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BOJ Raises Policy Rate to 0.5%

—While the main scenario is a continuation of mild rate hikes, there is a risk of accelerated rate hikes depending on Trump economic policy—

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- The Bank of Japan decided to raise its policy rate at BOJ Monetary Policy Meeting on 24th January. The rate is raised to around 0.5% from the current level of around 0.25%, 0.5 is the highest raised in 17 years. Looking ahead, the GDP gap is expected to turn positive and wage hikes of around 5% are expected in the current spring labor wage negotiations, which is expected to lead the economy toward the BOJ's goal of a complete break from deflation. Therefore, we expect that the interest rate hike phase will continue, and that the Bank of Japan will raise interest rates at a pace of 0.25% in every six months.

- I believe that it is desirable to raise interest rates gradually at a pace that does not adversely affect financial markets. If interest rates are too low, there will be less room for monetary easing in unforeseen circumstances, and there is a risk of being forced into unconventional monetary easing again at some point. Under circumstances where responding to the economic downturn is not the top priority, raising interest rates from the exceptionally low interest rate environment is desirable from the perspective of normalizing monetary policy.

- With regard to future price developments and monetary policy, what should be kept in mind is the ongoing depreciation of the yen in response to the Trump administration's economic policies. President Trump is attempting to take pro-inflationary policies such as raising tariffs and cutting taxes substantially. In that case, there is a risk that U.S. interest rates will rise above current market expectations. With the strong influence of interest rate differentials in the foreign exchange market these days, a strengthening of U.S. interest rates would be a factor in weakening the yen. We expect the BOJ to raise interest rates at a moderate pace, while the Fed will stop cutting rates in early spring in anticipation of inflationary pressures in the U.S. due to the new Trump administration's massive tax cuts and tariff hikes, etc.

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Therefore, we expect the U.S.-Japan interest rate differential to move slightly and have a limited impact on the currency. This is our main scenario. However, if the Trump administration's tariffs and tax cuts is larger than our expectations, there is a risk that the Fed will adopt hawkish monetary policy in response to higher-than-expected prices in the U.S., which could accelerate the yen's depreciation.

- Looking at the impact on Japan, the recent depreciation of the yen has benefited large corporations and the manufacturing sector, while small and medium-sized enterprises and the service sector have felt the pain through import inflation and other factors. In addition, while a weaker yen tends to lead to higher stock prices, which brings a plus effect for the wealthy people, it does not benefit the general public who do not own stocks. In other words, rather than benefiting the country as a whole, the yen's depreciation has accelerated the structure of social inequality.

- Therefore, if the yen weakens, the BOJ may accelerate the pace of interest rate hikes from the perspective of further weakening the yen and preventing imported inflation. President Trump's economic policy has also become an influence on Japan's monetary policy, and it is necessary to continue to watch it closely.

- **This is a English version of“（コメント）日銀が政策金利を 0.5%に引き上げ―メインシナリオはマイルドな利上げ継続ながら、トランプ政策次第では利上げ加速のリスクも―ー” in JRI Review (https://www.jri.co.jp/page.jsp?id=109896)**