23 August 2024

Political winds may be at Ueda's back

Key takeaways

- In an appearance before the House of Representatives' financial affairs committee, Bank of Japan (BOJ) Governor Ueda Kazuo restated his commitment to monetary policy normalization, suggesting additional rate hikes are possible.
- Despite market volatility, Ueda and the BOJ now face a political environment congenial to policy normalization.

Bank of Japan (BOJ) Governor Ueda Kazuo appeared before a recess meeting of the House of Representatives' financial affairs committee on Friday, 23 August to discuss the BOJ's 31 July policy decisions and the market volatility that followed. The committee's interest in questioning Ueda reflects heightened political sensitivities surrounding interest rates and exchange rates ahead of the Liberal Democratic Party's (LDP) leadership election and a possible general election that could follow soon thereafter. However, changes in the political environment could be favorable for Ueda and the BOJ. There are two main takeaways from Friday's hearing.

1. **Governor Ueda's fundamental position on policy normalization is unchanged**

In his remarks, Ueda did not fundamentally alter the position he articulated in his 31 July press conference. The BOJ will continue to adjust its monetary easing policies in response to economic and price data, and still sees risks that could push inflation above its two-percent target. He acknowledged the difficulty in estimating the neutral rate of interest but suggested that with the BOJ's policy rate still below inflation, there is still room for additional rate hikes. Finally, Ueda acknowledged the impact of yen weakness on inflation and said that the bank is taking currency depreciation into consideration as it makes policy. The implication of Ueda's comments Friday is that, notwithstanding market volatility, the BOJ could be poised to raise rates again before the end of the year.

2. The politics of monetary policy have shifted

However, Friday's hearing also highlighted the extent to which the political context around inflation, interest rates, and exchange rates has changed since 31 July. First, with the Federal Reserve now committed to cutting interest rates in addition to the BOJ's stance on raising rates, the yen faces upward pressure that will ease some of the political anxiety around the currency. The Kishida government can hold off on foreign exchange intervention; there will be less posturing about monetary policy during the LDP's leadership election; and opposition parties will have one less weapon with which to pressure the ruling coalition.

Meanwhile, the prospect of a drawn-out LDP election – the party will not select a new leader and prime minister until 27 September – which could be followed shortly thereafter by a snap election gives the BOJ a convenient reason to wait before another rate hike. This pause will allow it to see not only how the Japanese political situation unfolds and how the Japanese economy responds to rate hikes but also the US presidential race and the impact of US rate cuts.

Finally, despite the political anxiety that led lawmakers to convene Friday's recess meeting in the first place, it is possible that public opinion has been unperturbed by market volatility and may in fact be favorably disposed to the BOJ's policy normalization. A poll by national broadcaster NHK conducted following the 31 July announcement but before the big market swings of the following week suggested that a 54% majority greatly (11%) or somewhat (43%) approved of the rate hike, compared with the 32% who greatly (8%) or somewhat (24%) opposed it. A *Nikkei Shimbun* poll conducted this week, however, suggests that market volatility has done little to dampen enthusiasm for the BOJ's course of action, with 54% approving and 30% disapproving. If the public remains in favor of policy normalization, the LDP will likely continue its shift in a post-Abenomics direction. It is more likely than not that the next LDP leader and prime minister will be one of the candidates favorably disposed to policy normalization, since the LDP's conservative bloc – which is most skeptical of monetary policy normalization – may split its vote between several candidates. This suggests that the BOJ should anticipate a supportive political environment following the transition to a new government.