MONETARY AFFAIRS:

Review: BoJ Keeps Rates Unchanged,

But Slows The Pace of QT

by

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Executive Summary

- **Decision Made**: *The Bank of Japan (BoJ) maintained its policy rates in June*. The BoJ board voted in an unanimous decision to keep its short-term policy rate unchanged at 0.50%. The BOJ kept its current tapering plan to cut JGB purchases by ¥400 billion per quarter, targeting ¥3 trillion monthly buying by March 2026. From fiscal 2026, *it will slow the pace*, halving reductions to reach ¥2 trillion by March 2027, in line with market feedback, fearing an impact on market and financial stability.
- **Policy Discussion**: *Bank of Japan to ease pace of government bond purchase reductions from April amid rising growth risks.* The BoJ held interest rates steady and extended its rate-hike pause for a third consecutive meeting, following a 25 basis point increase in January. It also signaled a slower pace of balance sheet reduction next year, reflecting a cautious approach to unwinding its decade-long stimulus. The decision comes amid rising Middle East tensions and U.S. tariffs, which are complicating efforts to raise still-low rates and reduce a balance sheet nearly equivalent to Japan's GDP.

  Governor Kazuo Ueda noted that persistently high oil prices could push up underlying inflation and potentially warrant a policy response. However, he highlighted greater downside risks from U.S. trade policy uncertainty, warning this could weigh on corporate bonuses and wage negotiations next year. He stressed the need for more data before considering another rate hike, adding that even if U.S. trade policy stabilizes, its economic impact remains unpredictable.

  The BoJ left its current bond tapering plan intact, aiming to reduce monthly JGB purchases to ¥3 trillion by March 2026 through quarterly cuts of ¥400 billion. From fiscal 2026, it will slow the pace, halving the reduction to reach ¥2 trillion by March 2027 in response to market feedback. Board member Naoki Tamura dissented, favoring a continuation of faster reductions. The move reflects the BoJ's priority to support market stability, particularly after last month's surge in super-long bond yields.

Key Picture: Bank of Japan Forecasts – 2024-2026 – From the October 2024 Outlook

	2024*f*			2025*f*		2026*f*		2027*f*
	Latest Reading	May Report	January Report	May Report	January Report	May Report	January Report	May Report
GDP (*real growth, y-o-y*)	1.7	0.7	0.5	0.5	1.1	0.7	1.0	1.0
Inflation* (*%, y-o-y*)	3.6	2.7	2.7	2.2	2.4	1.7	2.0	1.9

Source: Bank of Japan '*Outlook for Economic Activity and Prices*' May and January 2025. *Note:* 1. Forecasts are for the fiscal year (FY) in Japan from April 1 - 31 March of the following year; 2. Latest GDP reading for Q1-2025; 3. Latest inflation reading for April 2025.

Analysis

- **DECISION MADE**: *On June 17, the Bank of Japan (BoJ) remained on hold.* The BoJ kept its the key short-term interest rate at "around 0.50%" in an unanimous vote. In terms of *forward guidance*, further rate hikes would hinge on how likely it is that the Bank's economic outlook is achieved. Governor Ueda also emphasized the need to closely watch developments in the Middle East, while warning that growing trade policy risks—particularly from abroad—could start reversing positive wage-setting behavior among firms, especially in the manufacturing sector.

  In terms of *balance sheet policies*, the BoJ, by an 8-1 vote, agreed to gradually reduce its monthly JGB purchases to around ¥2 trillion by January–March 2027—cutting about ¥400 billion per quarter until early 2026, then ¥200 billion per quarter from April 2026 onward. The Bank retains flexibility to intervene if long-term rates rise sharply and may revise the plan at any policy meeting if needed. As of the June 2025 quarter, the Bank of Japan is estimated to purchase approximately ¥4.1 trillion in JGBs each month.

- **POLICY DISCUSSION:** *The BoJ held rates steady and signaled a slower pace of balance sheet reduction next year, reflecting a cautious approach to unwinding its long-standing stimulus*. Rising Middle East tensions and U.S. tariffs are complicating efforts to raise still-low rates and shrink a balance sheet now roughly equal to Japan's GDP. The BoJ extended its rate-hike pause for a third consecutive meeting, after raising rates by 25 basis points in January.

  BOJ Governor Kazuo Ueda warned that if rising oil prices persist, they could push up underlying inflation enough to warrant a policy response. However, he emphasized that the greater concern lies in the uncertainty surrounding U.S. trade policy, which poses significant downside risks to Japan's economic and inflation outlook. Speaking at a news conference, Ueda noted that this uncertainty could dampen corporate winter bonuses and impact next year's wage negotiations with unions. He stressed the importance of waiting for more data before deciding on the timing of the next rate hike, adding that even if U.S. trade policy stabilizes, its impact on Japan's economy remains highly uncertain.

  The BOJ left its current bond tapering plan unchanged, aiming to cut monthly purchases to about ¥3 trillion by March 2026 through quarterly reductions of ¥400 billion. However, it decided to slow the pace from fiscal 2026, halving the reduction to reach ¥2 trillion by March 2027—aligning with market feedback. Board member Naoki Tamura dissented, favoring continued ¥400 billion cuts. The slower balance sheet drawdown reflects the BOJ's caution after last month's surge in super-long bond yields, prioritizing market stability over faster progress in reducing its large holdings.

- **ECONOMIC ASSESSMENT:** *Japan's economy is recovering moderately, though some sectors remain weak.* GDP contracted by 0.2% in the March quarter—the first quarterly decline in a year—driven by a drop in exports. Meanwhile, headline inflation reached 3.6% in April, remaining above the BOJ's 2% target for over three years.

  Overseas economies show similar moderate growth, with softness tied to trade policies. Exports and industrial production are flat overall, with temporary boosts from U.S. tariff changes. Corporate profits are improving, supporting a modest rise in business investment. Consumption is growing steadily, helped by better employment and income, though dampened by weak consumer sentiment and price pressures. Housing remains sluggish, and public investment is flat. Inflation (CPI ex-fresh food) is around 3.5%, driven by wage pass-throughs and rising food/import prices, while inflation expectations are rising gradually.

  Looking ahead, growth is expected to slow as global trade frictions weigh on exports and profits, but easy financial conditions should provide support. Growth may pick up later as global conditions improve. Inflation is expected to soften as earlier import and food price effects fade, but underlying inflation should gradually rise with labor shortages and firmer long-term expectations. The outlook remains highly uncertain due to global policy shifts and their effects on markets and Japan's economy.

- **OUR TAKE:** *Recent events have suggested a more cautious approach to balance sheet normalisation*. Therefore, any plan for a rate increase is now being re-considered. Given ongoing market tensions, the BoJ will reconsider the possibility of hiking rates in the future, and July will be a pivotal moment with the new growth and inflation outlook figures.
- **MARKET IMPLICATIONS:** *The market reaction was muted*. After the BOJ decision, he 10-year JGB yield increased by 3 bps to 1.491%, and now trades around 1.475%. 2Y JGB rose to 0.756%. *The yen firms after the decision.* The yen appreciated 0.13% to 144.55 per dollar. *Japanese stocks closed higher.* After the decision, the Nikkei 225 closed 0.6% higher at 38,536.74, reaching a four-month high. It was boosted by Wall Street gains and easing Middle East tensions. Bank stocks after the BoJ signaled a long-term path toward rate hikes, while the broader market took the expected policy hold and slower bond tapering in stride.