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# Risks Posed to Japanese Economy by Rising Interest Rates

*Interest rate hikes unaccompanied by economic growth will weigh on the economy, particularly capital expenditure*

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## Summary

- While long-term interest rates continue to rise and policy factors are exerting downward pressure on prices, real interest rates remain in positive territory. As long as real interest rates remained negative and accommodative monetary conditions were maintained, the adverse effects of rising interest rates on economic activity were not particularly pronounced; however, in an economy where real interest rates are clearly in positive territory, greater attention must be paid to the impact of rising interest rates.
- Based on our short-term macroeconomic model, simulations assuming that long-term interest rates remain 1%pt higher for one year indicate that capital expenditure would decline significantly and real GDP would fall by 0.5%. Housing investment, private consumption, and net exports would also decline.
- However, rising interest rates do not necessarily have a negative impact on the macroeconomy. If interest rates rise against the backdrop of an economic expansion, combined with factors such as increased productivity, the marginal rate of return on investment will rise, making it unlikely that capital expenditure will be adversely affected. On the other hand, if interest rates rise unaccompanied by economic growth – driven by concerns over fiscal deterioration or inflation – effects similar to those seen in the simulation results will likely manifest in the macroeconomy due to the crowding-out effect on capital expenditure and housing investment.