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Ueda concedes trade uncertainty clouds path of policy normalization

Key takeaways

- As the Bank of Japan (BOJ) downgraded its outlook for growth and prices due to global economic uncertainty, Governor Ueda Kazuo signaled that while the BOJ is still committed to normalization, it is difficult to determine the appropriate time for its next move.
- The bank still sees underlying conditions pointing to the gradual achievement of its inflation target, but is deeply concerned about the impact tariffs could have on domestic economic decision-making.

The Bank of Japan (BOJ) was not expected to adjust its policies at its 30 April-1 May policy board meeting, but the bank's quarterly Outlook for Economic Activity and Prices (the *tenbō*) – and Governor Ueda Kazuo's press conference – revealed that, while the BOJ is not abandoning its determination to normalize Japan's monetary policy, it is deeply concerned that the impact of disruptions to global trade arising from US trade policy could weigh on Japan's growth and inflation for years to come. The result is that the pace and timing of the bank's policy decisions, if not the directionality, will be uncertain while the bank assesses the impact that global economic developments will have on Japan's economy. "The path of underlying prices [to the inflation target] could stall along the way, making it difficult to determine when and how to make a decision," Ueda said. "It is possible that the median outlook itself could change."

While Ueda clearly does not intend to abandon policy normalization, he delivered a dovish message on Thursday, communicating that deepening economic uncertainty will prompt the bank to proceed cautiously, both because underlying inflation remains slightly below target and because global economic turbulence could slow the pace of

wage and price increases in Japan. While heretofore the BOJ has been relatively confident about the strength of Japan's domestic economy even as overseas risks have grown, on Thursday Ueda sounded a more cautious note, noting that the uncertainty generated by US tariffs has clouded the domestic outlook to the point that the bank seems slightly less confident about the strength of a virtuous cycle of rising wages and prices to boost domestic consumption and investment. In its quarterly outlook, it lowered its forecasts for both growth and inflation not just for the current fiscal year but for FY2026 as well. It now expects that real GDP growth during FY2025 will be only 0.5%, down from the January forecast of 1.1%. To be sure, Ueda suggested that labor shortages will continue to produce upward pressure on both wages and prices, but by referencing the possibility that inflation could "stall," he acknowledged that the headwinds created by global uncertainty could disrupt this process in the near term as businesses and households postpone investments and purchases. Ueda also acknowledged the risk of stagflation, which could further complicate the bank's policy choices.

Thus, while the BOJ is still inclined to raise short-term interest rates, the presumption for the time being should be that the bank will leave policy unchanged at future meetings until there is more clarity about the level of US tariffs that Japanese businesses will face and the broader direction of US trade policies and their impact on the US and global economies. It is possible that the Japanese government's trade talks with the US, which will resume on Thursday, 1 May in Washington, could progress to the point that by June the picture is clearer, but it may take a significant breakthrough to make the bank feel more confident in resuming its gradual tightening. As Ueda said Thursday, "We're still assuming that tariffs at a non-negligible level will remain," suggesting that even if the US and Japan conclude an agreement, the bank is still expecting some trade barriers to remain and weigh on domestic economic activity. It is therefore unlikely that the BOJ will provide much help to Prime Minister Ishiba Shigeru and the Liberal Democratic Party (LDP) in their struggles to manage surging prices of household staples before the upper house elections in July – and, to the extent that the BOJ's cautiousness results in a weaker yen, could complicate the government's efforts.