The yen weakens as the BoJ holds

The Bank of Japan held its key interest rate at 0.25% for the third time, in line with a narrow majority of market polls. The decision to keep rates unchanged and dovish comments from Governor Ueda are expected to weaken the JPY further, which will likely lead to a faster rate hike than Ueda's cautious messages have suggested

Bank of Japan Governor Kazuo Ueda

0.25%

BoJ target rate

Third consecutive hold decision

As expected

A January hike is not a done deal, says Ueda

According to the Bank of Japan's policy statement, it assessed that the economy is likely to continue growing at a pace above its potential growth rate and that underlying CPI is likely to rise gradually. However, it reiterated the uncertainty surrounding growth and inflation, which must have been arguably the main reason for its decision to keep interest rates on hold, in our view.

At the press conference, Governor Kazuo Ueda's comments were not as hawkish as the market exected – although there was one dissenter, and the JPY has already weakened significantly since yesterday's Federal Reserve rate decision. He mentioned the need to review more data, including wage hikes next year and the US economy under Donald Trump's incoming administration. His emphasis on the need to wait and see how Trump's economic policies will unfold is quite dovish. There is no guarantee that uncertainties over US economic policy will be resolved by the next meeting or even beyond. The next BoJ meeting will take place on 24 January, only four days after Trump's inauguration.

More meaningful information on wage negotiations will also not be available until early March. Ueda also argued that the underlying price trend and inflation expectations have been rising extremely slowly. However, core inflation has accelerated in the second half of 2024 compared to the first. Moreover, tomorrow's national CPI for November is expected to show an increase. The more the market perceives the governor as dovish, the more USDJPY rises, and then puts more pressure on the BoJ to hike sooner.

For that reason, we wouldn't take a January hike off the table yet. We will closely monitor data releases – Tokyo CPI, nationwide CPI and earnings data – between now and the next meeting. We expect labour earnings to continue to improve, while inflation is likely to accelerate a little more than it has recently. The weakening JPY increases the risk of inflation overshooting. Also, based on positive tones over recent wage negotiations from media outlets, there will be more anecdotal evidence that wage growth is likely to be solid again next year.

We expect the BoJ to continue its policy normalisation, with a total of 75bp of rate hikes by the end of 2025 to reach its target rate of 1.0%. We believe January, May, and October should be when these hikes materialise.

More FX intervention looks likely

After last night's hawkish FOMC meeting, USD/JPY has today pushed well above 155 on unchanged rates from the BoJ and seemingly no urgency to hike. USD/JPY is one of the most sensitive G10 FX pairs to US rates and today's BoJ communication has provided little defence for the yen.

Given that we expect the dollar backdrop to stay strong for the near and medium term, it looks like USD/JPY will explore levels where the BoJ has sold close to $100bn of FX reserves this year – in the 158/160 region. Presumably, the incoming US Treasury will not have a major problem with this (despite Japan's sales of US securities) since Japan is intervening to support its currency rather than prevent the yen from strengthening. Indeed, as China found in 2019, failure to prevent one's currency from selling off could result in a rather arbitrary currency manipulator label and more tariffs.

We still see the yen as the most undervalued currency in the G10 space. Yet the prospect of still higher US yields and a hesitant BoJ suggests Japanese authorities may well be doing battle with USD/JPY at 160 for the majority of 2025. Those our are baseline forecasts and indeed we have USD/JPY ending 2025 at 160.

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