

The BOJ's rate hikes and their impact on Japanese firms

Macro Commentary - October 2026

For professional investors only

Japan Equity Research Team

SMDAM

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Executive summary:

- Although the Bank of Japan (BOJ) raised its policy interest rate from 1.00% to 1.25% in September 2026, it maintains a stance toward continued rate hikes. We expect the policy rate to be raised to 1.75% during the current tightening cycle.
- While it is necessary to note that corporate resilience to rising interest rates varies by industry and firm size, we believe it is strengthening for corporate Japan as a whole. As evidence, this paper highlights two key factors: (1) restraint on the interest payment burden through strengthened financial health, and (2) corporate profitability that exceeds borrowing costs.

BOJ rate hikes expected to continue, but corporate resilience to rising rates is strengthening

At its Monetary Policy Meeting in September 2026, the Bank of Japan (BOJ) decided to raise its policy interest rate. This move brought the policy rate to 1.25%; however, the BOJ assesses that financial conditions remain accommodative and maintains its policy of continuing to raise rates. We anticipate additional rate hikes of 0.25 percentage points each in January and June 2027. We project the policy rate will reach 1.75%, which is roughly at the midpoint of the BOJ's estimated neutral interest rate range (1.1% to 2.5%).

While caution is required regarding variations in resilience across industries and firm sizes, companies appear, overall, to be strengthening their resilience to rising interest rates. This report highlights two underlying reasons: (1) restraint on the interest payment burden driven by strengthened financial health, and (2) corporate profitability that exceeds borrowing costs.

Restraint on interest payment burden via strengthened financial health

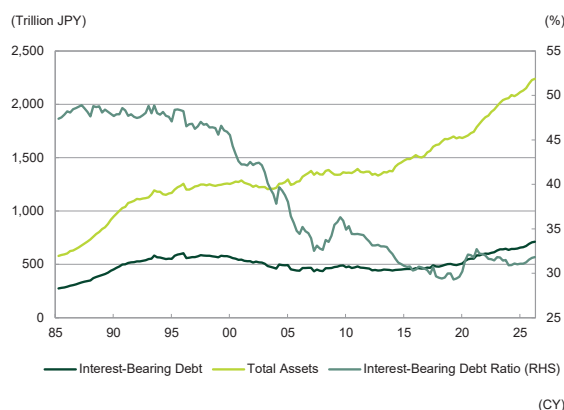
The first factor demonstrating corporations' growing resilience to rising interest rates is the restraint on their interest payment burden, achieved through the strengthening of their financial health.

Japanese firms' interest-bearing debt ratio (interest-bearing debt / total assets) declined substantially from the late 1990s through the 2010s (Figure 1). The catalyst was the domestic financial crisis of the late 1990s, which exacerbated the issue of excessive corporate debt. Severe experiences at the time, such as credit crunches and loan recalls, profoundly influenced corporate financial strategies. Strengthening balance sheets became an urgent priority, and companies made reducing interest-bearing debt a top managerial focus. Although the excessive debt problem began to ease in the early 2000s, the global financial crisis struck in the latter half of the decade. Companies were plunged into difficulty once again, prompting them to further accelerate efforts to reinforce their financial soundness.

On the other hand, interest-bearing debt has shown a clear upward trend since the 2020s. This began as a response to the COVID-19 shock, but subsequent increases appear to reflect factors such as rising working capital requirements amid the transition to an inflationary environment. However, because total assets expanded concurrently, the interest-bearing debt ratio has remained at a low level.

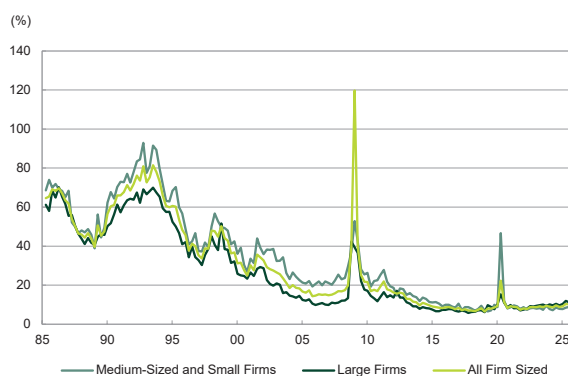
Along with the expansion in total assets, corporate profits have also grown, keeping the relative burden of interest expenses, etc. well contained (interest expenses, etc. mainly refer to interest payments on bank borrowings and corporate bonds). For example, the ratio of interest expenses, etc. to operating profit is at a historically low level (Figure 2).

