Japan Event Flash

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The Bank of Japan decided to raise policy rates in January. We expect policy rates to rise to 1% in FY25.

At the January 2025 Monetary Policy Meeting, the BOJ raised the policy rates from around 0.25% to around 0.5%, as the economy and prices have been performing well in line with the outlook. There were no surprises as the market had already factored in this rate hike due to the timing of the pre-Monetary Policy Meeting, when Governor Ueda and Deputy Governor Himino stated that they would discuss whether to raise rates at the next Monetary Policy Meeting, as well as a series of reports that the Bank was expected to raise rates in advance. Therefore, the market reaction immediately after the monetary policy meeting was generally limited, although the yen appreciated slightly and stocks and bonds weakened.

The reasons behind the decision to raise interest rates this time were mainly (1) at the January 9 branch managers' meeting, many reported that “companies in a wide range of industries and sizes, including small and medium-sized enterprises, have recognized the need for continuous wage increases under the structural labor shortage,” and (2) after Trump took office as U.S. President on January 20, the market has generally shown a calm reaction. In other words, in addition to the much anticipated wage hike in 2025, the market is not currently in a situation where it is greatly disturbed by President Trump's policy uncertainty, and this is believed to be the reason why the Bank decided to raise interest rates this time. In fact, there have been moves among small and medium-sized enterprises (SMEs) to raise basic wages, and according to a survey by the Shoko Chukin Bank, the percentage of SMEs planning to raise wages in 2025 has been steadily increasing (Exhibit 1 and 2).

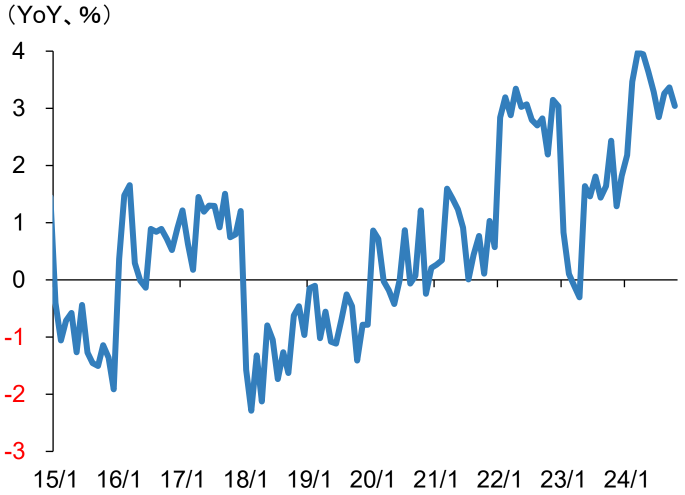
In its latest Outlook Report, the BOJ raised its outlook for prices in general from the previous report (Exhibit 3). This is due to the rise in rice prices as well as higher import prices resulting from the recent depreciation of the yen. Against the backdrop of a virtuous cycle between wages and prices (wages and prices mutually increasing each other), in addition to the improvement in the macro supply-demand gap, the BOJ expects underlying prices to remain roughly in line with the “price stability target of 2%” through FY2026.

Looking ahead, from spring to summer this year, attention will be focused on whether wage increases will be concluded at a high level in response to RENGO’s (the Japan Trade Union Confederation) demand (5% or more overall and 6% or more for small and medium-sized enterprises) in the 2025 spring labor offensive. (The author expects the 2025 spring labor offensive to be generally strong, as the earnings environment for small and medium-sized enterprises, in addition to large enterprises, is generally firm amid tight labor supply and demand due to the shortage of labor.) In the second half of this year, we expect the focus to shift to whether wage increases will lead to sustained price increases.

If, as the BOJ assumes, the market is not greatly shaken by President Trump's policy uncertainty, and wage growth in Japan leads to higher prices as overseas economies follow a moderate growth path, the BOJ will continue to raise interest rates, albeit cautiously, toward neutral rates (rate level that will neither overheat nor cool the economy). According to several models introduced by the BOJ, estimates of the real neutral rates (the natural rates of interest), the level of real interest rates that neither overheats nor cools the economy, range from ▲1% to +0.5%, but in a world where 2% inflation takes hold, the neutral rates would be at least +1%. We expect the BOJ to gradually raise the policy rates to 1% every six months at a cautious pace of 0.25% to ensure that the virtuous cycle between wages and prices is not interrupted.

