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Major Central Bank Policy Stances Amid Market Turmoil

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Executive Summary

Fed Tries to Resist Early Easing Amid Market Turmoil

- Further to the turmoil caused by the tariffs announcement on "Liberation Day", there have been calls for the Fed to intervene with rate cuts to stabilise markets. But the Fed is navigating stagflation risks, with inflation proving sticky and growth slowing. Recession probability has risen above 45%, with business sentiment deteriorating.
- Tariffs are now seen as the top threat to the U.S. economy. While many Fed officials expect their inflationary effects to be temporary, uncertainty around trade and fiscal policy complicates decisions.
- Markets still expect rate cuts this year, but opinions are divided. Some officials warn that reversing tariffs later could make premature easing risky, potentially damaging the Fed's credibility.
- Tariff-driven market turmoil may prompt support, but rising inflation and inflation expectations are keeping the Fed cautious on near-term rate cuts.

ECB Is Likely To Continue Its Easing Cycle Given the Turmoil

- The ECB faces heightened uncertainty amid rising global trade tensions and evolving fiscal dynamics, with no consensus among Governing Council members on the appropriate policy response.
- Tariffs are widely seen as growth-negative, but their inflationary impact remains disputed, splitting the Council into dovish and hawkish camps.
- Doves like Panetta see tariff-driven inflation as temporary and outweighed by global deflationary forces, while hawks like Vujcic warn of persistent inflation risks, urging caution on rate cuts.
- Due to these divisions, the ECB is in wait-and-see mode, pending more data on the real impact of tariffs and retaliatory measures.
- Germany's €500bn fiscal plan and EU-wide defense spending proposals have introduced uncertainty into ECB policy. The plan may either support growth and delay rate cuts or tighten financial conditions via rising yields, requiring immediate easing.

BOE to Cut Faster if UK Outlook Deteriorates

- BOE remains cautious amid sticky services inflation (5.0%) and a fragile economy. Although headline inflation fell to 2.8%, core inflation and weak growth are keeping the bank on alert.
- UK policymakers are monitoring rising energy costs, a new employment tax, and possible tariff spillovers from the US. These could stoke inflation but may be offset by weakening demand.
- Fiscal policy in the UK is not expected to shift inflation significantly. Growth is sluggish, public finances are worsening, and only modest adjustments are expected in the next budget.

BOJ Likely to Hold Rates in May as Tariff Uncertainty Grows

- The Bank of Japan kept its policy rate steady to assess the effects of January's hike and monitor escalating global risks, particularly from Trump's tariffs, which are dampening the outlook despite domestic progress on inflation.
- With firms bracing for profit hits and uncertainty rising, traders now assign less than a 50% chance of another BOJ rate hike this year, as the central bank signals caution in response to the unprecedented trade shock.
- U.S. trade measures, including 'Liberation Day' and auto tariffs, are set to stall Japan's growth through 2026, lower inflation forecasts, and likely prevent the BOJ from raising rates this year amid rising strain on households and small firms.

