

FLASH NOTE – BOJ HIKE, HAWKISH ENOUGH TO SHORE UP YEN BUT NOT HAWKISH ENOUGH TO GENERATE A SHOCK

The Bank of Japan has hiked rates as expected by 25bp to 0.5 per cent and governor Ueda looks to have threaded the needle on policy messaging successfully – with his signal being hawkish enough to shore up the Yen but not being so hawkish as to generate a shock to markets, which have digested the move well.

The overall message is the BoJ is oriented towards further careful rate normalization over time as it gains confidence that Japan's economy is normalizing with inflation settling durably around 2 per cent over the forecast horizon – underlined by a larger than expected upgrade to its inflation outlook – but does not see any need to rush.

Specifically we see Ueda as signaling relatively hawkish on the ultimate destination (both in terms of the terminal and neutral rate) while remaining careful, even a bit dovish on pace.

Ueda said “there is still a considerable distance to the neutral interest rate” – again citing the 1 to 2.5 per cent range from a BoJ study. Asked about the market-implied terminal rate of 0.75 per cent, he said “I do not have a particular level in mind as a limit to further hikes.”

But he also emphasized “we would like to proceed carefully with policy normalization.”

The BoJ governor said “we do not have any preconception about the pace or timing”. Some will suggest this points to upside risk of faster hikes but we think this is deliberate fuzziness intended to discourage a new wave of Yen carry trades.

With continued emphasis on global uncertainty including from Trump trade actions and – we think – gradual rather than rapid evolution of the Japanese economy, with risk that trade uncertainty could dampen the Shunto wage round some, we think the default pace is once per six months at present. We remain confident the BoJ will not move again before July, and retain our base case of one more hike this year – though with further tightening possible in 2026.

We continue to think Ueda is oriented towards taking rates to 1 per cent then assessing from the data whether the BoJ is done there or not, and the pace is a function of the Bank's risk management assessment.

If upside risk to inflation is mounting, the BoJ would hike at a pace of once per quarter. But if upside risk to inflation is moderate and/or balanced by downside risks, the BoJ would hike at the default once per six months pace.

At present this risk management assessment – taking into account Trump and the gradual evolution of the Japanese economy – favors the default once per six months.

The BoJ will learn along the way how high the neutral and terminal rates may ultimately lie. We are very open to the possibility that the ultimate destination is higher than the market anticipates,

but is reached in a slow and methodical manner to allow for the learning the BoJ needs, given lack of any experience in recent decades of how the economy will operate under higher rates.

Forecasts of the Majority of the Policy Board Members

y/y % chg.

	Real GDP	CPI (all items less fresh food)	(Reference) CPI (all items less fresh food and energy)
Fiscal 2024	+0.4 to +0.6 [+0.5]	+2.6 to +2.8 [+2.7]	+2.1 to +2.3 [+2.2]
Forecasts made in October 2024	+0.5 to +0.7 [+0.6]	+2.4 to +2.5 [+2.5]	+1.9 to +2.1 [+2.0]
Fiscal 2025	+0.9 to +1.1 [+1.1]	+2.2 to +2.6 [+2.4]	+2.0 to +2.3 [+2.1]
Forecasts made in October 2024	+1.0 to +1.2 [+1.1]	+1.7 to +2.1 [+1.9]	+1.8 to +2.0 [+1.9]
Fiscal 2026	+0.8 to +1.0 [+1.0]	+1.8 to +2.1 [+2.0]	+1.9 to +2.2 [+2.1]
Forecasts made in October 2024	+0.8 to +1.1 [+1.0]	+1.8 to +2.0 [+1.9]	+1.9 to +2.2 [+2.1]

Notes: 1. Figures in brackets indicate the medians of the Policy Board members' forecasts (point estimates).

2. The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate -- namely, the figure to which they attach the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.
3. Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.

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