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Bank of Japan set for a pause in May amid tariff concerns

Nominal wage growth accelerated in February thanks to a strong increase in bonus payments, but it failed to keep pace with price pressures. We think the Bank of Japan is likely to take a wait-and-see approach at its May meeting while monitoring the impact of the US tariffs on the economy



We think the impact of US tariff policy on exports and the overall economy will remain top of mind for the Bank of Japan for the time being

3.1% YoY

Labour cash earnings

Real cash earnings -1.2% YoY

Higher than expected

Nominal wage growth accelerated firmer than expected in February

Japan's labour cash earnings rose 3.1% year-on-year in February (vs 2.8% in January, 3.0%

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market consensus), boosted by a surge in bonus payments (77.4%). Yet, the Bank of Japan's preferred measure – same-sample cash earnings – slowed meaningfully to 1.9% (vs 3.0% in January, 3.0% market consensus). In our view, this is still a temporary slowdown as the spring wage negotiations resulted in an agreement of 5.47% growth on average, which will be reflected in April and May payrolls. Meanwhile, real wage growth contracted -1.2% in February, suggesting that high inflation is weighing on earnings. We therfore believe that today's labour cash earnings did not add to the possibility of a May rate hike, but still support the BoJ's policy normalisation ahead.

Real wage growth contracted for the second consecutive month



Source: CEIC

GDP and BoJ outlook

We have trimmed our GDP forecasts for Japan and changed our BoJ rate hike outlook.

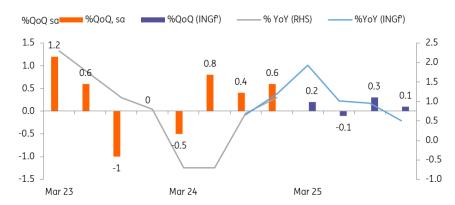
The frontloading of Japanese vehicles and machinery should help boost GDP for the first quarter of this year, but we expect a contraction in the second quarter as a technical payback. Strong wage growth and an easing fiscal stance should support the recovery in the second half of the year. Inflation is expected to soften a bit in this period too, which would support private spending. As a result, we have lowered our GDP growth forecast for 2025 to 1.1% YoY from 1.3% previously. The risk is tilted to the downside, depending on how the government seeks concessions from the US and the possibility of a US recession.

As for the BoJ's outlook, we continue to believe that near-term domestic conditions will support policy normalisation. Wage growth is expected to continue to rise on the back of strong wage negotiations this year (average 5.42% YoY increase in FY25), which should add to price pressures. Inflation is also expected to rise solidly in April, as many companies plan to raise prices to reflect the recent rise in input costs.

However, the strong Japanese yen may ease some of the BoJ's concerns about rising upside risks to inflation. More importantly, the central bank will be concerned about how the US tariff policy will affect exports and the overall economy. As a result, we now expect the BoJ to take a wait-and-see approach at its May meeting. We still pencil in a hike in July if we are right about inflation continuing to rise and wage growth remaining solid. We expect CPI inflation to stay above 3.5% throughout the first half of this year, and in turn, the BoJ should react to curb inflationary pressures. But if global risk-off sentiment continues and grows even more from here, we should revisit the rate hike outlook.

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GDP outlook: a contraction is expected in 2Q25



Source: CEIC, ING estimates

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