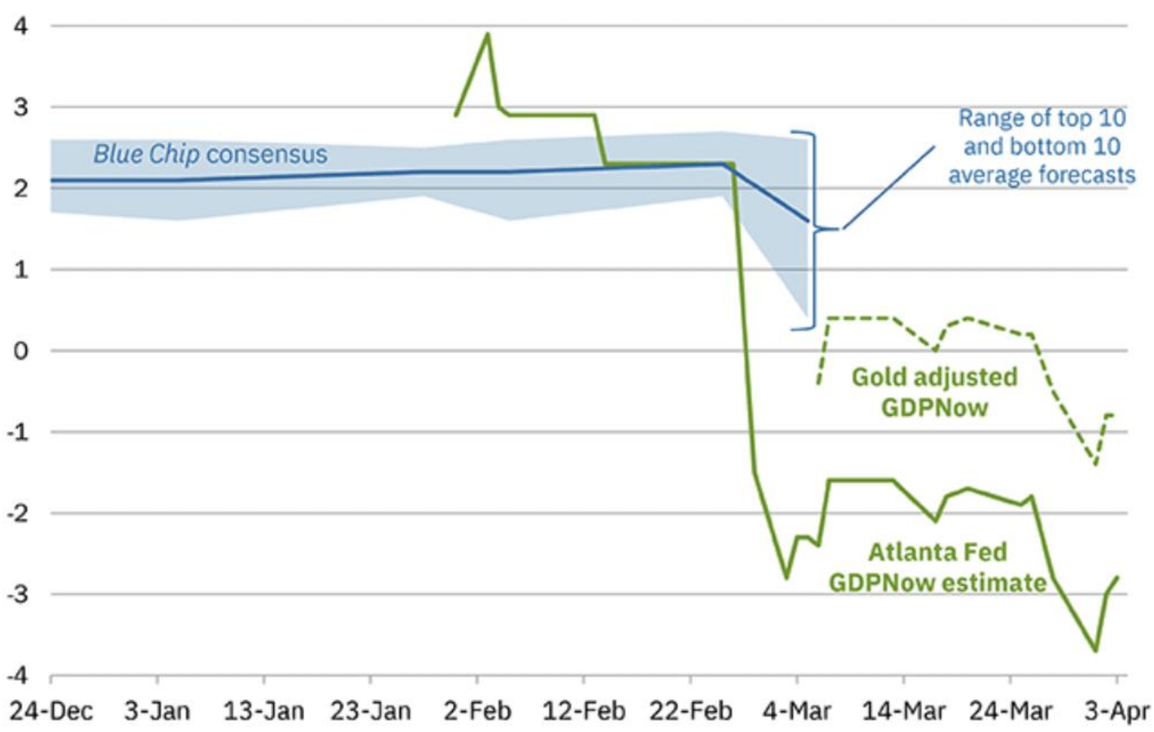
Fed Tries to Resist Early Easing As Growth Slows

Rising Recession Risks in the US

Further to the turmoil caused by the tariffs announcement on "Liberation Day", there have been calls for the Fed to intervene with rate cuts to stabilise markets. But we see the ongoing market turmoil being caused by a confidence crisis in the US institutions, especially given the very amateurish way the so-called "reciprocal tariffs" where calculated. As a result, if Powell were to capitulate to Trump's requests to cut rates to support the economy and markets, investors will also lose confidence in the autonomy of the Fed, further precipitating the US economy into chaos.

Clearly, recession fears in the United States are intensifying as economic uncertainty mounts (**Figure 1**). Goldman Sachs now sees a 45% chance of a U.S. recession, while J.P. Morgan has raised its U.S. and global recession odds to 60%, as escalating tariffs weigh on business confidence and growth forecasts. While unemployment remains low and some indicators still suggest modest economic growth, business sentiment is becoming increasingly cautious. Surveys show a growing belief among both consumers and firms that a slowdown or recession is becoming more likely.

Figure 1: Real GDP Estimate for Q1 2025 (Quarterly Percentage Change, SAAR)



Source: Atlanta Fed

This shift in sentiment is reflected in revised economic forecasts. The average GDP growth projection for 2025 has been cut from 2.4% to 1.7%. At the same time, inflation has shown renewed strength. The Fed's preferred measure—the core personal consumption expenditures (PCE) index—rose from 2.6% year-over-year to 2.8% in February, above the expected 2.7%. The headline PCE index stood at 2.5%, in line with expectations. These figures indicate that inflation remains persistent, and it's still too early to confirm a sustained disinflationary trend. Importantly, tariffs have now overtaken inflation as the top perceived threat to the US economy.

The Fed now faces a difficult trade-off: whether to ease policy to stabilize financial markets or hold off due to rising inflation pressures. While recent market turmoil due to latest tariffs announced may push the Fed to consider supportive measures, elevated inflation readings are likely to keep it cautious. At this stage, we do not expect a rate cut in May, as the Fed is likely to wait for clearer signals on both inflation dynamics and the broader economic outlook.

Fed Policy Outlook: Between Uncertainty and Stagflation

Uncertainty has become a defining theme in Federal Reserve communications. In its March Summary of Economic Projections, the Fed maintained its forecast for two rate cuts this year but simultaneously revised inflation projections upward and lowered growth estimates—largely due to tariff-related risks. Many Fed officials now view the dual threat of rising inflation and slowing growth—a potential stagflationary scenario—as a real possibility. Torsten Sløk, chief economist at Apollo, warned that this shock may intensify further.

