

Japan Event Flash

March 17, 2025

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BOJ to Continue Raising Interest Rates Toward Neutral Rate on Back of Strong 2025 Spring Wage Negotiations

On March 14, the first round of responses to the Spring Wage Negotiations was released with a headline wage increase rate (base increase for base salary bottom-up + regular salary increase) of a strong 5.46% YoY (final result of the Spring Wage Negotiations 2024 was +5.1% YoY) (Exhibit 1). In addition to the headline wage increase rate exceeding 5% for the second consecutive year, the level of the base increase portion alone was raised to +3.84% YoY (final result of the 2024 Spring Wage Negotiations: +3.56% YoY). Furthermore, in the 2025 Spring Wage Negotiations, the headline wage increase rate for small and medium-sized enterprises (with fewer than 300 union members) rose sharply to +5.09% YoY (+4.45% YoY in the final result of the 2024 Spring Wage Negotiations), exceeding 5% for the first time in 33 years since 1992 (Exhibit 2). The base increase alone was +3.62% YoY (final result of the 2024 Spring Wage Negotiations: +3.16% YoY). Although it is still in the first round of response tabulation, there are firm signs of movement toward raising wages at small and medium-sized companies, which was the target of the 2025 Spring Wage Negotiations. In the 2025 Spring Wage Negotiations, labor unions had previously demanded a higher level of wage increase than in 2024, and many companies met those demands. The trend toward higher wages seen over the past few years is not a temporary phenomenon, but is now firmly established in Japan, including at small and medium-sized enterprises.

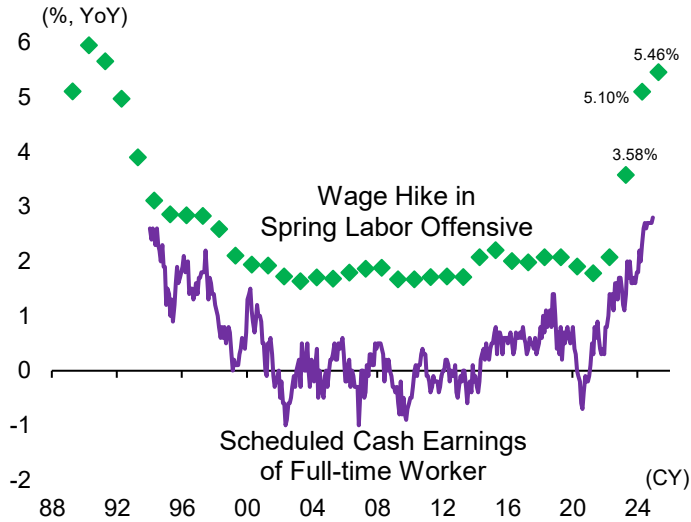
We expect the strong momentum around wage hikes to continue. With Japan's labor shortage becoming more acute, companies are expected to actively increase wages in order to retain the best talent in their ranks. There is no problem in terms of corporate earnings. Japanese companies are generally performing well, recording a significant increase in recurring profit YoY over the Q4 2024 period at 13.5%. Meanwhile, labor costs have been declining relative to strong sales, and Japanese companies have ample room to raise wages further (Exhibit 3). In recent years, companies have been able to transfer wage increases to prices, creating a virtuous cycle between wages and prices (i.e., wages and prices mutually increasing each other) (Exhibit 4).

Against the backdrop of the virtuous cycle between wages and prices, the BOJ is likely to continue to raise interest rates gradually to the neutral rate. We expect the BOJ to raise interest rates twice a year, this year and next, with the terminal rate (the final point of rate hikes) reaching 1.5% (the current policy rate is around 0.5%). Given that prices in Japan are not showing signs of overheating and the growing uncertainty surrounding overseas economies, the BOJ is likely to proceed cautiously in raising interest rates toward the neutral rate. We expect Japan's long-term interest rate to continue its gradual upward trend toward the upper 1% range. As for the dollar/yen, we see this as a phase that requires caution in the direction of yen appreciation, albeit gradual.

