacks scandal that led to the end of the Abe faction itself.

Whether the arrival of a new politics of macroeconomic policy is enough to save Kishida's premiership remains to be seen. While Kishida sought to use the BOJ's policy decisions to declare victory, the formation of a new mainstream consensus could just as easily enable another politician – one better placed to deliver the political change desired by the public – to step into the LDP's leadership with minimal disruption to the government's policy program. A new macroeconomic consensus in the LDP could also mean that the leadership campaign focuses more on microeconomic policies, which could leave Kishida vulnerable to attacks from potential aspirants like Motegi Toshimitsu – who has talked about regulatory reform while touring Southeast Asia this week – and Kōno Tarō, who has made digitalization and regulatory streamlining his central political goals.

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