

19 Mar 2025 07:11:26 ET | 9 pages

# Japan Economics

## BoJ MPM review: Neutral communication

### CITI'S TAKE

At today's MPM the BoJ unanimously decided to keep monetary policy unchanged, as had been widely expected. Governor Ueda pointed to encouraging wage hikes and upside risk to inflation expectations domestically, while also highlighting overseas uncertainty like US tariffs, thus keeping his overall communication neutral. We continue to expect a 25bp hike in each of June and December this year, but there is considerable uncertainty surrounding the monetary policy outlook at least until April.

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## BoJ MPM review: Neutral communication

At today's MPM the BoJ unanimously decided to keep monetary policy unchanged, as had been widely expected. The MPM statement contained almost no new elements, and the only risk factors added were developments in trade policies and the resulting influence on overseas economic and price trends, which was not a surprise. Governor Ueda pointed to encouraging wage hikes and upside risk to inflation expectations domestically, while also highlighting overseas uncertainty like US tariffs, thus keeping his overall communication neutral.

Governor Ueda said the results of spring wage negotiations were broadly in line with his expectations. Therefore, as we have previously noted, the wage hikes are unlikely to result a rush to hike rates in a deviation from the roughly once-every-six-months pace. However, Governor Ueda also said the wage hikes were on the stronger end of the expected range. He also revealed that some members had stated they would continue to monitor the upside risk to inflation. These factors may support a rate hike in June rather than July.

We continue to expect a 25bp hike in each of June and December this year. However, there are many variables that could affect the BoJ's decision. First, there is upside risk to domestic inflation expectations due to food price hikes, which Governor Ueda said could affect underlying inflation. Although he said underlying inflation is still below 2%, it was raised by one notch in January and drew closer to 2%. Under these circumstances we believe any upward surprise is more likely to trigger a rate hike than before. Attention will be focused on longer-term inflation expectations in the *Tankan* survey and the Household Opinion Survey due out in April.

On the other hand, a US economic slowdown and tariffs pose a downside risk to Japan's economy and prices. In the US more people will join the labor market from spring for seasonal reasons, which will be compounded by the layoffs of federal employees. Amid somewhat worsening sentiment at companies that have already restrained new hiring, it will be critical whether new entrants into the labor market can be absorbed.

Regarding tariffs, President Trump has indicated his intention to impose reciprocal and sectoral tariffs on April 2. If a 10% reciprocal tariff is imposed on Japan for reasons such as currency manipulation, we estimate this would push down Japan's GDP by 0.2ppt. If a 25% auto tariff is also imposed, this will further push down Japan's GDP by 0.1ppt-0.2ppt. In addition to the direct impact on Japan, tariffs on Europe as well as additional tariffs on China could increase the risk of a downturn in the global economy. This could mean the BoJ has no choice but to watch and wait. If tariffs were to continue for a long time, the next rate hike could be delayed even further from the summer. Governor Ueda says the US trade policy should become clear to some extent by early April, and its impact on the Japanese economy and prices will likely be reflected in the Outlook Report to be issued at the next meeting.

Finally, the domestic political situation is a bit concerning, given the drop in Cabinet approval ratings in the wake of the PM Ishiba's gift certificate issue. The opposition could unite to pass a motion of no confidence, but we think pressure for the PM's resignation from opposition parties is likely to be limited, as they will not likely be able to unite in the ensuing PM election vote and may believe it would be more advantageous to have PM Ishiba remain in power until the upcoming Upper House election. Rather, future developments in the Cabinet's approval rating and corresponding actions within the LDP will be key ahead of the election. At this

point we do not see PM Ishiba's resignation as our baseline scenario. Even if he were to resign, the situation is too uncertain at this moment to be sure who would be the next PM, including whether the chance of it being Sanae Takaichi, who calls for aggressive fiscal and monetary easing, is high.

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