Liquid Insight

BoJ preview: Navigating a delicate balance amid downside risks

28 April 2025

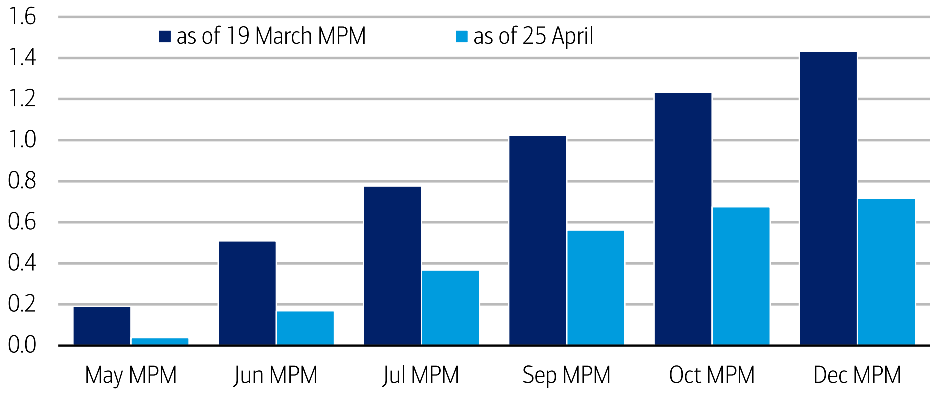
Rates and Currencies Research
Global

Key takeaways

- BoJ to stand pat at 1 May MPM; Governor Ueda to strive for a balanced tone while acknowledging downside risks.
- Rates: Bond market also focused on Governor Ueda's press conference; risk of curve bear-flattening.
- FX: Watch BoJ guidance on potential for Jun/Jul hike; market is long JPY = further rebound in USD/JPY possible

By Takayasu Kudo/Shusuke Yamada/Tomonobu Yamashita

Chart of the day: Number of BoJ rate hikes priced in by the market for each MPM
Market expectations for BoJ's rate hikes have significantly receded since the last MPM in March



Source: BofA Global Research, Bloomberg

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BoJ to stand pat: Focus on new forecasts, governor's comments

The BoJ's next monetary policy meeting (MPM) is scheduled for 30 April-1 May. We expect the BoJ to keep the policy rate at 0.5%, and as of the time of writing the market (OIS) concurred with our view, pricing in just a 2% chance of a rate hike. We think the BoJ will be forced to adopt a wait-and-see stance given the drastic changes in external conditions triggered by US tariff policy since the last MPM on 19 March. We think the focus at the MPM will be (1) the BoJ's new economic and inflation forecasts in its latest Outlook Report, and (2) Governor Ueda's comments at the post-MPM press conference on the outlook for economic activity and the path to normalizing monetary policy.

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Outlook Report: BoJ to stick with basic stance, cut FY25 forecasts

The BoJ will release its latest quarterly Outlook report at the upcoming MPM. We think it is unlikely for the bank to change its baseline scenario where it expects GDP growth to exceed the potential growth rate, and underlying inflation to increase gradually. The BoJ will likely stick to its rate-hiking cycle, in line with its previous statements that "if the outlook for economic activity and prices...will be realized, the Bank will accordingly continue to raise the policy interest rate and adjust the degree of monetary accommodation."

However, given the recent development of US tariff policy and its potential impact, we expect the BoJ to revise down its economic and inflation forecasts for FY25 (Exhibit 1). FY25 BoJ core CPI forecast (ex. fresh food and energy) will likely be lowered from +2.1% in January to 2% or below, factoring in the recent yen appreciation and the impact of free high school tuition from April. However, we expect the BoJ to forecast a return to near 2% inflation once the economic impact of tariffs fades, maintaining its c. 2% estimate for FY26 and adding a similar estimate for FY27. We will be looking both at the BoJ's forecasts and at its assessment of individual risks (Exhibit 2) to get a read on Policy Board members' current economic and inflation outlook.

