Daiwa's Economic View

BOJ Ueda's press conference: Policy response freehand amid uncertainty

- Ueda stressed uncertainty caused by tariffs during press conference
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Ueda stressed uncertainty caused by tariffs during press conference

At its 30 Apr-1 May Monetary Policy Board meeting, the BOJ decided to maintain the status quo for its monetary policy. Its existing policy of gradually hiking interest rates was also unchanged. Meanwhile, its significant downward revisions for economic growth rates indicate that the BOJ is very concerned about the impact of tariffs. During his post-meeting press conference, BOJ Governor Kazuo Ueda emphasized the risk of tariffs imposed by the Trump administration, stating that "uncertainty is extremely high."

During the press conference, Ueda said, "We have slightly revised our image of underlying inflation converging at around 2% to an image of prices again rising after a pause." He added, "We're not considering forcibly raising interest rates at a time when inflation is slowing." Ueda indicated the possibility of a temporary standstill for the underlying inflation rate due to tariff shocks and indicated that the Bank would basically not raise interest rates under such conditions. Ueda went on to say, "We still expect the underlying inflation rate to reach 2% in the second half of our projection period (from FY25 to FY27)." He also suggested the possibility that the timing for achieving the price stability target could be pushed back by about one year from 2H FY25 to 2H FY26. The pace for real interest rate hikes is also decelerating.

However, at this juncture, the BOJ is creating post-tariff shock narratives. Specifically, Ueda said, "Japan's growth rate will increase as overseas economies return to moderate growth paths, while an increased sense of labor shortages should also raise medium-term inflation expectations." If the economic activity and price outlooks follow this narrative, any decision to raise interest rates would be based on improving economic and price conditions.

Meanwhile, we should note that even within the BOJ, this narrative is viewed as a temporary storyline. As for projections in the April *Outlook Report*, Ueda said, "We expect US tariffs to be above the base 10% levied (not including any additional reciprocal tariffs)." We believe that a more realistic estimate was made based on the assumption of a tariff scenario that is highly probable at this time.

That said, Ueda also noted that, "The central outlook itself could change in the event of major developments for tariff policy." As such, uncertainty about the future outlook is extremely high. As stated in the *Outlook Report*, "Attention is warranted on the possibility that the outlook for economic activity and prices could change considerably depending on the future course of the policies in each jurisdiction and the response of firms and households in these jurisdictions to the policies." In particular, we should note that tariff policy could significantly alter the BOJ's scenarios.

Even though the BOJ maintains a scenario of continued rate hikes amid high uncertainties brought about by tariffs, that scenario itself is accompanied by strong uncertainty, and the BOJ will maintain a free hand in terms of its policy response. Going forward, it will be necessary to determine (1) whether there will be any major changes in tariff policy and (2) whether the BOJ's new economic activity and price outlooks will be realized as expected (= "on-track"), based on the data and information available at each point in time. That said, with indications of a temporary standstill for underlying inflation, a reasonable amount of time will be needed before the conditions for the next rate hike are met.

Ueda said, "Recent developments surrounding tariffs will weigh on Japan's economy by slowing global growth, hurting corporate profits, and prodding households and companies to hold off on spending due to heightening uncertainties" In particular, Ueda said that the question is whether to return to a cost-cutting mode of behavior as profits are pushed down by tariffs. This also suggests the risk of reverting to deflationary conditions.

In this regard, the most important point from the perspective of confirming that the BOJ is "on-track" with its projections is whether the "virtuous cycle of higher wages → higher prices," which was finally realized after 30 years of economic stagnation, will continue in the future. Attention should be paid to conditions for exports and production, specifically how reduced exports and production could impact profits at Japanese corporations. More specifically, "winter bonuses and the 2026 annual spring labor-management wage negotiations" are key points regarding the impact of tariffs on corporate profits and wages.

Will not slow QT pace as monetary policy measure

Also, Ueda was asked if there is any possibility of slowing the pace of QT to support the economy with regard to the interim assessment (of JGB purchases) to be discussed at the Bank's next meeting in June. Ueda responded by saying, "Our monetary policy response will focus on manipulating short-term interest rates. We will consider this while looking at the level of functioning for JGBs and monitoring the discussions at meetings with JGB market participants." Regarding the interim assessment during the June meeting, the BOJ will determine the pace of reductions after referencing the level of JGB market functioning at that time, as well as any feedback from meetings with JGB market participants.

Key economic and price outlook points, government's economic measures (incl. consumption tax cuts)

An important issue for the future economic activity and price outlook is the government's economic stimulus measures, including possible consumption tax cuts. The economic activity and price outlook presented in the April *Outlook Report* has been created based on already determined policies. We should note that the government's package of emergency economic measures to counter the adverse effects of US tariffs, as well as consumption tax cuts, will be newly incorporated into future outlooks.

Within the government's package of emergency economic measures to counter the adverse effects of US tariffs, we estimate that the core CPI for FY25 will be pushed down by about 0.1% as a result of measures to lower gasoline and other prices. We think this has already been factored into the April *Outlook Report*. Meanwhile, the specific details of the support measures for electricity and gas rates have not yet been determined, so these effects cannot be factored in at this juncture. If the amount of subsidies used in March 2025 is left unchanged, we could expect a drag of about 0.17% on Aug-Oct CPI, which would probably be factored into the forecasts in the July 2025 *Outlook Report*.

However, the government's package of emergency economic measures to counter the adverse effects of US tariffs is viewed as a stopgap measure. The biggest focus will be on consumption tax cuts as a major influence on the future economic activity and price outlook.

Normally, major revisions to the taxation system, including the consumption tax, are compiled at the end of each year in the form of the tax reform guidelines by the government/ruling party's Tax

System Research Council. In that case, the government submits a package of bills during the following year's ordinary Diet session (convened in January). That said, as an emergency economic measure or as a special measure by the new administration after the election, it is possible that a consumption tax law revision bill could be submitted separately from the tax reform guidelines.

However, after such a bill is enacted, there is usually a preparatory period so that businesses can prepare their systems and inform all parties concerned. So, a certain amount of time is required for the bill to come into effect. Therefore, even if consumption tax cuts are realized, we can assume that the cuts would not take place until April 2026 or later.

If the tax rate for food products (currently 8%) is reduced to 0%, that would have the effect of depressing the CPI by about 1.5%, which would require major revisions for the BOJ's economic activity and price outlook. In April 2014, when Japan's consumption tax was raised from 5% to 8%, the BOJ included in its *Outlook Report* at that time a case in which the impact of the consumption tax hike was excluded. In a similar manner, the BOJ could provide in a future *Outlook Report* a case in which the impact of a consumption tax cut is excluded. We expect this to be sorted out as a temporary impact.

If consumption taxes are actually cut, in the short term, the increase in consumption due to the increase in real purchasing power would support economic growth while exerting downward pressure on prices. That said, over the medium term, we could expect underlying upward pressure on prices to increase on the back of an improved output gap. It will still take some time before a consumption tax cut is actually determined and its effects are factored into the BOJ's forecasts. Still, we note that this effect may support a scenario in which the BOJ's long-term price stability target is achieved.

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