Despite these risks, most market participants still expect the Fed to begin easing. Approximately 75% of respondents in a recent CNBC survey anticipate at least two quarter-point rate cuts this year. Although inflation remains elevated, the prevailing view is that the inflationary impact of tariffs will be temporary. Two-thirds of those surveyed believe tariffs will cause a one-time price jump rather than sustained inflation, which supports the case for rate cuts.

However, the policy outlook is far from clear-cut. While a majority expects easing, around 19% believe the Fed will hold rates steady all year. The challenge for the Fed, and for Chair Jerome Powell in particular, is navigating this uncertainty. If the Fed cuts rates in response to rising unemployment or slowing growth, and the tariffs are later reversed by the Trump administration, it could undermine the Fed's credibility and suggest it acted prematurely.

The Tariff Effect: Inflation, Growth, and Policy Trade-offs

Tariffs remain a central concern for policymakers. According to St. Louis Fed President Alberto Musalem, if new tariffs are fully implemented, St. Louis Fed staff estimates they could add up to 1.2 percentage points to the inflation rate—roughly split between direct and indirect effects. While it might be appropriate to "look through" the one-time effects, the indirect, second-round impacts must be watched carefully, especially if they threaten to un-anchor inflation expectations. Retaliatory measures from trade partners could further complicate the picture. They may dampen growth and reduce inflationary pressure, adding another layer of complexity to monetary policy decisions. St. Louis Fed President Alberto Musalem also added that if inflation expectations were to rise significantly, he might consider supporting a rate hike. For now, however, that scenario seems unlikely for most of his fellow policymakers.

Tariffs are only one piece of a much larger puzzle. Fed Chair Jerome Powell emphasized last week that policymakers must assess the combined impact of the Trump administration's full agenda—including spending cuts, tax changes, deregulation, and stricter immigration policies. Taken together with tariffs, the overall effect remains highly uncertain.

Richmond Fed President Tom Barkin echoed these concerns, stating that the Fed's current "moderately restrictive" policy stance is appropriate given the fast-moving and unpredictable nature of US government policy. While he did not directly address the newly announced 25% auto tariffs, Barkin acknowledged they could drive inflation higher—though this might be offset by forthcoming tax or regulatory changes.

So far, upward pressure on goods prices from the "Liberation Day" tariffs—combined with a recent sharp rise in US households' medium-term inflation expectations—suggests the Fed is likely to adopt a more cautious stance on additional rate cuts in the near term.

The ECB Is Likely To Continue Its Easing Cycle Given the Turmoil

Introduction

The European Central Bank (ECB) stands at a crossroads. As the Eurozone contends with new trade tensions and evolving fiscal dynamics, the ECB's Governing Council remains divided on how to respond. Two key forces are shaping the policy debate. First, the imposition of tariffs and countermeasures has introduced a new layer of uncertainty for inflation and growth. Second, Germany's fiscal expansion—alongside broader European-level proposals—raises questions about the appropriate scale and pace of monetary easing. As the ECB prepares for its next moves, it must navigate a landscape marked by external shocks, internal disagreements, and shifting political alliances.

The Impact of Tariffs: Division and Delay

President Trump's April 2 "Liberation Day" tariffs mark a sweeping escalation in trade tensions, with the U.S. imposing "discounted reciprocal tariffs" based not only on tariff levels but also on non-tariff barriers like VAT and technical standards. The EU was hit with a 20% tariff—second only to China's 34% (subsequently raised to 104%) —raising serious concerns over its export exposure and economic outlook. The economic hit could be significant. The 20% blanket tariffs could reduce eurozone GDP by 0.3 pp over two years. Consumer and business sentiment is already weakening, likely curbing spending and investment.

On that issue, there is broad consensus that their effect on growth is negative. ECB Executive Board member Fabio Panetta has argued that tariffs weaken economic confidence and activity, exacerbating the fragility already present in the Eurozone economy. However, the implications for inflation are far less clear-cut, leading to stark divisions within the Governing Council.