Post-MPM press conference: Navigating a delicate balance

We expect questions at Governor Ueda's press conference to focus on how the drastic changes in external conditions since the previous MPM could affect the BoJ's economic and inflation outlook and monetary policy conduct. We expect Governor Ueda to reiterate his view that tariffs represent a major downside risk for the Japanese economy, as per his 16 April Sankei Shimbun interview, a 17 April speech by policy board member Junko Nakagawa, and his subsequent Diet testimonies. At this point, we think he will just reiterate his previous comments about carefully assessing the situation at upcoming MPMs and continuing to make appropriate policy decisions.

Given the wide range of economic and inflation scenarios that could arise depending on US tariff policy developments and the outcome of trade negotiations, we think he will aim for a balanced message that leaves the BoJ with the broadest possible range of policy options in the future.

We therefore think he will acknowledge that thus far the economy and inflation have remained solid and on track with the BoJ's forecasts, while reiterating both the downside risk to the economy from US tariff policy and the upside risk to inflation from rising food prices.

We think the market will be looking to Governor Ueda's comments for clues about the likelihood of a rate hike at the 17 June or 31 July MPM; it currently prices in a combined 30% chance of a hike. However, the BoJ's messaging could remain unclear due to the need to acknowledge both upside and downside risks, and we doubt the upcoming MPM will give the market a high clarity on the outlook for monetary policy.

-Takayasu Kudo, Japan Economist

Exhibit 1: BoJ policy board GDP/CPI forecasts (median)
We expect the BoJ to downgrade its FY25 forecasts for growth and inflation in the May Outlook Report

	FY24	FY25	FY26	FY27
Real GDP				
New forecasts*	0.7	0.7	0.8	1.0
January forecasts	0.5	1.1	1.0	-
CPI ex fresh food				
New forecasts*	2.7	2.1	2.0	2.0
January forecasts	2.7	2.4	2.0	-
CPI ex fresh food & energy				
New forecasts*	2.3	1.9	2.1	2.0
January forecasts	2.2	2.1	2.1	-

Source: Bank of Japan, Bloomberg, BofA Global Research *New forecasts are BofA's expectations for the May Outlook Report

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Exhibit 2: Risk assessment of CPI (ex fresh food) forecasts
BoJ's risk assessment as of January Outlook Report

	FY24	FY25	FY26
2.8	△○		
2.7	○○○○○	△	
2.6	△○	△	
2.5		△	
2.4		○○	
2.3		△▼	
2.2		○	
2.1		○	△○○
2.0			△○
1.9			○○
1.8			○▼

Source: Bank of Japan, BofA Global Research; Note: The locations of ○, △, and ▼ in the charts indicate the figures for each Policy Board member's forecasts to which they attach the highest probability. The risk balance assessed by each Policy Board member is shown by the following shapes: ○ indicates that a member assesses "upside and downside risks as being generally balanced," △ indicates that a member assesses "risks are skewed to the upside," and ▼ indicates that a member assesses "risks are skewed to the downside." The yellow-shaded figure refers to the median of the Policy Board members' forecasts

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Rates: Risks skewed toward bear-flattening

As noted, the market (including us) generally expects the BoJ to stand pat at the upcoming MPM. It will likely look to Governor Ueda's press conference for clues to the timing of the next rate hike and the outcome of the BoJ's interim assessment of its JGB purchase reduction at the 16-17 June MPM.

However, as our Japan economist notes, a variety of scenarios for the Japanese economy and inflation could emerge depending on future US-Japan trade negotiations, and we therefore expect Governor Ueda to strive for a balanced message that leaves the BOJ as many options as possible, as per his recent Diet testimony.

Some JGB market participants think the BoJ should accelerate its current ¥400bn per quarter cuts to JGB purchases. However, the BoJ announced that it will hold a meeting of the Bond Market Group on 20-21 May to exchange views on its JGB purchases. We therefore expect Governor Ueda to limit his comments at the post-MPM press conference to noting that it will make a decision after listening to bond market participants' views (regarding cuts to JGB purchases from April 2026).

The 2yr forward 6-month OIS, which rose to around 1.2% at one point, has recently fallen to around 0.8%, indicating that bond market participants' expectations for rate hikes have retreated significantly. Media reports suggest that the potential for the government to draw up a supplementary budget in the near future, which had driven bear-steepening of the JGB curve, has now receded. While we expect the JGB curve to remain steep due to a lack of demand, we think risks from the upcoming MPM are skewed toward bear-flattening.

