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The impact of the Bank of Japan's additional rate hike on households

Positive for households as a whole, but significant negative impact for debt-holding households

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Speculation mounts that the Bank of Japan will increase the rate in January

Expectations are growing that the Bank of Japan will raise the policy rate from the current 0.25% to 0.5% at the policy meeting scheduled for January 23 to 24. This would be the third rate hike, following the increase in March 2024 that marked an end to the BOJ's negative interest rate policy and the increase to 0.25% in July 2024. With major wage hikes anticipated during this year's annual wage negotiations, as was achieved last year, and consumer prices likely to trend around the BOJ's inflation target of 2% year-on-year, the Japanese economy seems to be edging closer to a "world with positive interest rates" on the back of monetary policy normalization.

This report analyzes the possible impacts on Japanese households of the Bank of Japan's policy rate increase to 0.5%. Specifically, we set certain assumptions and estimated the positive and negative effects on household budgets, including direct effects such as changes in deposit interest income and mortgage interest payments, as well as indirect impacts resulting from exchange rate changes.

Estimation's assumptions: Ordinary deposit interest rate and variable mortgage rate climb to 0.2% and 0.6%, respectively

Chart 1 shows the assumptions used in this estimation. Along with the policy rate's 0.25%pt hike, the long-term interest rate (10-year government bond yield) is assumed to rise by the same degree.

Among interest rates that affect household budgets, the ordinary deposit interest rate is assumed to rise by 0.1%pt, from 0.1% to 0.2%. This is the same level of increase as in 2007 when the policy rate was last raised from 0.25% to 0.5%. The time deposit interest rate (10 years) is assumed to increase by 0.2%pt, from 0.5% to 0.7%. These assumptions are based on past trends of time deposit interest rate hikes, which were greater than the rise for ordinary deposits.

As for mortgages, the variable rate for new loans (the minimum rate after applying preferential discounts) is presumed to rise by 0.25%pt, from 0.35% to 0.6%.[1] The variable rate applied to existing borrowers is also

[1] In general, the levels of variable mortgage rates are determined by subtracting the preferential discount rate from the base interest rate at the time of lending. After the rate hike in July 2024, major city banks raised the base interest rate by 0.15%pt, from 2.475% to 2.625% in October, but measures regarding preferential discounts for new mortgages were varied. With some banks expanding the preferential discounts, the minimum variable mortgage rate for new loans remained in the region of 0.35%. (Since preferential discounts for borrowers already making repayment are fixed at the time of lending, they were only applied the base interest rate increase of 0.15%pt.) Based on the supposition that preferential discounts for new loans will not be

assumed to increase by the same degree,[2] and the fixed mortgage rate (the minimum rate of Flat 35) to rise by 0.2%pt, from 1.8% to 2.0%. A policy rate increase will not affect households paying back mortgages under a fixed rate, but new borrowers will be affected. In Japan, variable rate loans account for roughly 80% of the total value of new mortgages. We also assumed the ratios of variable and fixed-rate mortgages will not change before and after an additional policy rate increase.

Lastly, in terms of exchange rates, the yen is assumed to rise by around 3.5 yen against the US dollar, as the Bank of Japan's additional rate hike will narrow the interest rate gap between the US and Japan. This assumption, however, only considers the change in interest rates in Japan. It should be noted that the yen may rise further or possibly fall, depending on interest rate movements in the United States.

[Chart 1: Estimation assumptions of an additional 0.25%pt rate hike]

	Before additional rate hike	After additional rate hike
Policy rate	0.25%	0.5%
Long-term rate	1.0%	1.25%
Ordinary deposit interest rate	0.1%	0.2%
Time deposit interest rate (10 years)	0.5%	0.7%
Variable mortgage rate	0.35%	0.6%
Fixed mortgage rate	1.8%	2.0%
USD/JPY exchange rate	-	JPY rises by 3.5 yen

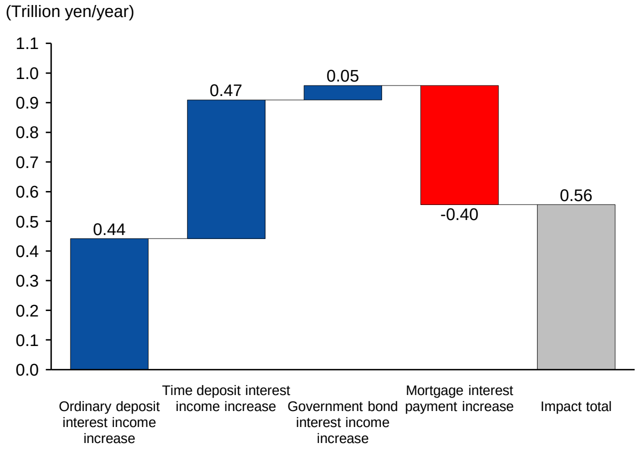
Note: Figures in "before additional rate hike" are averages for the period from August to December 2024. Figures in "after additional rate hike" are the author's estimates. Long-term rate is the 10-year government bond interest rate. Deposit rates are data aggregated by the Bank of Japan. Variable mortgage rate is the minimum level of new borrowing rates at major city banks (with preferential discounts applied.) Fixed rate is the lowest Flat 35 mortgage rate.
Source: Made by MHRT based on the Bank of Japan, the Finance Ministry, financial institutions, and the Japan Housing Finance Agency.