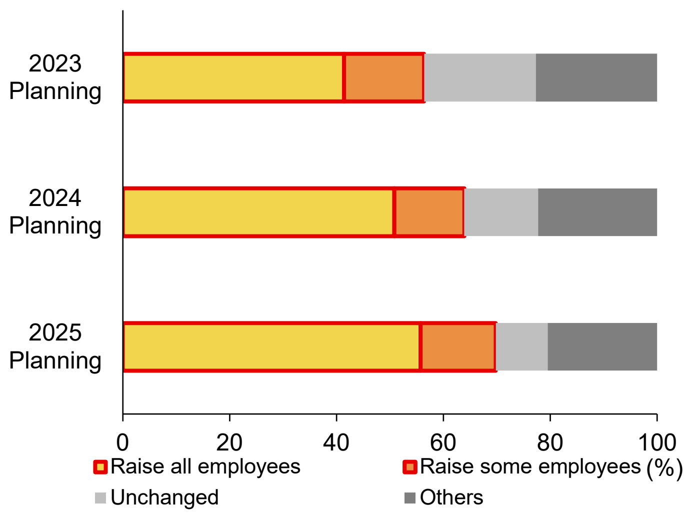
We believe that Japan's long-term interest rates are likely to rise gradually to around 1.5% in FY2025 as the BOJ steadily raises policy rates (Exhibit 4). The BOJ's gradual reduction in JGB purchases (QT) will also be a factor in a modest rise in long-term interest rates on the supply-demand side. Therefore, the yen is unlikely to depreciate further in the foreign exchange market, and USDJPY is likely to hover between 140-160. In the stock market, the rise in long-term interest rates is likely to continue to support some value stocks, such as financial stocks.

Exhibit 1: Trends in Wage Increases in Small and Medium Enterprises (Regular Salary)



Note: Small and medium enterprises have less than 100 employees.
Source: Ministry of Health, Labour and Welfare, MUFG: Trust Bank

Exhibit 2: Regular Salary Planning in Small and Medium Enterprises



Source: Shoko Chukin Bank, MUFG: Trust Bank

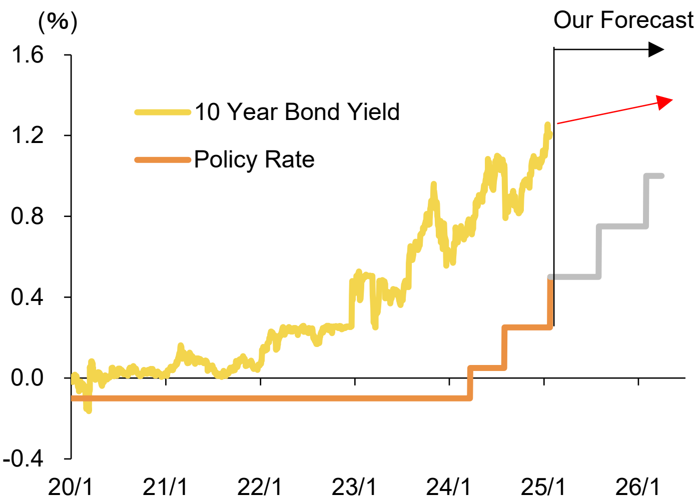
Exhibit 3: BoJ Outlook for Economic Activity and Prices

(YoY、%)

	Real GDP	CPI (all items less fresh food)	(Reference) CPI (all items less fresh food and energy)
FY24	0.5	2.7	2.2
	< 0.4 ～ 0.6 >	< 2.6 ～ 2.8 >	< 2.1 ～ 2.3 >
October	0.6	2.5	2.0
	< 0.5 ～ 0.7 >	< 2.4 ～ 2.5 >	< 1.9 ～ 2.1 >
FY25	1.1	2.4	2.1
	< 0.9 ～ 1.1 >	< 2.2 ～ 2.6 >	< 2.0 ～ 2.3 >
October	1.1	1.9	1.9
	< 1.0 ～ 1.2 >	< 1.7 ～ 2.1 >	< 1.8 ～ 2.0 >
FY26	1.0	2.0	2.1
	< 0.8 ～ 1.0 >	< 1.8 ～ 2.1 >	< 1.9 ～ 2.2 >
October	1.0	1.9	2.1
	< 0.8 ～ 1.1 >	< 1.8 ～ 2.0 >	< 1.9 ～ 2.2 >

Note: As of January 2025.
Source: BOJ, MUFG: Trust Bank

Exhibit 4: Japan's Policy Rate and 10 Year Bond Yield



Source: Bloomberg, MUFG: Trust Bank

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