# Daiwa's View

## BOJ meeting focal points: Tariff risks, future of interest rate hiking policy

- Expect BOJ to maintain status quo, with no change to its rate hiking policy at next meeting
- No change to rate hiking policy due to virtuous cycle (higher wages → higher prices) scenario
  May consider soaring prices, forex risks, and US/Japan negotiations
- *Outlook Report*: Our focus on economic/price outlooks, how conduct of monetary policy is expressed

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### Expect BOJ to maintain status quo, with no change to interest rate hiking policy at next meeting

The BOJ will hold its next Monetary Policy Meeting on 30 April to 1 May. In his 16 April *Sankei Shimbun* interview, BOJ Governor Kazuo Ueda commented on the tariff policy of the Trump administration, saying, "The situation has been moving toward a worse scenario since February." He added that, according to the degree of downward pressure on Japan's economy stemming from tariffs, "A policy response would probably be required." Here, he stressed that the Bank will conduct policy in a flexible manner, presenting various policy response options, even interest rate cuts.

At this juncture, the BOJ is carefully assessing US tariff policy risks. As such, a decision to maintain the status quo for monetary policy is expected at the upcoming meeting. That said, we expect the Bank to maintain its direction toward the underlying 2% price target, with no changes to the existing policy of "proceeding with gradual interest rate hikes." At its next meeting, the BOJ will likely stick to the storyline of achieving its long-term price stability target of 2%, while keeping a watchful eye on risks originating from the US.

The main reason for the BOJ to maintain its rate hiking policy is based on a scenario in which it is "in a position to aim for its underlying price target of 2%," even taking into account the impact of tariffs. In addition, the following three factors are also possible: (1) recent higher-than-expected rise in consumer prices, (2) forex risks, and (3) consideration of Japan/US negotiations.

The latest Tokyo CPI released on 25 April showed that consumer prices continue to rise at a higher-than-expected clip, along with broader-than-expected cost-push inflation (passing on higher costs to prices). If the BOJ were to take an overly dovish stance under such circumstances, there would be concerns that speculators could unwind their yen-buying positions, leading to rapid yen depreciation and prolonged inflation. Such cost-push inflation could cause a decline in consumer confidence, which in turn could become a downward risk for the economy and prices. With the uncertainty caused by tariffs increasing, we feel that the BOJ intends to limit further uncertainty as much as possible. Also, consideration of the "currency problem" that the Trump administration has pointed to in tariff negotiations is also a reason for maintaining the policy of raising interest rates.

Even as a normal central bank policy decision, in a situation where price risks are balanced (details provided below) and the US tariff policy outlook is uncertain, "inertia due to uncertainty" will kick in. Here, it would be appropriate to maintain the conventional policy of raising interest rates, while maintaining a wait-and-see approach for now. Also, determining the impact of tariffs on the Japanese economy will require careful assessments of future data and it will take a certain amount of time to grasp the big picture. We believe that the next rate hike will be in Oct-Dec 2025.

## BOJ meeting focal point (1): Outlook for economic activity and prices

Two points of interest at the upcoming *Outlook Report* are (1) outlook for economic activity and prices and (2) the Bank's wording for its future conduct of monetary policy in the *Outlook Report*.

First, our understanding is that the outlooks for economic activity and prices in the *Outlook Report* are expected to be revised downward, but there were reports citing relevant parties saying that it is hard to envision a situation in which wage hiking momentum and underlying price inflation improvements falter. Even taking into account the impact of tariff policies, growth needed to maintain the virtuous cycle of higher wages leading to higher prices is expected.

This scenario of a "sustained virtuous cycle between higher wages and higher prices" is also supported by the International Monetary Fund's (IMF) "*World Economic Outlook*" released on 22 April. The IMF expects Japan's economic growth rate to be +0.6% in 2025 (previously +1.1%) and +0.6% in 2026 (previously +0.8%). The impact of the tariffs has been limited to cancelling out the effect of "higher household incomes → higher consumption" due to wage increases that exceed price increases. The IMF uses the tariff measures announced through 4 April (including 2 Apr announcement of additional reciprocal tariffs) as its baseline scenario.