An additional rate hike's overall impact on households will amount to 0.6 trillion yen annually

Based on above assumptions, the direct impact of an additional 0.25%pt rate hike on households was calculated as shown in Chart 2.

The impact of an additional rate hike on overall households was estimated to be a net 0.6 trillion yen annually. One major positive effect is an increase in deposit interest income. Combining ordinary and time deposits, the increase in interest income is estimated to be approximately 0.9 trillion yen annually. The increase in household-owned government bond interest income is also expected to contribute to the positive effect to a small degree.

[Chart 2: Effects of an additional 0.25%pt rate hike on overall households]



Source: Made by MHRT.

On the other hand, the negative effect is an increase in interest payments on mortgage loans, but the amount for overall households is estimated at an annual 0.4 trillion yen, smaller than the increase in deposit interest income.

This result is a straightforward reflection of the structure of household balance sheets. According to the Bank of Japan's "Flow of Funds Accounts," households' total financial assets stood at 2,179 trillion yen as of the end of September 2024, while household debts totaled 392 trillion yen, indicating that households as a whole have a

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expanded after the expected rate hike, we assumed the variable mortgage rate for new loans will rise by 0.25%pt for the base rate increase, but it must be noted that actual developments may differ from the assumption, depending on the banks' strategies.

[2] In general, the base interest rate for variable rate mortgages is reviewed every six months (normally in April and October) and applied to existing borrowers in two to three months. Therefore, the impact of the rate hike in January 2025 on borrowers is expected to be felt around June or July.

considerable excess of financial assets. Although interest rates on assets and liabilities differ, it is natural for a rate hike's positive effects on the asset side to outweigh the negative effects on the liability side. The estimation illustrates such a structure.

Negative effect will be greater for debt-holding households, particularly for working generations

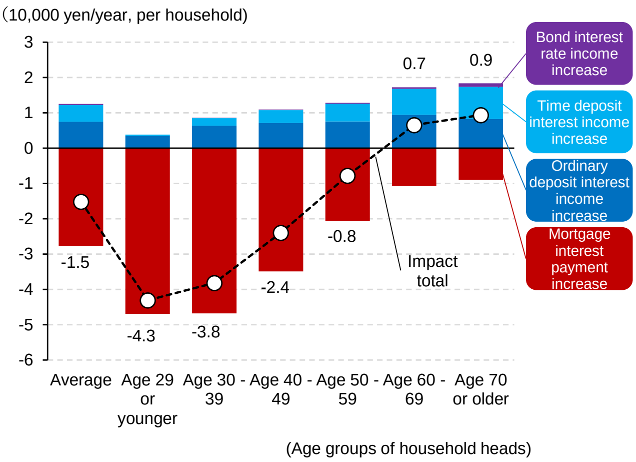
The estimation does not mean the positive effects are greater than the negative effects for all households. As seen earlier, household assets as a whole largely exceed their liabilities, but households in this case include families with no mortgage burden or have paid off their loans. Households with mortgages are likely to have asset balance less than debt balances. The impact of a rate hike on such families will be quite different from the situation of overall households.

Therefore, we also estimated the impact of an additional 0.25%pt rate hike on households with mortgages or other loans. The results were converted to an amount per household and shown by age group of the head of household in Chart 3.

As Chart 3 indicates, the annual impact facing debt-holding families is -15,000 yen on average. The positive effect, mainly from the increase in deposit interest income, amounts to 13,000 yen annually, while the negative impact from increased mortgage rates is 28,000 yen, significantly outpacing the positive effect. Since the ratio of variable rate mortgages is high in Japan, as explained earlier, a rate hike's negative impact shows itself mainly as a higher interest payment burden for households that already have a mortgage.