Despite growing concerns about a slowdown in the U.S. economy due to uncertainty surrounding President Trump's tariff policies, Japanese companies are generally performing well and the Revision Index has remained relatively

strong compared to U.S. and European companies (Exhibit 5). Despite concerns over the uncertain external environment, domestic demand-related stocks have outperformed overseas demand-related stocks in the Japanese equity market due to strong Japanese domestic fundamentals (Exhibit 6). While uncertainty over President Trump's policies is expected to remain high for the time being, the Japanese economy is expected to remain strong, led by consumer spending on the back of rising real wages, and domestic demand-related stocks will continue to outperform overseas demand-related stocks. Small-cap stocks are likely to outperform large-cap stocks as domestic demand-related stocks are more heavily weighted in small-cap stocks than large-cap stocks amid ongoing concerns over the strong yen.

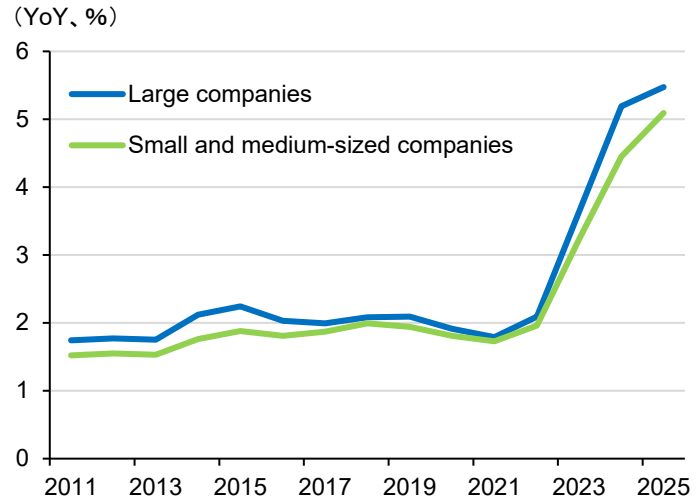
Exhibit 1: Wage Growth of Full-time Worker



Note: Wage hike includes regular salary increases; scheduled cash earnings are for full-time workers in establishments with five employees or more.

Source: JTUC-RENGO, MIC, MUFG: Trust Bank

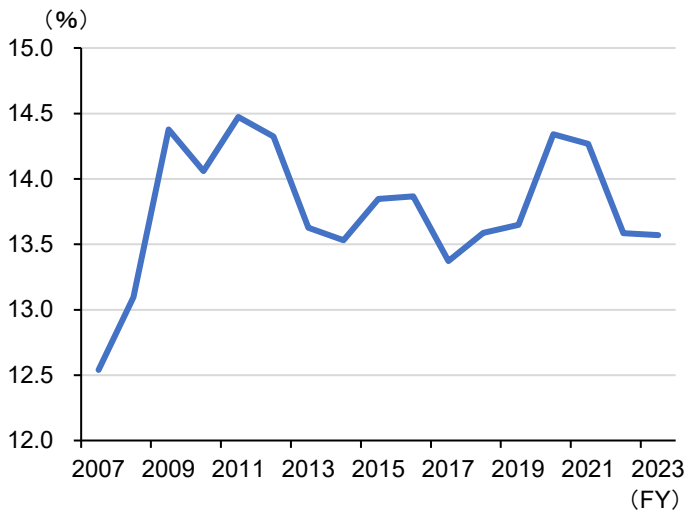
Exhibit 2: Wage Hike in Spring Wage Negotiations by Company Size



Note: Large companies have more than 300 union members; small and medium-sized companies have less than 300 union members.