Based on these factors, we expect the economic forecasts in the *Outlook Report* to land at +0.7% for FY25 (previously +1.1%), +0.8% for FY26 (previously +1.0%), and +1.0% for FY27. Under this outlook, the view that the Japanese economy will maintain a certain level of positive growth without any major shocks will probably strengthen, despite these downward revisions. Also, with regard to the balance of risks in the economic outlook, it is likely that the downside risk is seen as more significant from FY25 onward due to the tariff impacts.

Also, the price outlook is also likely to be revised downward due to an economic downturn caused by US tariffs, yen appreciation, and lower oil prices, as well as the impact of free high school education starting in April 2025. We think core CPI will land at +2.1% in FY25 (previously +2.4%), +1.8% in FY26 (previously +2.0%), and +2.0% in FY27. Considering that the free high school education will produce a 0.2% drag on the core CPI in FY25 and FY26, the price inflation rate is expected to hold at about 2% over the long run. Also, regarding the balance of risks in the price outlook, there is currently a standoff between (1) the broadening trend of passing on higher costs to prices (positive trend) and (2) decreased demand due to tariffs and other factors (negative trend). As such, there is a good chance that risks could be generally balanced in FY25, while there is also a good chance that downside risks will likely increase in FY26 onward, reflecting reduced demand due to tariffs and other factors.

**Chart 1: BOJ Policy Board Members' Projections (median, y/y %)**

| | Real GDP | | | Core CPI | | | Core core CPI | | |
|---|---|---|---|---|---|---|---|---|---|
| | Jan 2025* | **Apr 2025**** | Our forecasts | Jan 2025* | **Apr 2025**** | Our forecasts | Jan 2025* | **Apr 2025**** | Our forecasts |
| FY24 | +0.5 % | **+0.8 %** | +0.8 % | +2.7 % | **+2.7 %** | +2.7 % | +2.2 % | **+2.3 %** | +2.3 % |
| FY25 | +1.1 % | **+0.7 %** | +0.4 % | +2.4 % | **+2.1 %** | +2.1 % | +2.1 % | **+2.0 %** | +2.0 % |
| FY26 | +1.0 % | **+0.8 %** | +0.7 % | +2.0 % | **+1.8 %** | +1.7 % | +2.1 % | **+1.9 %** | +1.7 % |
| FY27 | – | **+1.0 %** | +0.9 % | – | **+2.0 %** | +1.8 % | – | **+2.0 %** | +1.8 % |

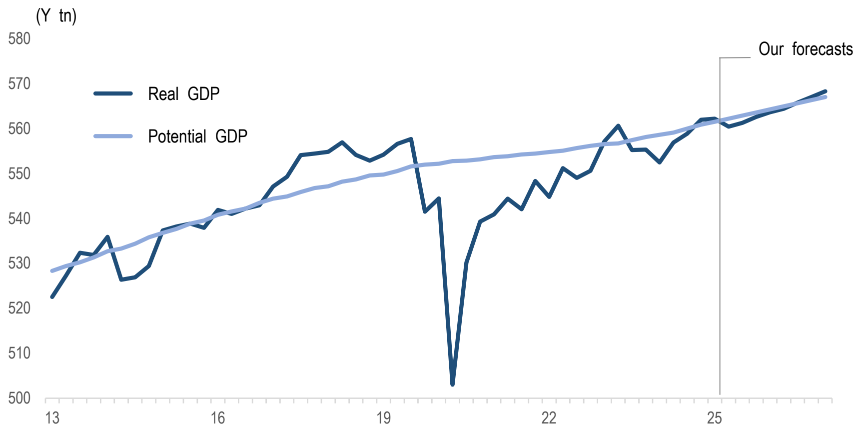
*Source: BOJ, various materials; compiled by Daiwa.*
**BOJ projections. **Our estimates for policy board member projections (highlighted in light blue).*

As mentioned above, the economic and price outlooks are expected to fall within ranges that will not impede the longer-term scenario of achieving the 2% price target, even taking into account the impact of tariffs.

Meanwhile, as a technical point, we should note that the BOJ's economic outlook includes a growth rate "carry-over effect." This growth rate "carry-over effect" refers to the phenomenon in which a high GDP level at the end of the fiscal year pushes up the apparent annual growth rate even when there is little substantial new growth in real terms. For FY25, it is estimated that there will be a "carry-over effect" of about 0.4%, so even if the FY25 growth rate presented in the *Outlook Report* is +0.7%, the actual growth will be only about +0.3%.