Panetta, often seen as one of the more dovish voices on interest rates, emphasizes that the downside risks to growth and suggest that inflationary pressures from tariffs are likely to be short-lived and outweighed by deflationary forces. Panetta explained that while higher US tariffs—and any European retaliation—could lead to a weaker euro, this effect would likely be offset by a broader global economic slowdown. Additionally, if China redirects goods affected by the tariffs to Europe, it could further ease inflationary pressures, balancing out the impact of a weaker currency. Others, such as Yannis Stournaras, in a similar manner, contend that the inflationary and deflationary impacts of tariffs essentially cancel each other out, leaving the overall effect broadly neutral. Retaliation may raise inflation in the short term, but weaker economic activity would ease pressures in the medium term. The initial stagflationary effect is likely to give way to deflationary forces, so this should not derail the ECB's path toward lower rates.

Yet there is also a more hawkish camp, represented by figures like Vujcic, who warn that tariffs could drive inflation materially higher—justifying a more cautious approach to monetary easing. He warns that a retreat from globalization could fuel rising consumer prices in the years ahead. Calling the trend "mostly" inflationary, the Croatian central banker pointed to a range of contributing factors—from trade tariffs and higher energy costs to more expensive labor, rising production expenses, and weaker foreign demand for domestic goods and services.

So far, While the EU has delayed its initial countermeasures until mid-April and remains open to negotiation, it has signaled a readiness to retaliate if no resolution is found. Proposed responses include reinstated tariffs on U.S. goods, expanded duties on sensitive sectors (agriculture, machinery, consumer goods), and possible restrictions on U.S. firms under the Anti-Coercion Instrument.

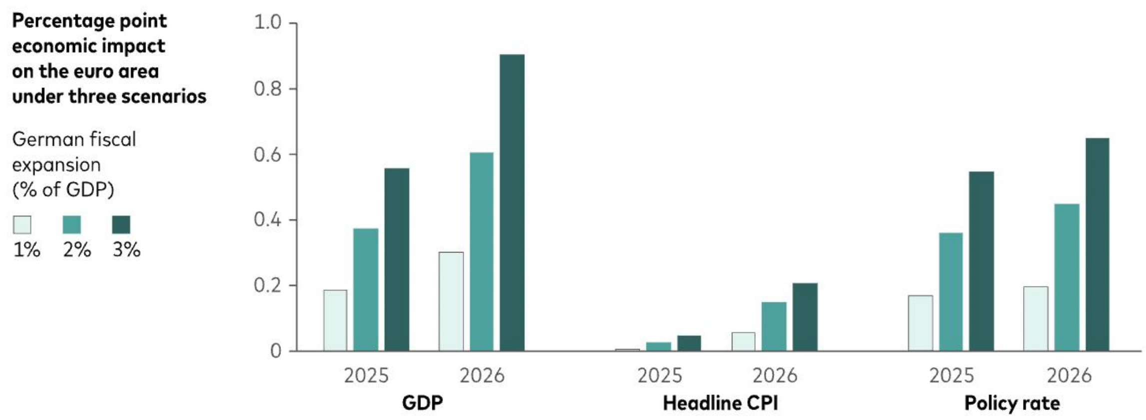
These divergent assessments have left the Governing Council without a clear direction. As a result, no resolution is expected in the immediate term. Policymakers are awaiting more concrete data on the economic effects of the tariffs themselves and the potential consequences of the countermeasures recently announced by the European Union. Until these effects are better understood, the ECB is likely to maintain a wait-and-see approach.

Fiscal Expansion

Parallel to the tariff debate, a more fundamental shift in the fiscal landscape is unfolding. At the European level, the European Commission has proposed the ReArm Europe/Readiness 2030 plan that aims to quickly mobilize up to €800 billion for defense investments. It provides financial incentives for EU Member States to boost investments in defence capabilities. However, this initiative remains at the conceptual stage—it is not yet real money, but rather a declaration of intent and a potential borrowing facility. As such, its near-term impact on growth is uncertain and will depend on political negotiations and implementation timelines.

At the national level, the more immediate and consequential development is Germany's proposed €500 billion fiscal package, aimed at infrastructure and other strategic investments (**Figure 2**). This marks a significant departure from Germany's traditional fiscal conservatism and has been met with intense political contestation. To enable this spending, an amendment was passed with the support of at least two-thirds of parliamentarians, allowing the government to increase the budget deficit by one percent.