Source: JTUC-RENGO, MUFG: Trust Bank

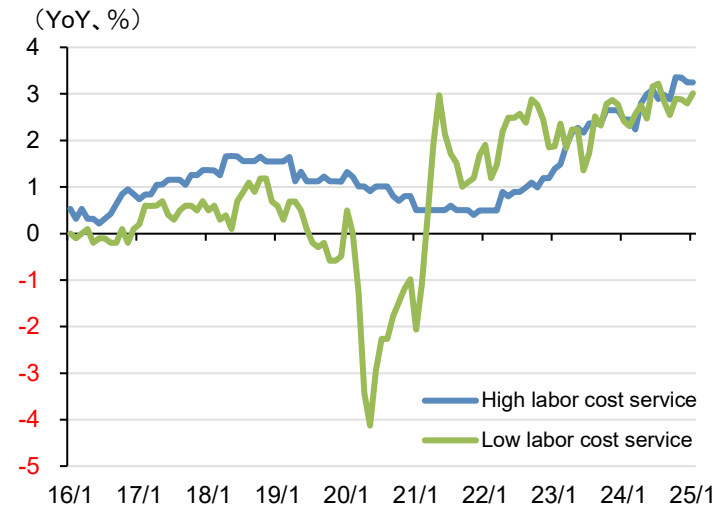
Exhibit 3: Labor Cost to Sales Ratio



Note: Labor cost=Executive salaries+executive bonuses+employee salaries+employee bonuses+benefit costs.

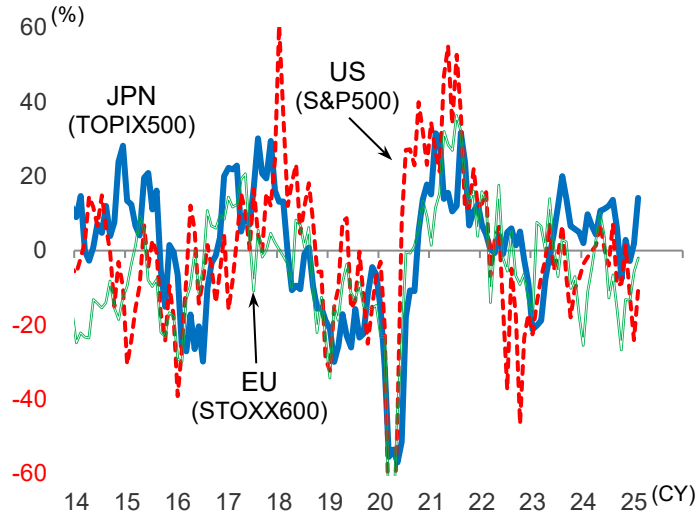
Source: Ministry of Finance, MUFG: Trust Bank

Exhibit 4: Price of Business Services by Labor Cost



Source: BOJ, MUFG: Trust Bank

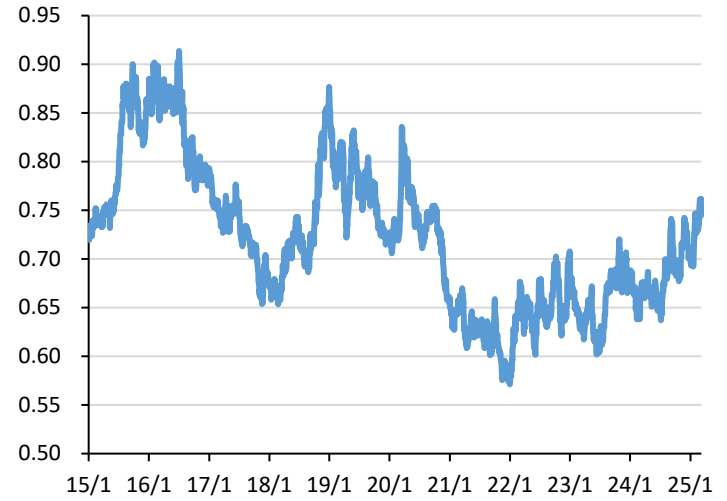
Exhibit 5: Revision Index for the U.S., EU, and Japan



Note: The S&P 500 in the U.S., the STOXX 600 in Europe, and the TOPIX 500 in Japan; earnings forecasts are FactSet consensus estimates, as of February 2025.

Source: FactSet, MUFG: Trust Bank

Exhibit 6: Nikkei Domestic Demand 50 Index ÷ Nikkei Foreign Demand 50 Index



Source: Bloomberg, MUFG: Trust Bank

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