- Tomonobu Yamashita, Rates strategist

FX: Focus on BoJ guidance

We think the market will be looking to the BoJ's upcoming MPM for hints at a potential rate hike at the June or July meeting. The announcement of Trump tariffs abruptly increased uncertainty about future BoJ policy. The market has backed off its rate-hike expectations and now prices in a terminal rate of just over 0.75% (previously 1.25%), with the timing for the next hike pushed back from June to the end of 2025. However, we hear a variety of views from market participants:

1. The BoJ wants to raise interest rates while it can despite rising uncertainty, and could hike as early as June/July.

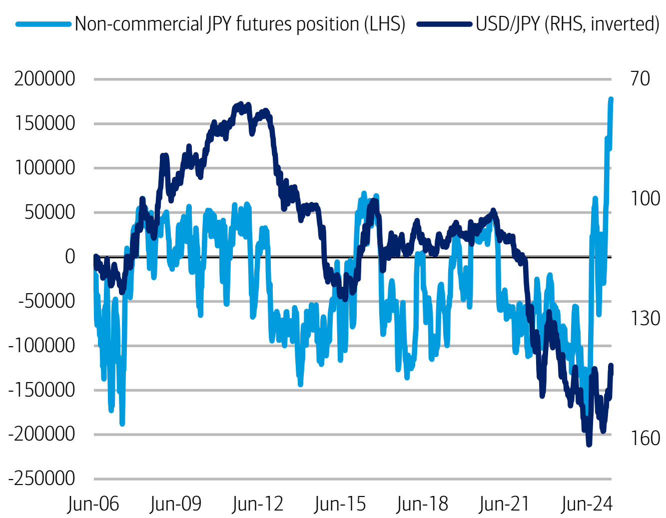
2. Growing downward pressure on the Japanese economy from tariffs and policy uncertainty will prevent the BoJ from hiking again during 2025 (or FY3/26).

3. The BoJ could face pressure to quickly raise rates if realigning USD/JPY is part of the agenda for Japan-US trade negotiations.

Our base case is (2). While we see (3) as unlikely (see Japan Viewpoint: US-Japan negotiations – potential policy and market implications 17 April 2025), we think (1) is a possibility and will be watching the BoJ's guidance.

Investor positioning is long JPY and overall sentiment on USD remains bearish. The market continues to price in a moderate chance (just under 30%) of a rate hike in June or July. The pricing looks fair but it should move by June in either way. While there are two-way risks, we think the risk is skewed to a further bounce in USD/JPY given (1) record-long JPY positioning among spec traders at CME and (2) stabilization in USD/JPY during London trading hours.

Exhibit 3: Spec JPY positioning at CME
Yen long at all time high



Source: BofA Global Research, Bloomberg

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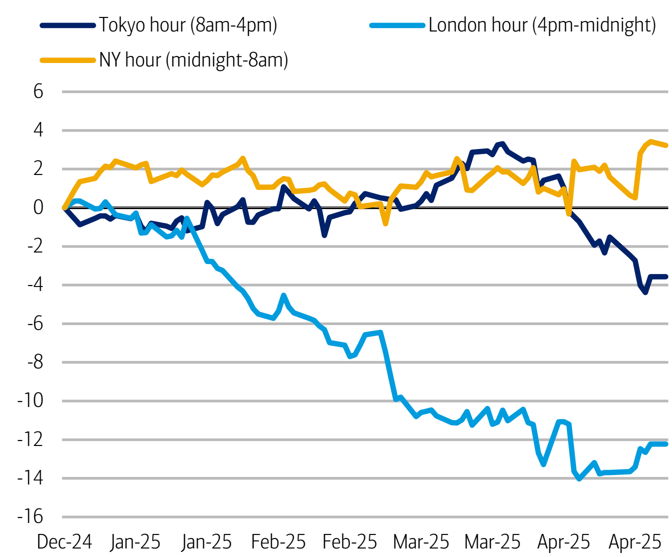
Exhibit 4: USD/JPY cumulative change by trading zone (hours in Japan Standard Time)
USD/JPY has been dragged down by USD weakness in Asia trading hour



Source: BofA Global Research, Bloomberg

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- Shusuke Yamada, FX/Rates strategist

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