Figure 2: Germany's Fiscal Easing Effects



Source: Vanguard

Yet the political context in Berlin is highly volatile. Coalition talks remain fraught. Friedrich Merz pushed through the fiscal amendment before the new parliament was officially seated, prompting constitutional complaints from AfD and Sahra Wagenknecht Alliance on the grounds that such decisions during an election transition period violate democratic norms. Critics argue that no emergency justifies this move, and the legal challenge has placed a sword of Damocles over the incoming government.

Meanwhile, parties jostle for influence. Germany's two likely governing parties – CDU and SPD – have agreed to adopt a significantly tougher stance on migration. However, key issues remain unresolved. The SPD continues to oppose the CDU's proposal to establish asylum processing and return centers outside the country. Beyond migration, the parties are also divided on defense policy. The CDU is pushing to raise defense spending to 3.5 percent of GDP—well above NATO's 2 percent target—which would elevate Germany's military standing and reshape European defense. While the SPD acknowledges the need to strengthen the armed forces, it is reluctant to commit to such an ambitious increase. Meanwhile, as part of the defense and infrastructure deal, the Greens secured a constitutional provision linking spending to climate neutrality.

The spectre of a failed coalition haunts the negotiations, as Merz hints that failure to form a government could lead to the dissolution of parliament and new elections. In that scenario, the AfD could gain further ground, a prospect that may eventually pressure the SPD into accepting a CDU-led coalition, with or without formal participation from the Greens. Although tensions are high, the most likely outcome remains a CDU-SPD coalition, possibly with informal Green backing. The Greens are already signaling a desire to differentiate between green infrastructure spending and military outlays. Nonetheless, the fiscal direction of the new government remains central to the ECB's decision-making.

Even though, Germany's fiscal announcement came too late for inclusion in the ECB's March forecasts, the ECB struck a cautious tone in its statement, highlighting greater uncertainty and fiscal loosening as risks to the euro area outlook. Uncertainty remains around the fiscal plan's timing and implementation, particularly regarding defense spending.

The ECB's Policy Dilemma: When and How Much to Cut?

ECB President Christine Lagarde has so far kept her cards close to her chest. She is waiting to see the final contours of Germany's coalition agreement and the fate of the proposed fiscal package. Until those questions are resolved, no major shift in policy can be expected. The ECB does not want to move prematurely without understanding how fiscal developments will affect growth and financial conditions.

If the German fiscal package fails to materialize, the ECB is widely expected to cut rates in April and again in June. There is also a reasonable chance of additional cuts in July and September. This scenario assumes that without fiscal stimulus, the ECB will need to carry more of the burden in supporting the Eurozone economy.

If, on the other hand, the German package is approved, the debate becomes more complicated. The one argument is that stronger fiscal support will lift growth prospects and allow the ECB to ease more cautiously. Under this view, the ECB could afford to pause in April, cut in June, pause again in July, and potentially cut again in September.

However, the other argument contends that this logic is flawed. While fiscal announcements may improve growth prospects in the long term, in the near term they are causing long-term bond yields to rise, effectively tightening financial conditions. Indeeed, the planned surge in government debt to fund Germany's fiscal package sparked a bond sell-off, causing the biggest weekly yield jump since reunification in 1990. Moreover, the growth effects of infrastructure spending will take years to materialize. In the meantime, the ECB still needs to act to support demand and prevent real rates from becoming too restrictive.

This second argument may be more compelling in the short run. If financial conditions are already tightening due to rising yields, the case for rate cuts in April and June remains strong. Waiting for the fiscal expansion to deliver growth may take too long to address current weaknesses.

In this context, a potential compromise is emerging. The ECB could cut rates in April and June, and clearly signal that these are the final moves of the current easing cycle. This approach might be acceptable to both hawks and doves. The hawks could support it on the basis that 2 percent represents a reasonable end-point, while the doves would view it as the minimum necessary to support the recovery—particularly if fiscal support proves limited or delayed. By acting decisively now and drawing a line under further cuts, the ECB could avoid prolonged internal divisions while still fulfilling its mandate.

