



Weekly round up (Week 11)

For the past year or so, market watchers have been keeping a close eye on events in the Land of the Rising Sun. While most of their attention has been focused on the surge in the Japanese stock market - which has returned to levels seen during the country's economic boom of the 1980s - they have also been interested in when the Bank of Japan (BoJ) might end its negative interest rate policy (NIRP), in place since 2016.

The BoJ has made it clear that, in order to achieve its goal of keeping inflation around 2% on a sustainable basis, rising consumer prices must be passed on to wage demands. Thus, the announcement on March 15 that Rengo, the trade union group representing some 7 million workers, had agreed a 5.38% wage increase with Japan's largest companies could be the green light for the BoJ to end the NIRP and raise key rates for the first time since 2007.

The exit from NIRP was announced in today's date. Markets were unimpressed. Jpy to USD fell slightly. Stocks moved a bit higher.

The implications of a Japanese rate hike

When policy rates and bond yields rise, the main beneficiaries are lenders, to the detriment of borrowers. This should improve the profitability of banks, pension plans and insurance companies. However, the windfall effect may not be universal, as paper losses on government bonds held by banks could force some financial institutions to set aside additional capital, as we saw in the recent crises affecting US regional banks and UK pension schemes.

The Japanese government's debt servicing costs are forecast to rise to 27,000 billion yen (US\$180 billion), or around a quarter of its annual budget for fiscal 2024. With most Japanese homeowners taking out variable-rate loans linked to short-term interest rates, rising mortgage payments could reduce consumer spending and cool the housing market. As for corporate borrowers, they will come under increased pressure if they rely on cheap financing or are unprofitable, as rising borrowing costs and tightening liquidity are likely to accelerate bankruptcies.

From an investment point of view, and as we saw recently with Mexico, higher policy rates can attract capital, both from international and domestic investors. Japanese investors hold around \$4,000 billion in overseas investments, including \$1,100 billion in US Treasuries and around 10% of Australian and Dutch public debt markets. Given the importance of Japanese supply for international assets in recent years, a rise in interest rates could trigger a repatriation of capital and lead to higher global yields.

Higher policy rates could also strengthen the yen in the near future. This seems likely if Japanese rates rise while the US Federal Reserve and European Central Bank begin to cut theirs. A stronger yen should help importers, including large



buyers of raw materials and energy, but at the expense of exporters, such as automakers. Toyota Motors estimates that its operating profits increase by 45 billion yen (\$300 million) for every yen drop against the dollar. Finally, Japan's booming tourism industry could slow down as a result of a stronger yen, impacting the hotel and retail sectors.

Also in the news last week

Government bond yields rose last week, as US debt underperformed. Oil prices hit new highs for 2024, with the WTI Crude index surpassing \$81 on March 15. The US dollar appreciated against most currencies, with the notable exception of the Mexican peso - the best-performing major currency this year - which appreciated to levels not seen since 2015. With key rates at 11.25%, solid growth and political stability, Mexico continues to attract capital. US stock indices ended the week broadly stable, while on the economic front, inflation data was the main variable on which investors focused and which influenced market prices.

In the US, both headline and core consumer prices rose by 0.4% month-on-month in February. Energy was the main driver of overall inflation, with gasoline prices rising by 3.8% after falling by 3.3% the previous month.

Turning to core prices, economists will be relieved to see that core services inflation moderated to 0.5% in February, from 0.7% in January, due to a slowdown in homeowners' equivalent rent, this moderation confirming that January's surprising jump was probably just parasitic noise. On a 12-month basis, core prices continued their disinflationary trend, the 3.8% increase in February being slightly lower than the 3.9% recorded in January. However, on a half-yearly basis, core prices rose from 3.6% to 3.9%, which could indicate that disinflation is running out of steam.

At company level, producer prices were higher than consensus, registering the biggest rise in six months - 0.6% vs. 0.3% expected - partly due to high fuel and food costs. Several categories of the Producer Price Report are used to make up the Fed's preferred measure of inflation, the Personal Consumption Expenditure (PCE) index. Prices paid for portfolio management, a key component of the PCE index, rose by 0.2%, a sign of stability after rising by 5.9% in January.

In Asia, consumer prices in China unexpectedly rose by 0.7% year-on-year in February, against a consensus forecast of 0.3%, as January, close to the lunar year, continued to distort economic data. A more representative measure is to take the average of the first two months, which shows that consumer prices remained unchanged year-on-year. In contrast to the US, Chinese producer prices continued their deflationary trend, falling by 2.7% year-on-year.



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