Figure 1: Interest-Bearing Debt, Total Assets, and Interest-Bearing Debt Ratio



Note: Data covers the period from Q2 1985 to Q2 2026. Seasonally adjusted.
Source: Compiled by Sumitomo Mitsui DS Asset Management based on Ministry of Finance data.

Figure 2: Interest Expenses, etc. / Operating Profit (by Firm Size)



Note: Data covers the period from Q2 1985 to Q2 2026. Seasonally adjusted. Large firms refer to corporations with capital of 1 billion yen or more. Medium-sized and small firms refer to corporations with capital of 10 million yen or more but less than 1 billion yen.
Source: Compiled by Sumitomo Mitsui DS Asset Management based on Ministry of Finance data.

Reflecting the recent expansion of interest-bearing debt as well as higher average interest rates paid (interest expenses, etc. / interest-bearing debt) driven by rate hikes, interest expenses, etc. themselves have certainly increased (Figure 3, Figure 4). Nevertheless, relative to corporate earnings, the interest payment burden remains small. Although inter-company disparities must be borne in mind, this pattern is evident not only among large firms but also across medium-sized and small firms.

With further rate hikes anticipated, to what extent will interest expenses, etc. increase? We examine this through a simple simulation.

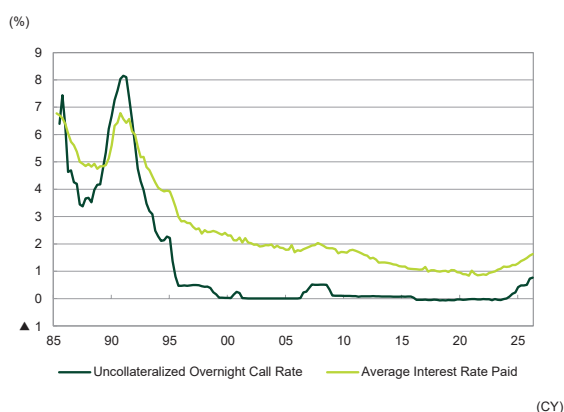
In recent years, the uncollateralized overnight call rate and the average interest rate paid have moved in tandem. Based on this trend, we assume for the time being that the average interest rate paid will rise by the same margin as the policy rate.

We assume a 1 percentage point increase in the policy rate. This accounts for:

- (a) the rate hikes already decided in June and September 2026 (from 0.75% to 1.25%), and
- (b) future expected rate hikes (from 1.25% to 1.75%).

Condition (a) is included because the latest data for the average interest rate paid is for Q2 2026 (April–June), meaning it hardly reflects the impact of the June rate hike, let alone the September hike.

Figure 3: Uncollateralized Overnight Call Rate and Average Interest Rate Paid (All Firm Sizes)



Note: Data covers the period from Q2 1985 to Q2 2026. Average interest rate paid is seasonally adjusted. Average interest rate paid = Interest expenses, etc. / Interest-bearing debt.

Source: Compiled by Sumitomo Mitsui DS Asset Management based on Ministry of Finance and Bank of Japan data.

Figure 4: Interest Expenses, etc. (All Firm Sizes)



Note: Data covers the period from Q2 1985 to Q2 2026. Seasonally adjusted.

Source: Compiled by Sumitomo Mitsui DS Asset Management based on Ministry of Finance data.

Figure 5 shows the impact on interest expenses, etc. if the average interest rate paid rises by 1 percentage point, in line with the policy rate. At present, total interest-bearing debt across all corporations stands at around 710 trillion yen (Figure 1). Assuming the outstanding balance of interest-bearing debt remains constant, a 1 percentage point increase in the average interest rate paid would raise interest expenses, etc. by 7.1 trillion yen. This amount corresponds to 6.5% of operating profit and 4.7% of ordinary profit.

Meanwhile, following the exit from deflation, Japan's nominal GDP growth rate has been trending at a high level. We expect growth of around 3% to be achievable for the time being. Given the historical relationship between nominal GDP and corporate profits, aggregate corporate earnings can be expected to grow by roughly 10% in this scenario. As long as the increase in interest expenses, etc. remains within the projected range, corporate profits are expected to remain solid.