Conclusion

The ECB's policy trajectory remains highly uncertain, shaped by internal divisions, political gridlock in Germany, and shifting global trade dynamics. President Lagarde has adopted a cautious stance, avoiding premature commitments while key fiscal developments remain unresolved. The months ahead—particularly April and June—are likely to be pivotal. The central bank's approach will hinge on whether Germany's fiscal package is approved and how quickly its effects materialize.

In this environment, a gradual easing path—anchored by limited and well-communicated rate cuts—may serve as the most pragmatic compromise for a divided Governing Council. As Panetta has argued, relying too heavily on elusive concepts like the "neutral rate" (R-star) risks distracting from the ECB's core mandate. With inflation still above target, the focus must remain on actual price dynamics and whether current policy settings are adequate for guiding inflation back to 2%. In the end, flexibility, realism, and a sharp eye on underlying trends—not theoretical benchmarks—will be key to navigating the ECB's next steps.

After considering all this, and in the light of continued market turmoil, it seems that a rate cut in April is the more likely outcome. With that move almost fully priced in, if the ECB were to disappoint market, this would constitute a further tightening of financial conditions at the time in which markets are already tumbling. If a cut occurs in April, then a one in June becomes almost automatic. What happens next depends on the economic and financial conditions prevailing at that time, and the new forecasts issued by the ECB on that occasion.

BOE to Cut Faster if UK Outlook Deteriorates

Inflation Cools Slightly, But Remains Elevated

The UK has been as affected as other countries by the market turmoil deriving from "Liberation Day" announcements, even if the country managed to get only a 10% tariff, compared to the 20% imposed to the EU. On the macro front, UK inflation eased modestly in February but stayed well above the Bank of England's (BOE) 2% target, likely prompting continued caution among policymakers. Consumer prices rose by 2.8% year-over-year, down from 3.0% in January. The dip was slightly sharper than economists had forecast and was largely attributed to a smaller increase in energy costs and goods such as clothing and footwear. Some of this was partially offset by minor price increases in categories like alcoholic beverages, according to the UK statistics agency. Despite the decline, February's inflation rate was still the second-highest since March 2023, indicating persistent price pressures across the economy.

Of particular concern to the BOE is the services inflation rate, which held steady at 5.0%—a level seen as a strong indicator of domestic inflation dynamics. Meanwhile, core inflation, which excludes volatile items like food and energy, eased to 3.5%. Although the decline is welcome, it is unlikely to shift the BOE away from its cautious stance on rate cuts.

Although energy costs are set to rise in the coming months, global energy prices have recently fallen. If this trend is passed through to UK households more quickly than the BOE expects, inflation could return to target sooner than forecast. Such a development would give the BOE more flexibility to accelerate rate cuts, which could help stimulate growth in an economy that contracted at the start of the year and continues to show signs of weakness.

Monetary Policy: Steady Rates, Cautious Tone

The BOE opted to hold interest rates steady at its most recent meeting in March, mirroring the Fed's decision the day before. BOE Governor Andrew Bailey reaffirmed that while rates are expected to decline gradually, any policy easing would be approached with care. The UK has been slower to reduce rates compared to its European counterparts, and officials emphasized they will remain "cautious and careful" in future decisions.

The central bank projects inflation will rise further in the short term, possibly reaching 3.7% by mid-year. This outlook reflects the scheduled 6.4% increase in household energy prices from April 1, on top of earlier hikes in January.

Tax Increases and US Tariff Spillovers

Adding to the uncertainty is a new employment tax set to take effect in April. Policymakers expect some of the increased costs to be passed on to consumers, but the extent will depend on how strong demand remains in the economy.

The BOE also cited risks stemming from US trade policy, particularly the potential impact of higher American tariffs. These tariffs are raising costs for US businesses and could push up consumer prices. If the UK were to respond with retaliatory tariffs, domestic inflation could rise further. However, the British government has so far limited its actions to duties on steel and aluminum, avoiding broader trade confrontation with the US.

