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# Earlier BoJ hike would support JPY appreciation

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**The BoJ kept policy rates unchanged while maintaining a balanced tone on the justification versus impediments to further rate hikes. The recent strengthening of economic momentum in Japan though suggests the next hike might happen earlier, in July, followed by another by March 2026 before a pause. To manage the level of national debt, the BoJ will need to carefully manage the rise of policy rates and JGB yields. The BoJ's policy stance though supports our current Neutral stance on Japan equities, and our expectation of a gradual USDJPY decline over the coming months.**

The recent Bank of Japan (BoJ) monetary policy meeting yielded no change in rates and a balanced statement from Governor Kazuo Ueda. The tone of the statement points to a gradual approach to policy normalization, with a comprehensive consideration of economic risks. Markets remained unmoved, and stuck to only fully pricing in a 25bps rate hike by October, with full-year pricing at just a little more.

Although the BoJ's tone and market expectations remain unchanged, we believe economic circumstances have changed sufficiently to warrant a shift in when we expect the lone hike in 2025. We now think this 25bps hike is more likely to happen in July than in October, as we had previously expected. This is largely due to positive economic developments, such as accelerating inflation, strong wage increases, and the Trump administration's unhappiness about the USDJPY exchange rate being too high. The expectation of a slightly hawkish shift from the BoJ reinforces our investment views.

One caveat to this timeline is potential political turmoil should the ruling Liberal Democratic Party (LDP) lose the Upper House election (due by 27 July), or if US tariffs severely affect US and global economic activity. We ascribe a 40% probability to these developments leading to a slight postponement of the rate hike to the latter part of 3Q25.

**Ten-year JGB yield likely to remain around current 1.5% level through 2026.** Given the substantial government debt, Japan's policymakers will need to manage the rise in policy rates, which will exert upward pressure on JGB yields. Beyond the July rate hike, we expect one more by March 2026 (to hit 1%), and then a pause as the BoJ evaluates the impact of these hikes amid a potential downturn in the economic cycle. Our projections suggest that keeping the policy rate under 1.5% would help maintain a stable debt even in our worst-case economic scenarios. This maps onto our estimation of the terminal rate for this hiking cycle at 1.00-1.25%, and the BoJ's likely use of recalibrations of the pace of quantitative tightening (QT) to contain any spikes in JGB yields.

**Stay Neutral, and selective, on Japanese equities.** Uncertainty surrounding tariffs and regulations is likely to persist over the near term at least. This is likely to generate elevated levels of volatility and keep Japanese equities broadly rangebound. Within Japan equities, we continue to recommend Japanese banks as a core holding. Also important as a core holding are high-quality stocks with earnings drivers that are more resilient against the current environment of uncertainty, which will allow these stocks (in sectors such as IT services and power) to outperform. Lastly, we like stocks that could benefit from the bottoming out of the inventory destocking cycle.

**Policy stance supports yen appreciation.** We think the BoJ's tone supports our medium-term bullish view on the yen. We continue to see the USDJPY declining to 145 by year-end and to 142 by March 2026. We continue to favor selling USDJPY upside risks from 153 for yield pickup.

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