Figure 5: Impact of a 1 percentage point increase in average interest rate paid on interest expenses, etc.

	All Firm Sizes	Lsrge Firms	MSCI Sector
Amount (Trillion JPY)	7.1	4.5	2.7
% of Operating Profit	6.5	6.9	5.9
% of Ordinary Profit	4.7	4.6	4.9

Note: Data covers the period from Q2 1985 to Q2 2026. Seasonally adjusted. Large firms refer to corporations with capital of 1 billion yen or more. Medium-sized and small firms refer to corporations with capital of 10 million yen or more but less than 1 billion yen.

Source: Compiled by Sumitomo Mitsui DS Asset Management based on Ministry of Finance data.

Profitability exceeding borrowing costs

The second factor demonstrating corporations' growing resilience to rising interest rates is profitability that exceeds borrowing costs.

ROA (operating profit / total assets), a key indicator of profitability, experienced a sharp drop during the COVID-19 shock but has since followed an upward trajectory. In the latest Q2 2026 data, it reached 4.9%, marking its highest level since 1990 (Figure 6). In addition to the post-pandemic rebound in demand, factors such as margin expansion driven by progress in price pass-through appear to be behind the improvement in ROA. Meanwhile, although the average interest rate paid (representing borrowing costs) has also risen, it stood at only 1.6% in the latest quarter.

The spread between ROA and the average interest rate paid (ROA minus average interest rate paid) is 3.3 percentage points, standing at a substantially wide level from a long-term perspective. Broken down by firm size, ROA clearly exceeds the average interest rate paid across both large firms and medium-sized and small firms (Figure 7, Figure 8).

As shown in the earlier simulation, even assuming rate hikes continue and the average interest rate paid rises by 1 percentage point, corporate Japan as a whole is highly likely to maintain an adequate spread of around 2 percentage points.

Regarding the spread between ROA and the average interest rate paid, an interesting observation is that it moves in tandem with the Financial Position DI ("Easy" minus "Tight") in the BOJ's Tankan survey (Figure 9). This correlation has strengthened particularly since the late 2000s, with both metrics tracking identical paths. Whether companies can secure profitability that exceeds their borrowing costs is believed to influence corporate financing conditions through liquidity on hand and financial institutions' lending attitudes.

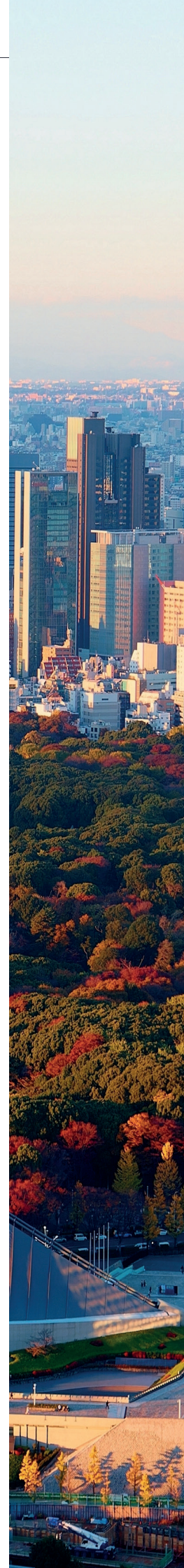


**Figure 6: ROA and Average Interest Rate Paid
(All Firm Sizes)**

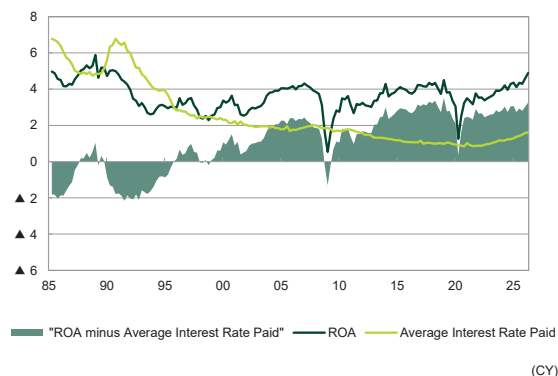
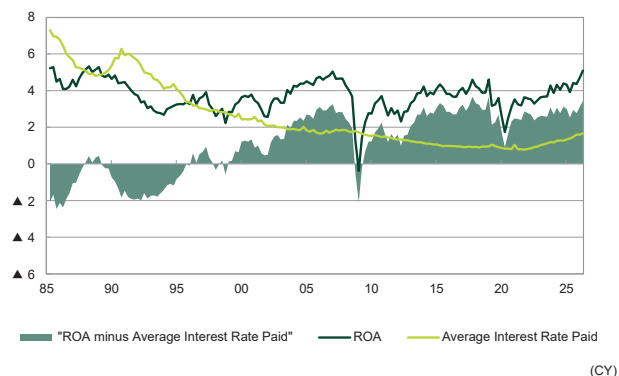