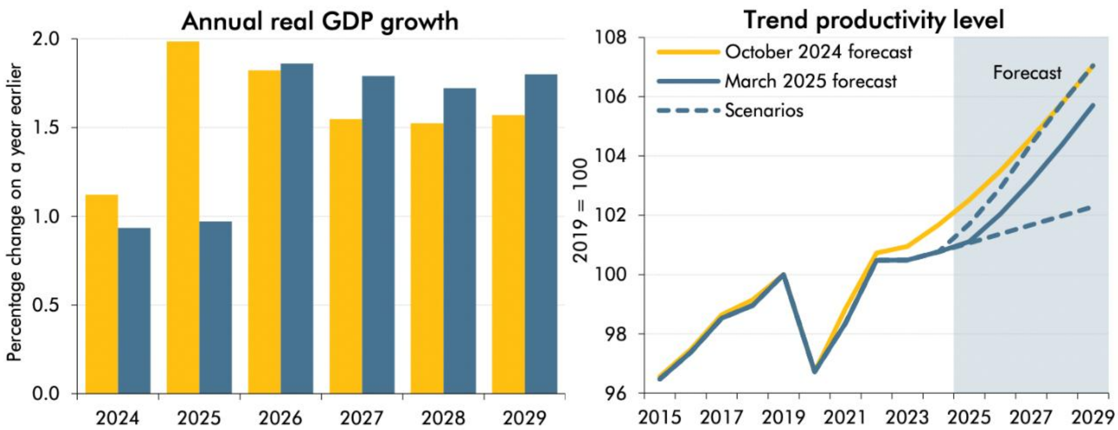
Bailey emphasized the importance of patience, saying it is essential to accumulate the evidence of easing price pressures. He added that they really do have to wait to see that evidence unfold, signaling a cautious approach to any policy shifts.

Rising U.S. tariffs could actually help lower UK inflation, according to BOE policymaker Swati Dhingra. Speaking in South Africa, she noted that global prices fell during Trump's first term as exporters in China and elsewhere cut prices to stay competitive. If this pattern repeats, combined with a weaker pound—which affects the 35% of UK imports priced in dollars—it could push UK prices downward. Dhingra said this dynamic would likely strengthen the case for interest rate cuts, consistent with her recent lone vote on the Monetary Policy Committee to begin easing now.

Fiscal Outlook Unlikely to Shift Inflation Trajectory

The UK's broader fiscal and economic outlook has become more challenging since the Autumn Budget. Growth stagnated in late 2024, confidence has fallen, and recent data offer little clarity about the country's domestic prospects. GDP growth is now expected to reach only 1% in 2025, half the rate projected last October, before slowly recovering. Inflation is projected to peak at 3.7% in mid-2025 before gradually returning to target.

Figure 3: Annual Real GDP Growth and Trend Productivity Level



Source: ONS, OBR

At the same time, the fiscal picture has weakened. Higher debt interest payments and disappointing revenues have reversed a previously projected surplus into a deficit. While policy reforms aim to offset part of the deterioration, borrowing and public debt are now expected to be higher by the end of the decade.

With only modest tax and spending adjustments expected in the upcoming budget, fiscal policy is unlikely to materially shift the inflation trajectory. For now, the BOE remains cautious, balancing persistent inflationary pressures against weak growth and heightened uncertainty. We expect a 25bps to take place in May: whether this will lead to an acceleration of the easing cycle (with cuts at every meeting instead of only during Monetary Policy Report months), is yet to be seen.

BOJ Likely to Hold Rates in May as Tariff Uncertainty Grows

Introduction

The Bank of Japan (BOJ) kept its policy rate unchanged at 0.5% to assess the impact of its January rate hike and wait for greater clarity on U.S. policy developments, after the 24% tariff slammed by the US on "Liberation Day." The BOJ's decision to keep rates on hold came amid concerns over a global slowdown driven by Trump's tariff policies, which overshadowed domestic wage and price data showing progress toward the 2% inflation target. The move, in line with market expectations, comes ahead of the U.S. Fed's policy meeting, where rates are also expected to be held steady. In January, the central bank raised its short-term rate to 0.5%—the highest since 2008—and has signaled further hikes are possible if growth and inflation stay on track.

However, with the new tariffs announced, Market expectations for a BOJ hike this year have sharply declined, with traders now seeing less than a 50% chance. The BOJ warned that rising uncertainty, driven by U.S. tariffs, is clouding Japan's economic outlook as firms fear profit losses. A BOJ branch manager called the Trump-led trade shock "unlike any other," signaling the central bank is likely to stay on hold for now.