However, even considering the impact of this carry-over effect, expectations are that the downward pressure on prices due to the narrowing of the output gap should be limited. Chart 2 shows real and potential GDP based on our assumed GDP outlooks (lower than *Outlook Report* forecast). Even when considering the output gap, which is the gap between the real and potential GDP, downward pressure on prices due to tariff shocks will remain limited as compared to the past. In addition, while it has been pointed out that the labor shortage may increase upward pressure on prices beyond what the output gap suggests, it would be hard to assume at this point that the improvement in the underlying price inflation rate will collapse.

**Chart 2: Forecasts for Real GDP and Potential GDP**




*Source: Cabinet Office; compiled by Daiwa.*
*Note: Potential GDP is a simplified estimate based on the assumption that 2024 growth trend will continue.*

## BOJ meeting focal point (2): Changes in wording for conduct of monetary policy

While we do not believe that tariff policies will push Japan's economy into a recession, such policies will certainly add downward pressure on the Japanese economy and prices, at the very least. As a result, achievement of the BOJ's 2% price stability target will likely be pushed back. It is very likely that there will be some delay in terms of the pace for interest rate hikes, as compared to the previous assumption of a hike about once every six months.

In this regard, the most noteworthy point in the *Outlook Report* is how conduct of monetary policy is expressed. The previous January report said that "In the second half of the projection period, the rate of increase in the CPI is likely to be at a level that is generally consistent with the price stability target." Such wording was taken to mean "levels consistent with the price stability target (specifically, hiking interest rates to the neutral interest rate level) from the second half of FY25 to FY26." It will be interesting to see how the description is worded when adding FY27 to the forecast period, as this would provide an excellent opportunity to revise the wording. If the phrase "second half of the outlook period" is retained, the period would automatically become "FY26 to FY27," which would mean that the interest rate hike could be pushed back by about six months.

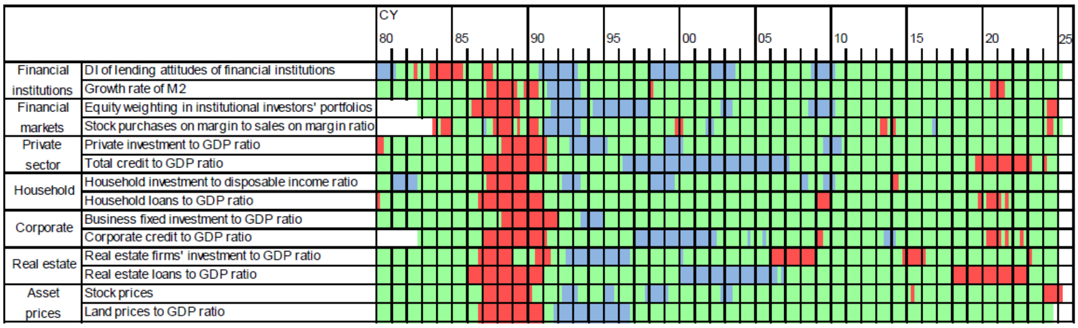
## *Financial System Report* justifies rate hike, but no need to rush

On 23 April, the BOJ released its *Financial System Report*. The report mentions the resilience to rising interest rates among banks, firms, and households. Specifically, the report said: (1) Banks' resilience to rising interest rates has improved compared to a while ago, (2) Firms' resilience to rising interest rates has generally been improving, reflecting the recovery in their profits, in addition to a rising trend in the number of de facto debt-free firms, and (3) As for households' resilience to rising interest rates, even though home loans are increasing among younger home owners, their repayment burden is likely to gradually decline since increases in income are likely to continue as their salary climbs up along the wage curve. All told, there is no clear indication that interest rate hikes are having significant impacts on each entity at this time.

Also, during his February speech, BOJ Policy Board member Hajime Takata said, "The viewpoint of gradually shifting gears after the additional interest rate hike in January, in order to prevent the risk of financial overheating from materializing, is important." However, in the *Financial System Report*, the Bank stated that, "No major financial imbalances have been seen in current financial activities."

At this juncture, rate hikes have not had any significant impacts on each economic entity and the risk of financial overheating has not materialized. As such, the BOJ can conclude that there is enough time to assess the tariff impacts while maintaining its policy of raising interest rates.

**Chart 3: Heat Map for Financial Cycle**




*Source: Reprinted from BOJ Financial System Report (Apr 2025).*

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