**Figure 7: ROA and Average Interest Rate Paid
(Large Firms)**



Source: SMDAM using BARRA data as at 31 May 2026

Note: Data covers the period from Q2 1985 to Q2 2026. Seasonally adjusted.

Source: Compiled by Sumitomo Mitsui DS Asset Management based on Ministry of Finance data.

Note: Data covers the period from Q2 1985 to Q2 2026. Seasonally adjusted. Large firms refer to corporations with capital of 1 billion yen or more. Medium-sized and small firms refer to corporations with capital of 10 million yen or more but less than 1 billion yen.

Source: Compiled by Sumitomo Mitsui DS Asset Management based on Ministry of Finance data.

The current Financial Position DI stands at a high level of 11 percentage points, indicating ample financial leeway. Considering the recent correlation with the spread between ROA and the average interest rate paid, even if future rate hikes compress the spread to around 2 percentage points, the DI is very likely to remain in positive territory. While variations across individual firms warrant caution, a scenario in which corporate financing conditions deteriorate rapidly across the corporate sector as a whole appears unlikely.

**Figure 8: ROA and Average Interest Rate Paid
(Medium-Sized and Small Firms)**

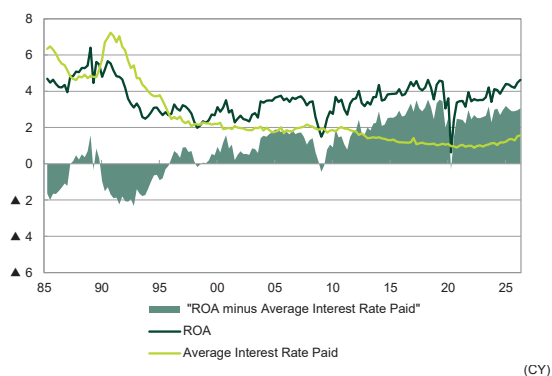
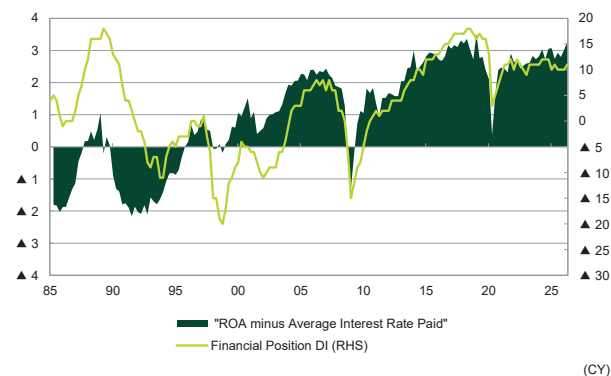


**Figure 9: "ROA minus Average Interest Rate Paid" and
Financial Position DI (All Firm Sizes)**



Note: Data covers the period from Q2 1985 to Q2 2026. Seasonally adjusted. ROA = Operating profit / Total assets. Average interest rate paid = Interest expenses, etc. / Interest-bearing debt. Large firms refer to corporations with capital of 1 billion yen or more.

Source: Compiled by Sumitomo Mitsui DS Asset Management based on Ministry of Finance data.

Note: Data covers the period from Q2 1985 to Q2 2026. "ROA minus average interest rate paid" is seasonally adjusted. ROA = Operating profit / Total assets. Average interest rate paid = Interest expenses, etc. / Interest-bearing debt.

Source: Compiled by Sumitomo Mitsui DS Asset Management based on Ministry of Finance and Bank of Japan data.

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