BOJ Caught Between Inflation Risks and Tariff Fallout

Before the "Liberation Day" tariffs were announced, BOJ Governor Kazuo Ueda signaled that the central bank stands ready to raise interest rates if sustained increases in food prices begin to fuel broader inflation across the economy. Ueda noted that while Japan's recent bout of high inflation has been largely driven by temporary factors such as rising import and food costs, a more persistent shift in underlying prices would warrant policy tightening. Ueda made clear that if rising food prices begin to trigger broader inflation throughout the economy, the Bank of Japan would have to act by raising interest rates. His remarks underscored the central bank's increasing readiness to withdraw monetary support if inflation pressures deepen.

Minutes from the BOJ's January meeting revealed that policymakers debated the pace of future rate hikes after raising short-term rates to a 17-year high. Some members noted that even with the hike, real interest rates would remain deeply negative, preserving accommodative financial conditions. One member described the move as a modest adjustment rather than a shift away from easy policy. The board agreed that if economic and inflation forecasts hold, further tightening would be appropriate.

However, recently, Democratic Party of the People leader Yuichiro Tamaki warned that the Bank of Japan may need to reverse course and consider cutting rates if U.S. tariffs hurt the economy, shelving any plans for further hikes. Market expectations for a BOJ hike this year have sharply declined, with traders now seeing less than a 50% chance. Tamaki also criticized the BOJ's ongoing bond purchase reductions and emphasized the need for coordinated fiscal and monetary support amid rising prices and weak wage growth. Prime Minister Ishiba has voiced concern over the tariff impact, though Japan may receive priority in upcoming trade talks with the U.S.

Core and Underlying Inflation Still Below Target—But Rising

Japan's core consumer inflation reached 3.0% in February, marking nearly three years of readings above the BOJ's 2% target. However, Ueda emphasized that much of this is still due to temporary drivers, particularly food prices. The BOJ, he said, continues to focus on underlying inflation—long-term price trends that exclude short-term volatility.

The cost of living in Tokyo climbed more than expected in March, reinforcing expectations that the Bank of Japan may continue raising interest rates. Core consumer prices, which exclude fresh food, rose 2.4% from a year earlier, driven by faster inflation in processed food, according to data released Friday by the Ministry of Internal Affairs. The figure exceeded the median forecast of 2.2% and topped all estimates in a Bloomberg survey. Headline inflation also increased to 2.9%, up from 2.8% in February.

Ueda expressed confidence that it will gradually converge to the target as labor market tightening and economic recovery support steady wage growth and price increases. Nevertheless, he acknowledged the risk that underlying inflation could accelerate more rapidly than anticipated, suggesting that the BOJ is prepared to act if needed.

Wage Growth Key to Future Policy Moves

Wage dynamics remain central to the BOJ's inflation outlook. Ueda noted that the central bank is closely monitoring whether current wage growth—around 3% annually—can be sustained and broaden beyond large firms. A key question is whether wage hikes will filter through into service-sector prices and help anchor long-term inflation expectations.

Recent data show service-sector inflation hitting 3.0% in February, reinforcing expectations that further rate hikes may be on the horizon. Markets appear to agree—yields on 10-year Japanese government bonds briefly reached 1.585% last week the highest level since 2008, as investors price in further policy tightening.

Global Risks Add to BOJ's Cautious Stance

External uncertainties, particularly U.S. trade policy, complicate the BOJ's plans. The 'Liberation Day' and auto tariffs will significantly weaken Japan's growth outlook, with the economy expected to barely grow in 2025–2026. The government is unlikely to retaliate to avoid harming consumers, given Japan's reliance on U.S. food imports. Inflation forecasts will be lowered due to weaker growth, though supply chain disruptions could still push prices up. The Bank of Japan is now unlikely to raise rates this year, as the tariffs further strain households and small businesses.

The BOJ will issue fresh economic forecasts at its next policy meeting on April 30–May 1. A key focus will be how food prices, wage growth, and global risks shape the inflation outlook. Analysts widely expect the next rate hike to occur in the third quarter, most likely in July, if wage trends and inflation momentum continue.