

# Daiwa's Economic View

## July BOJ MPM: One step closer to 2025 rate hike

- BOJ still concerned about downside risks to economy, but uncertainty has eased
- Concerned about sustained rise in food prices
- Conditions may be growing more conducive to rate hike within 2025

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## Tariff uncertainty recedes

Recent progress with tariff negotiations between the US and jurisdictions including Japan, the EU, and South Korea has reduced uncertainty about US tariff policy, the greatest risk factor for the global economy. The IMF raised its 2025 real GDP growth forecasts (released 29 Jul) from 2.8% to 3.0% for the world and from 1.8% to 1.9% for the US to reflect lower-than-expected tariffs. It also raised its 2025 real GDP growth forecast for Japan from 0.6% to 0.7%, though the figures do not factor in US tariff agreements with Japan, the EU, or several other countries.

That said, we will be monitoring future trends given that tariffs' impact has yet to feed through to Japan's real economy. The 29 July US-China trade talks in Stockholm also resulted in an expected 90-day extension of the pause on US-China tariffs, which was previously set to expire on 12 August. Uncertainty remains about both the final shape and the impact of US tariff policy.

Against this backdrop, the Bank of Japan (BOJ) unanimously decided to remain on hold at its 30-31 July Monetary Policy Meeting (MPM). However, its latest *Outlook for Economic Activity and Prices* report (*Outlook Report*) notes that progress with tariff negotiations has eased uncertainty about national trade policies to some extent, from "extremely high" to "high".

That said, recent progress with tariff negotiations has been broadly in line with the BOJ's expectations. In short, the BOJ is sticking with the scenario where its price stability target is reached between 2H FY26 and FY27, with underlying CPI inflation "likely to be sluggish, mainly due to the deceleration in the economy. Thereafter, however, underlying CPI inflation is expected to increase gradually...[and in] the second half of the projection period, underlying CPI inflation is likely to be at a level that is generally consistent with the price stability target." Progress with tariff negotiations is giving the BOJ greater confidence that inflation is on track to achieve its target.

### IMF World Economic Outlook (yly %)

	2024	2025	Difference from previous projections	2026	Difference from previous projections
World	3.3	3.0	0.2	3.1	0.1
Advanced Economies	1.8	1.5	0.1	1.6	0.1
US	2.8	1.9	0.1	2.0	0.3
Japan	0.2	0.7	0.1	0.5	-0.1
Euro Area	0.9	1.0	0.2	1.2	0.0
Emerging Market and Developing Economies	4.3	4.1	0.4	4.0	0.1
China	5.0	4.8	0.8	4.2	0.2

Source: IMF; compiled by Daiwa.

## **Economic outlook: BOJ raises estimates to reflect macro trends**

We focus at the recent MPM on the BOJ's economic and inflation outlook and risk assessment based on recent macroeconomic conditions and tariff policy trends.

The BOJ raised its FY25 real GDP growth forecast (median of majority of Policy Board members' forecasts) in the *Outlook Report* from +0.5% to +0.6%, but left its forecasts unchanged at +0.7% for FY26 and +1.0% for FY27. We think the FY25 upward revision mainly reflected recent macroeconomic data, which has yet to be affected by tariffs, and the revision was within the range [we expected](#). Given that recent progress with tariff negotiations has been broadly as the BOJ expected, we doubt that the breakthrough in the Japan-US talks was the main driver of the upward revision.

The BOJ maintains its scenario whereby "Japan's economic growth is likely to moderate [due to the impact of] trade and other policies in each jurisdiction," but its "economic growth rate is [then] likely to rise, with overseas economies returning to a moderate growth path." We think recent progress with tariff negotiations makes this scenario considerably more likely (see "Conditions for next rate hike" section).

## **Inflation outlook: BOJ raises forecasts on sustained rise in food prices**

The BOJ raised its inflation forecasts (median of majority of Policy Board members' forecasts) from +2.2% to +2.7% for FY25, from +1.7% to +1.8% for FY26, and from +1.9% to +2.0% for FY27. This mainly reflects the impact of rising food prices. While its FY25 forecast rose more than [we expected](#), the revision for FY26 was broadly in line.

The BOJ is also increasingly focusing on the stickiness of recent food price inflation. The *Outlook Report* notes the risk that "as recent price rises are also somewhat attributable to the pass-through of increased personnel expenses and distribution costs to selling prices, it is possible that the price rises will persist for longer than expected, depending on firms' wage- and price-setting behavior."

However, the BOJ's baseline scenario remains that the "effects of the recent rise in food prices, such as rice prices, are expected to wane". It raised its FY27 core CPI forecast from +1.9% to +2.0%, but left its core-core forecast at +2.0%, suggesting that it does not expect underlying inflation to pick up appreciably.

However, we would watch the potential for a sustained uptrend in food prices. A Teikoku Databank survey published on 31 July confirmed that food prices are set to continue rising at least through October. We see a growing risk of sustained food price inflation despite the easing of external cost-push factors such as import prices.

