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BOJ to Continue Raising Interest Rates on the Back of Strong 2026 Spring Wage Negotiation Results

On April 3, the results of the third round of responses for the 2026 spring wage negotiations were released, showing robust headline wage growth (base pay rise plus regular pay rise) of +5.09% year-on-year (compared to the third-round results of the 2025 spring wage negotiations: +5.42%, and the final results: +5.25%) (Exhibit 1). Not only did the headline wage increase rate exceed 5% for the third consecutive year, but the base increase portion alone also reached +3.58% (compared to +3.82% in the third round of the 2025 spring wage negotiations and +3.70% in the final results). Furthermore, in the 2026 spring wage negotiations, the headline wage increase rate for small and medium-sized enterprises (with fewer than 300 union members) also remained at a high level of +5.0% (2025 spring wage negotiations: third-round results: +5.0%, final results: +4.65%) (Exhibit 2). Even looking solely at base pay increase, the rate stands at +3.68% year-on-year (3rd round of responses for the 2025 spring wage negotiations: +3.73% year-on-year; final result: +3.49% year-on-year). Although we are still at the stage of compiling the third round of responses, clear momentum toward raising base wages in small and medium-sized enterprises is evident in the 2026 spring wage negotiations as well. In the 2026 spring wage negotiations, trade unions had initially put forward demands at a level comparable to that of 2025, and it appears that many companies have responded firmly to those demands. The trend of wage increases observed in recent years is not a temporary phenomenon but is becoming firmly established in Japan, including among small and medium-sized enterprises.

The strong momentum surrounding wage growth is likely to continue. With labor shortages becoming increasingly acute in Japan, companies are expected to actively raise wage to retain talented staff. Overall, there are no concerns regarding corporate earnings either, as Japanese companies are performing well. Ordinary profits for the October–December 2025 quarter rose by 4.7% year-on-year (based on the Corporate Statistics Survey), marking a meaningful increase in profits. As inflation takes hold in Japan and price hikes take effect among consumers, many companies are achieving record-high profits by improving margins through cost pass-through. On the other hand, labor costs have actually declined relative to robust sales over the past few years, indicating that Japanese companies have ample room for further wage increases (Exhibit 3). In recent years, companies have been effectively passing on wage increases to service prices, creating a virtuous cycle between wages and prices (where wages and prices mutually reinforce each other) (Exhibit 4).

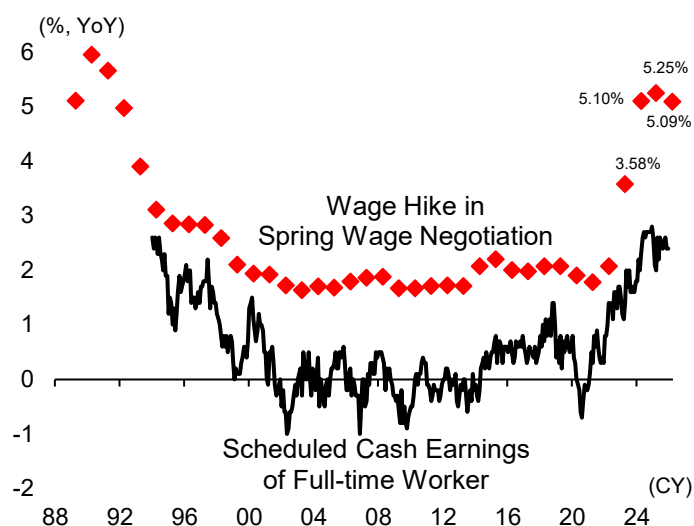
On March 26, the Bank of Japan (BOJ) began publishing a new consumer price index that excludes “special factors” such as regulatory changes, as a measure of underlying inflation. Because this new index excludes government policies—such as free education and subsidies for petrol, electricity, and gas bills—as special factors, it tends to show higher readings than the conventional consumer price index. While the CPI (all items excluding fresh food) for February 2026 stood at +1.6% year-on-year and the CPI (all items excluding fresh food and energy) stood at

+2.5% year-on-year, the CPI (all items excluding fresh food and special factors) stood at +2.2% year-on-year, and CPI (all items excluding fresh food, energy, and special factors) was +2.7% year-on-year. We believe this indicates that the BOJ has greater scope for further interest rate hikes.

In its April Regional Economic Report (Sakura Report), the BOJ stated that the impact of the unrest in the Middle East is currently limited and expressed confidence in the current state of the economy and wage growth. The BOJ believes that, provided the unrest in the Middle East does not drag on, the impact on the Japanese economy will be minimal. On April 7, President Trump announced that he had agreed to a two-week suspension of large-scale attacks on Iran, suggesting that the situation in the Middle East is moving toward de-escalation. Against this backdrop, the BOJ is likely to proceed gradually with interest rate hikes toward the neutral rate, supported by a virtuous cycle of wages and prices. We expect the BOJ to raise rates twice this year (projected for June and December), with the terminal rate (the ultimate level of interest rate hikes) reaching 1.25% (the current policy rate is 0.75%). Given that there are no signs of overheating in Japan's prices, that rapid rate hikes would have a significant negative impact on the economy, and that uncertainty surrounding the global economy is increasing, the BOJ is likely to proceed cautiously with rate hikes toward the neutral rate.

