

Global Macro Insight

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Bank of Japan on hold

- We expect no change in the policy rate from the Bank of Japan (BoJ) at this week's monetary policy meeting.
- The underlying macro backdrop – activity and prices – is likely to unfold in a manner consistent with the BoJ's forecast. As such we expect the BoJ to hike two more times this year by 25bp each in May and October.
- BoJ officials are closely watching financial market developments. Heightened trade policy originating from the Trump administration could be a source of volatility in financial markets in April. If volatility is elevated, BoJ officials will have limited appetite to adjust policy in May.

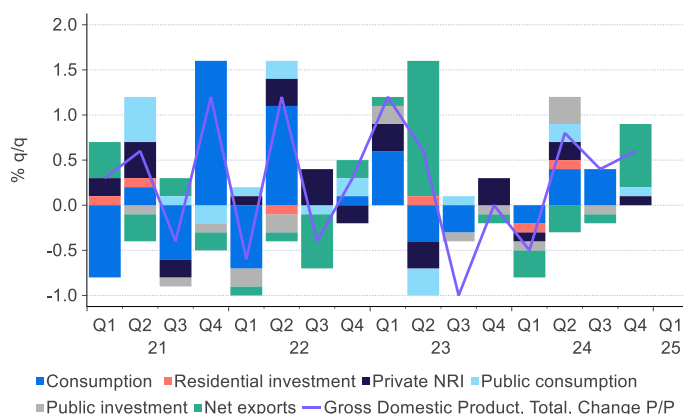
BoJ on course for gradual rate normalisation

The BoJ is on course to leave rates unchanged following a 25bp hike in January. Our sense is that it is on track to gradually tighten policy towards neutral this year, as the economy unfolds in line with its expectations – the criterion it set for further rate hikes.

Recent developments in activity support the BoJ's contention that growth is running above trend. GDP growth has been running above potential for the last three quarters. The variable mix in contributions to growth is worth watching, as it suggests the foundations for growth aren't sustainable. For example, household consumption was flat in Q4 2024. That said, there appears to be a strengthening virtuous cycle between income and spending for both households and businesses. Corporate profits are healthy and the appetite for capex is strong according to the latest Tankan survey. Significant labour shortages are another motivator for capex. Meanwhile, favourable household income fundamentals should support private consumption.

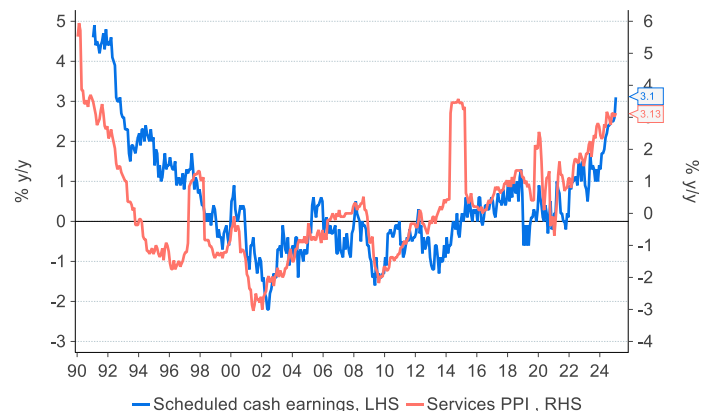
Underlying inflation continues to exceed the BoJ's 2% target. Although some of this is due to temporary cost-push factors, inflation running at 2% is looking more sustainable. Indeed, services inflation is steadily grinding higher amid strong economy-wide wages growth. Scheduled cash earnings are growing at over 3% for the first time in more than three decades. In addition, Rengo just announced its first round result of the 2025 spring wage negotiations. It is seeking a 5.46% pay rise, which is up on last year.

Figure 1. Japan GDP – contributions



Source: BoJ, SBJ, Macrobond, ANZ Research

Figure 2. Wages and services inflation

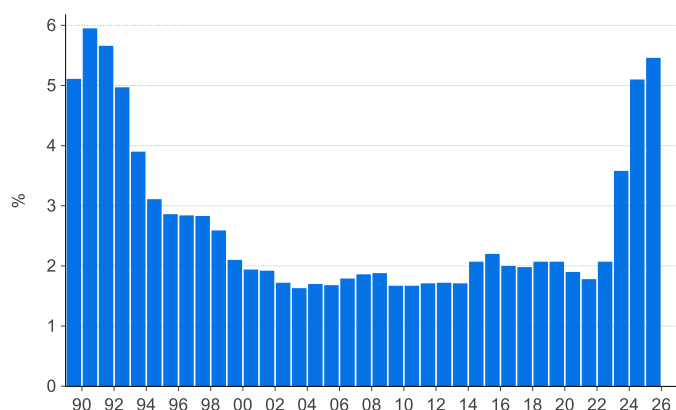


Source: BoJ, SBJ, Macrobond, ANZ Research

Given the macro backdrop and additional updates on the unions' wages demands for the 2025 financial year, we think the BoJ will be on course to hike rates by 25bp at its next meeting on 30 April-1 May. Then to raise rates again in October taking the policy rate to 1%, which we consider to be the terminal rate for this hiking cycle. Our call is based on no tumult in financial markets at the time of these policy meetings. Multiple BoJ officials have made it clear that they will not consider a tightening in policy if financial markets are volatile.

A potential source of instability for financial markets will be the Trump administration's trade policy. Several new tariffs are expected to be announced in early April which could have meaningful implications for global trade and markets. These developments will be watched carefully by BoJ members when deciding on future policy adjustments.

Figure 3. Unionised annual pay increments



Source: Rengo, Macrobond, ANZ Research

Figure 4. 10y JGB yields



Source: BoJ, Macrobond, ANZ Research

Recent developments in the Japanese government bond (JGB) market have not phased the BoJ.

The JGB 10y yield has risen to 1.5%, the highest since 2008. Governor Ueda says the rise to date reflects expectations of future policy moves from the central bank. The market is pricing at least one 25bp hike this year plus a 25% chance of another hike. If JGB yields were to become too volatile, the BoJ is likely to alter its JGB purchases to counter the rise in yields.

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