Japan News Update

January 6, 2023

- 10-Year JGB Auction Highest Yield Since June 2015
- November Real Wages Drop 3.8%
- What We Have Here is a Failure to Communicate
- Japan to Forward Position Ammo Dumps in Southern Ryukyu Islands

10-Year JGB Auction Highest Yield Since June 2015

The Ministry of Finance (MoF) held its first 10-year JGB auction of the year on Thursday. The new #369 bond had the coupon raised from 0.2% to 0.5%. The auction finished with a yield of 0.5% at the lowest accepted price (100.00). There was no tail. The 0.5% yield was the highest since the June 2015 auction and was double the yield at the December 2022 auction (0.25%).

The #369 bond became the 10-year benchmark bond on Friday. There was considerable selling of the new issue and the BoJ had to step in to defend the upper end of the trading range at 0.5% by purchasing ¥593.7 billion worth of the three on-the-run issues through fixed-rate operations. This was in addition to the scheduled purchase of ¥300.5 billion worth of 10-year JGBs through the regular Dutch auction operation.

Investors were seen to be closing short positions in the former benchmark #368 bond and opening new short positions in the new benchmark #369 bond.

An article in Nikkei Friday morning raised the question of who will buy 10-year JGBs now? The BoJ Monetary Policy Board will meet on January 17-18 and traders are wary about the possibility of another surprise tweak to current monetary policy. As one Japanese bond trader put it, "There are very few people who are willing to buy 10-year JGBs at yields below the upper limit on the trading band [0.5%]." Another bond investor for an overseas institution told Nikkei, "When the BoJ changes policy, it will happen suddenly. Until that time people will continue to short JGBs."

In the OIS market, which is outside of the BoJ's purview, the 10-year yield is an annualized 0.9%—far above the cap of 0.5%. Clearly, the market thinks the BoJ will have to widen the trading band again and that it will be sooner rather than later.

The next auction that might influence the market is the 5-year JGB a week from today on the 13th. As you may recall, the BoJ conducted three special fixed-rate operations in the benchmark 2-year and 5-year JGBs at the end of December to try to eliminate the kink in the yield curve between 5-years and 10-years. Since trading resumed on January 4, no such operations were conducted but traders should expect the central bank to step in if shorter yields start to move out of line.

November Real Wages Drop 3.8%

Real wages fell 3.8% in November, the largest decline in real wages since May 2014 (-4.1%). Higher consumer prices and slower growth in nominal cash wages combined to erode consumers' purchasing power during ghe month. Nominal cash wages increased by 0.5% to ¥283,895, the eleventh consecutive month of year-on-year increases. However, the pace of growth slowed from the 1% to 2% seen in previous months.

Consumer prices as measured by the All-Item index less owner equivalent rent, increased 4.5% during November.

The sharp decline in real wages has made the current spring wage negotiations even more critical. Rengo, the largest federation of trade unions in Japan, is planning to ask for a 5% wage hike for FY 2023 (year ending March 31, 2024). For its part, management, represented by Keidanren, is expected to grant wage hikes of at least 3%. The wage negotiations will be closely watched by both the BoJ and the government. If the wage increases are large enough, a virtuous cycle of higher wages and higher prices may develop.

What We Have Here is a Failure to Communicate

Bank of Japan Governor Haruhiko Kuroda, like the Captain in Cool Hand Luke, is having a hard time getting the market to listen to his message. In a speech given to the Japan Bankers' Association on Wednesday, Kuroda said, "We will continue monetary easing in order to achieve the price stability target in a sustained and stable manner, accompanied by wage increases."

What We Have Here is a Failure to Communicate

Source: Cool Hand Luke (1967)

Kuroda continued, "Our economy is expected to continue to grow at a relatively solid and stable rate. The main reason for this is that the monetary environment remains accommodative."

However, ever since the BoJ widened the trading band around the 10-year peg from 0.25% to 0.50% last month, the market has been wary of taking Kuroda's statements at face value. As a result, Kuroda's message is not getting through to the market, which has already begun to look through the end of Kuroda's term in April, expecting the new governor to be more willing to raise interest rates.

Comment: We think current policies cannot continue forever but, at the same time, neither Kuroda nor his successor will be in any hurry to change things. Right now, everything depends upon a satisfactory conclusion to the ongoing spring wage negotiations. If we get an average increase of more than 3% in wages for FY

2023 (year ending March 31, 2024), then stable consumer inflation of 2% might be achieved. That is what everyone is waiting for.

Japan to Forward Position Ammo Dumps in Southern Ryukyu Islands

The Ministry of Defense said Friday that it wants to build new ammo dumps in the Southern Ryukyu Islands, close to Taiwan and the disputed Senkaku Islands. The MoD wants to have more ammunition and other combat stores available to it in case China invades Taiwan. Japan currently has 1400 ammo dumps throughout Japan but 70% of these are in Hokkaido, thousands of miles away from any potential war zone in Taiwan.

The army was to build 90 new ammo dumps in the Southern Ryukyu Islands—most of these are likely to be in Okinawa—while the navy wants 40 new ammo and missile storage facilities in the southern islands.

This is part of the government's strategy to spend ¥5 trillion over five years to ensure that Japan has adequate supplies of ammo available if it enters a war with China, North Korea, Russia or all three.