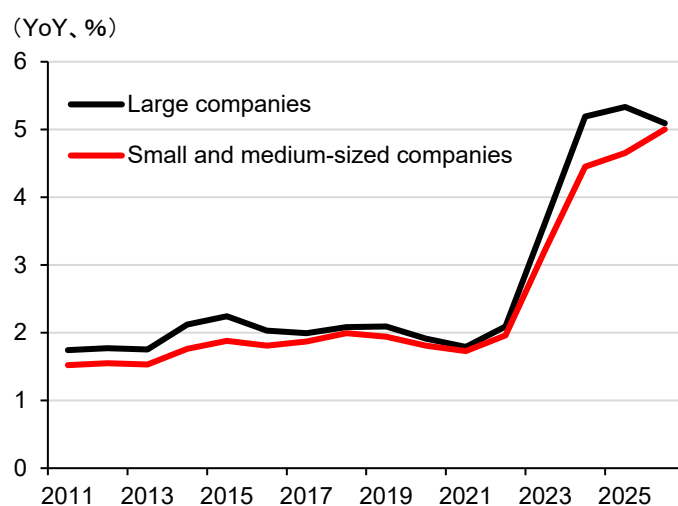
We expect Japan's long-term interest rates to continue their gradual upward trend toward the upper 2% range, driven by concerns over inflation stemming from high oil prices and the Takaichi administration's expansionary fiscal policy, as well as the BOJ's stance on continuing interest rate hikes. In the foreign exchange market, since the BOJ's gradual pace of rate hikes is already largely priced in, these hikes are unlikely to provide sufficient momentum to drive yen buying. Regarding USD/JPY exchange rate, while we expect it to decline slightly in the short term as emergency dollar-buying pressure eases amid a stabilization of the situation in the Middle East, we believe the environment of yen weakness will persist. This view is based on concerns over the Takaichi administration's fiscal policy, Japanese households' increasing investment in overseas assets, the widening of Japan's digital deficit, and the continued attractiveness of yen carry trades. We expect USD/JPY to continue trading in a range centered around 155 yen per dollar.

Exhibit 1: Wage Growth of Full-time Worker



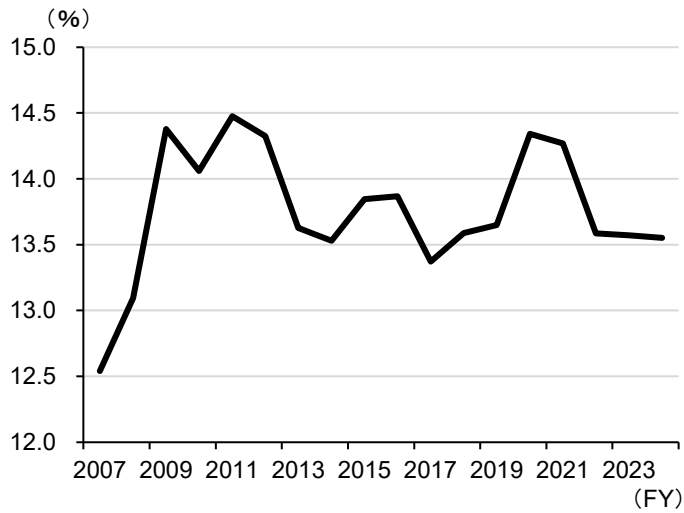
Note: Wage hike includes regular salary increases; scheduled cash earnings are for full-time workers in establishments with five employees or more.
Source: JTUC-RENGO, MIC, MUFG: Trust Bank

Exhibit 2: Wage Hike in Spring Wage Negotiation by Company Size



Note: Large companies have more than 300 union members; small and medium-sized companies have less than 300 union members.
Source: JTUC-RENGO, MUFG: Trust Bank

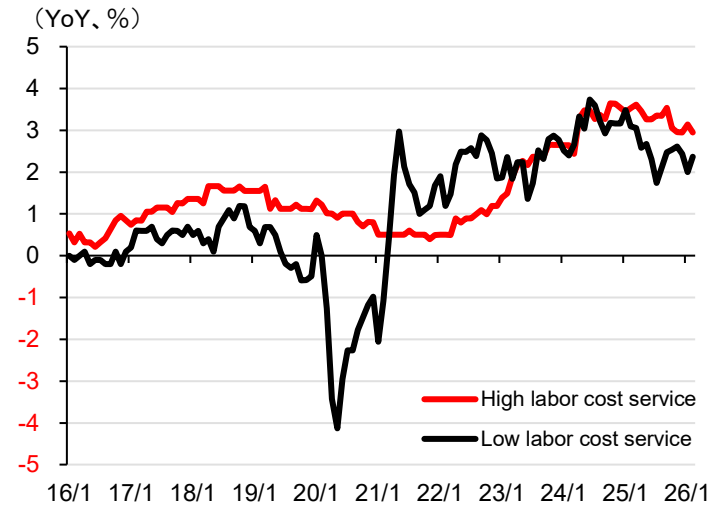
Exhibit 3: Labor Cost to Sales Ratio



Note: Labor cost=Executive salaries + executive bonuses + employee salaries + employee bonuses + benefit costs.

Source: Ministry of Finance, MUFG: Trust Bank

Exhibit 4: Price of Business Services by Labor Cost



Source: BOJ, MUFG: Trust Bank

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