PERSPECTIVES Memo

BoJ rate steady amid uncertainties

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Key takeaways

- The Bank of Japan (BoJ) kept interest rates unchanged – as widely expected – with the short-term rate at 0.5%. The BoJ's wait-and-watch approach reflects concerns around tariffs, U.S. economic growth, global equity market volatility and rapid JPY appreciation.
- We remain hawkish on the BoJ and expect three rate hikes, with the short-term rate to touch 1.25% by March 2026 in light of steady wage growth and inflation.
- We reiterate our constructive view on Japanese equities underpinned by corporate reforms that are well underway, domestic consumption supported by wage hikes and ongoing rate normalisation as the BoJ steers carefully amidst external headwinds. Valuations remain attractive with Topix 12m forward EPS growth expectations of 8.0% and a price/earnings ratio of 13.7x, which is in line with the long-term average.

What happened?

As widely expected, the Bank of Japan (BoJ) board unanimously decided to keep interest rates unchanged amid U.S. tariff uncertainty. Following the rate hike in January this year, the BoJ policy rate – which now stands at 0.5% – is already at its highest level in 17 years.

While inflation remains on an upward trajectory, growth headwinds from tariffs are holding the BoJ back temporarily from progressing on its interest rate normalisation path. CPI rose to 4.0% YoY in January, its highest in two years, due to rising food prices while core CPI (ex. fresh food prices) and super core CPI (ex. food and fuel prices) also remained elevated at 3.2% and 2.5% respectively, well above the BoJ's 2.0% target. Inflation is likely to moderate slightly in February due to the resumption of subsidies on electricity and gas prices, however, super core inflation is likely to remain steady at 2.5%. Wage hikes have also been supportive with Japan's largest trade union Rengo securing a 5.46% hike for 2025, higher than last year's 5.28% and a third consecutive annual hike following decades of stagnant wages.

In the monetary policy statement, the BoJ recognised the "moderate" recovery in Japan's economy. Business fixed investment has been steadily increasing on the back of rising corporate profits, and household consumption has been recovering thanks to improving labour market conditions. However, the BoJ highlighted the uncertainty of the trade policies of individual countries as one risk to the economy.

February exports were up 11.4% YoY as corporates built up inventories ahead of tariff implementations. Tariffs on steel and aluminium came into effect last week, while those on automobiles are likely to take effect from April 2. Japan's overall exports to the U.S. accounted for approximately USD138bn, i.e. 3.5% of GDP, of which auto exports made up about USD41bn, i.e. 1.0% of GDP. According to industry estimates, a 25% tariff by the U.S. on autos is likely to hit Japan's GDP by 0.2%. However, reciprocal tariffs on other products could also be applied by the U.S. although, Japan's average applied tariff rate of 1.9% is among the lowest globally.

What does it mean for investors?

Japanese equities showed a muted reaction to the BoJ decision. At the time of writing, the benchmark Nikkei 225 remained flat while the Topix Index was up slightly at +0.6%. USD/JPY fell by 0.2% to 149.6 at the time of writing, but it has risen +4.9% YTD, driven by USD weakening and rate hike expectations in Japan. The 10-year JGB yield remained flattish at 1.51% today – compared with 1.08% at end-2024.

Global equity markets and especially the U.S. market have seen higher volatility in recent weeks, due to tariff uncertainty and U.S. economic growth concerns. Against this backdrop, the BoJ will probably want to take a "wait-and-watch" approach, by avoiding hiking rates too quickly. In addition, on the political front, the upper house elections looming in July could create uncertainty for the current prime minister Ishiba, whose approval ratings have already reached a nadir amid the recent unfolding of the gift scandal. Ishiba's minority government had to make amendments to the upcoming annual fiscal budget plan under pressure from the opposition parties. Market participants may now be looking more closely at domestic political developments ahead of the parliamentary vote on the budget for the fiscal year beginning in April before the March 31 deadline.

On the economic front, we forecast Japan's growth to recover this year to 1.2% (vs. 0.1% in 2024). Meanwhile, favourable wage evolution and labour shortages are likely to remain a structural driver of inflation. We maintain our hawkish view on the BoJ and expect three rate hikes with the short-term rate expected to climb to 1.25% by March 2026. Weakness in external demand caused by tariff and U.S. macroeconomic uncertainties remains a key risk for the BoJ normalisation process. With these rate hikes, the JPY is likely to strengthen, and our USD/JPY forecast is 140 by March 2026. A rapid appreciation in JPY would be a key headwind for Japanese exporters.

We reiterate our constructive view on Japanese equities, underpinned by corporate reforms that are well underway, domestic consumption supported by higher wage negotiations and ongoing rate normalisation, with the BoJ steering carefully amidst external headwinds. We prefer high-quality names across sectors with a focus on balance-sheet strength and restructuring efforts. Valuations remain attractive with Topix 12m forward EPS growth expectations of 8.0% and a price/earnings ratio of 13.7x, which is in line with the long-term average.

Glossary

The **Bank of Japan (BoJ)** is the central bank of Japan.

The **consumer price index (CPI)** measures the price of a basket of products and services that is based on the typical consumption of a private household.

Earnings per share (EPS) is a financial ratio, which divides net earnings available to common shareholders by the average outstanding shares over a certain period of time.

The **Financial Services Agency (FSA)** is a Japanese government agency and an integrated financial regulator responsible for overseeing banking, securities and exchange, and insurance sectors in order to ensure the stability of the financial system of Japan.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

JGB stands for Japanese government bonds.

JPY is the currency code for the Japanese yen, the Japanese currency.

Nikkei 225, or the Nikkei Stock Average, more commonly called the Nikkei or the Nikkei index, is a stock market index for the Tokyo Stock Exchange.

Purchasing manager indices (PMI) provide an indicator of the economic health of the manufacturing sector and are based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. The composite PMI includes both manufacturing and services sectors. They can be published by public sector or private agencies (e.g. Caixin, Jibun Bank).

The **price-to-earnings (P/E) ratio** measures a company's current share price relative to its per-share earnings.

Return on equity (ROE) is a measure of a company's financial performance calculated by dividing net income by shareholders' equity.

Tokyo Stock Exchange (TSE) is the largest stock exchange in Japan and lists the nation's biggest companies.

Tokyo Stock Price Index, commonly known as Topix, along with the Nikkei 225, is an important stock market index for the Tokyo Stock Exchange in Japan, tracking all domestic companies of the exchange's Prime market division.

USD is the currency code for the U.S. Dollar.

YoY refers to year-on-year which compares data in a given month from the immediately preceding year.

Appendix

Historical performance

Performance	18.3.2020 - 18.3.2021	18.3.2021 - 18.3.2022	18.3.2022 - 18.3.2023	18.3.2023 - 18.3.2024	18.3.2024 - 18.3.2025
Topix	58.0%	-4.9%	2.6%	38.9%	2.3%
Nikkei 225	80.7%	-11.2%	1.9%	45.4%	-4.8%
USD/JPY	0.8%	9.4%	10.8%	13.0%	0.2%
10-Year Japan Treasury	-0.1%	-0.5%	2.6%	-2.8%	-4.6%

Source: Deutsche Bank AG, Bloomberg Finance L.P., LSEG Datastream; Data as of March 18, 2025.

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