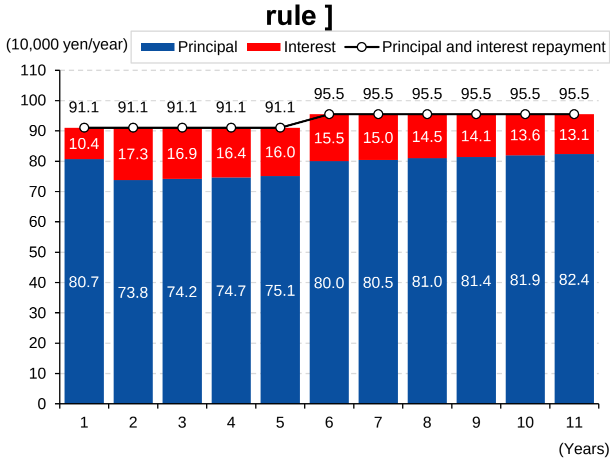
By age, the effect on working-generation households in their 20s to 50s will be negative. The impact is particularly large for people aged 29 or younger and those 30 to 39, at an annual -43,000 yen and -38,000 yen respectively. The positive effect of higher deposit interest income is expected to be less than 10,000 yen for both age groups, while the negative effect of increased mortgage interest payments is thought to reach 47,000 yen annually. Since households in their 20s and 30s are the main home buyers holding large mortgage balances, their household balance sheets are likely to be vulnerable to rate hikes. Meanwhile, households in their 60s and 70s or over have mostly paid off their mortgages and have also accumulated financial assets, compared with working-

[Chart 3: Effects of an additional 0.25%pt rate hike on debt-holding households (per household, by age)]



Note: Figures in the chart are the value of total effects.
Source: Made by MHRT

[Chart 4: Repayment simulation of a variable rate mortgage applying the 5-year rule]



Note: Based on the assumption that a total of 30 million yen was borrowed with the payment period of 35 years, adopting the equal payment method, and the interest rate increases from 0.35% to 0.6% in the second year of payment.
Source: Made by MHRT.

generation households. The impact of a rate hike will be slightly positive for such families. In this way, the effects of a rate hike will vary widely even among debt-holding households based on their ages.

For mortgages applying the “5-year rule,” in which the principal and interest payments are reviewed every five years, a rate hike does not immediately lead to increased monthly payments. In such a case, the effect of a rate hike appears as a higher ratio of interest payments to the total payment amount during the 5-year period. Chart 4 shows a model case of a variable rate mortgage of 30 million yen spread out over 35 years. A simulation of mortgage payments under the 5-year rule was run on the assumption that the interest rate rises from 0.35% to 0.6% in the second year of the payment period. Even if the interest rate increases, the annual payment remains the same at 911,000 yen for the first five years, although the amount of interest payment jumps in the second year from an annual 104,000 yen to 173,000 yen. The payment amount is revised in the sixth year to an annual 955,000 yen, which will be maintained until the payment’s completion (assuming the interest rate does not rise further after the second year). Eventually, the amount of interest payment totals 3.21 million yen, which is 1.33 million yen higher than 1.88 million yen in the case where the interest rate remains at 0.35% throughout the period.

A higher yen will be a factor reducing the household burden through curbed inflation, but the effect will be comparatively small

Lastly, we look at an additional rate hike’s impact on households through exchange rate changes. If the yen rises, import costs are expected to decline and ease inflation.

If the yen rises 3.5 yen against the US dollar as in Chart 1, that rise, along with the effect of the 0.25%pt rate hike, is thought to be a factor in curbing inflation by around 0.05%.[3] Considering that the annual consumption of two-or-more-person households is approximately 3.6 million yen, according to the Family Income and Expenditure Survey, the burden on households is expected to be reduced by around 1,800 yen annually through the price curbing effect. A stronger yen is good news for families struggling with surging prices, but compared with the direct effects of a rate hike explained earlier, the impact of the yen rising around 3.5 yen on households is limited.

However, a higher yen tamping down prices is expected to appear mostly for items frequently purchased by households, such as food and energy. This means that households may feel a greater impact than seen in the statistical consumer price figures, motivating budget-minded households to spend to some extent (increase in consumption propensity). As the yen starts to rise and import costs come down, not only households, but many small and medium sized firms will also be able to reduce costs and improve their business performance. As a result, small businesses will have more leeway to raise wages, bringing the benefit of pay increases to a wide range of households.[4] To what extent a rate hike will impact consumption and wages in this respect requires further analysis.

Summarizing the estimations laid out in this report, a rate hike’s direct effects on households as a whole will be positive, but debt-holding households, particularly working-generation households, will experience negative effects as mortgage interest payments increase. Even taking into account the effect of the yen’s appreciation on

[3] Calculated by using personal consumption deflator multipliers (first year) for short-term rate increases and the yen’s depreciation against the US dollar, based on the Cabinet Office’s short-run macroeconometric model of the Japanese economy (2022 version).

[4] On the other hand, for large companies, a decline in the value of exports due to the strong yen and a decrease in yen equivalent value of overseas profits may put downward pressure on earnings. Effects on nationwide wages must be examined based on the ability of large companies and smaller firms to raise wages and their labor shortage situations.

curbing inflation, households with liabilities are likely to suffer some negative impacts. In examining the effects of an additional rate hike on households, it is crucial to understand that the impacts will vary depending on their attributes.

Reference

Refer to the original Japanese report by clicking the URL below for the reference material.

https://www.mizuho-rt.co.jp/publication/2025/research_0003.html