**FY25-27 Forecasts of Majority of Policy Board Members (y/y %)**

	Real GDP	CPI (all items less fresh food)	(Ref) CPI (all items less fresh food and energy)
FY25	+0.5 ~ +0.7 [+0.6]	+2.7 ~ +2.8 [+2.7]	+2.8 ~ +3.0 [+2.8]
As of Apr	+0.4 ~ +0.6 [+0.5]	+2.0 ~ +2.3 [+2.2]	+2.2 ~ +2.4 [+2.3]
FY26	+0.7 ~ +0.9 [+0.7]	+1.6 ~ +2.0 [+1.8]	+1.7 ~ +2.1 [+1.9]
As of Apr	+0.6 ~ +0.8 [+0.7]	+1.6 ~ +1.8 [+1.7]	+1.7 ~ +2.0 [+1.8]
FY27	+0.9 ~ +1.0 [+1.0]	+1.8 ~ +2.0 [+2.0]	+2.0 ~ +2.1 [+2.0]
As of Apr	+0.8 ~ +1.0 [+1.0]	+1.8 ~ +2.0 [+1.9]	+1.9 ~ +2.1 [+2.0]

Source: BOJ; compiled by Daiwa.

Notes: (1) Figures in brackets indicate the medians of the Policy Board members' forecasts (point estimates).

(2) The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate – namely, the figure to which they attach the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.

(3) Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.

**Risks to economic/inflation outlook: Skewed to downside for economy, balanced for inflation**

The BOJ maintained its view that risks to its economic forecasts are "skewed to the downside" for both FY25 and FY26. However, it revised its assessment of risks to its inflation forecasts to "generally balanced" to reflect progress with tariff negotiations and the sustained uptrend in food prices.

We think the BOJ's decision to maintain its assessment of risks to its economic forecasts despite the progress with US-Japan tariff negotiations also reflects the IMF's view in its 29 July *World Economic Outlook* that risks to the global economy are "tilted to the downside".

However, the BOJ clearly thinks that the uncertainty caused by US tariff policy has eased, with the *Outlook Report* citing risks to the economic outlook from "trade and other policies in each jurisdiction and developments in overseas economic activity and prices" while noting the "positive developments in trade and other policies, such as negotiations between Japan and the United States resulting in an agreement". It also mentions the upside risk that "developments such as recent moves toward fiscal expansion, particularly in the United States and Europe, could push up the global economy."

The BOJ indicates that risks to its inflation forecasts for FY25 and FY26 are generally balanced, with three board members concerned about an overshoot and three concerned about an undershoot. This confirms that several members remain concerned about downside risks amid ongoing uncertainty about the final shape of tariff policy and its impact.

**Conditions for next rate hike**

We have thus far cited the following conditions for the BOJ's next rate hike: (1) a shift in the balance of risks to the economy and inflation from "skewed to the downside" to "balanced" (lower uncertainty about tariffs), and (2) careful assessment of the impact of tariffs on the Japanese economy and prices. The recent outcome means that one of these conditions is close to being met, in that uncertainty about US tariff policy, the biggest concern thus far, has now eased. The BOJ's greater emphasis on the risk of a sustained rise in food prices also implies that the conditions for a further move to normalize monetary policy within 2025 are falling into place.

We would note that trends in [the US economy, the key source of final demand, are more important](#) in gauging tariffs' impact on Japan. Japanese firms' pursuit of value-added strategies makes them more susceptible to the effects of US business sentiment transmitted through income elasticity than to the loss of competitiveness from passing through tariff costs.

Progress with tariff negotiations has reduced the risk of a sudden jump in the US's average effective tariff rate. This has in turn eased concerns about US domestic inflation and a recession and made a soft landing more likely. We will be monitoring the extent to which firms pass through higher tariff costs to US end consumers over the summer and the impact on households and companies. Summer trends in the US will likely be a key indicator of the Japanese economy's ability to bounce back after its growth slump.

The positive US-Japan tariff agreement should also help mitigate the shock to Japan's economy and inflation. If a soft landing for the US economy comes to look more plausible and Japanese firms' earnings and capex remain upbeat through Oct-Dec, we think this would further increase the BOJ's conviction about its next rate hike.

### Governor Ueda's press conference: Expect hawkish message despite ongoing uncertainty

We focus at today's press conference on whether BOJ Governor Kazuo Ueda emphasizes the lessening of uncertainty driven by progress with tariff negotiations (including the US-Japan deal) or the remaining uncertainty about tariffs' impact.

However, as noted, we think the press conference will project a more hawkish impression given the growing likelihood of a limited impact from tariffs and the risk that food prices could continue to rise. On the inflation front, we focus on Mr. Ueda's views about the impact on underlying inflation from broader-based hikes to food prices to pass through higher costs.

#### Main Contents of Outlook Report

<b>● Baseline Scenario of the Outlook for Economic Activity</b>	
Jul 2025	Japan's economic growth is likely to moderate, as trade and other policies in each jurisdiction lead to a slowdown in overseas economies and to a decline in domestic corporate profits and other factors, although factors such as accommodative financial conditions are expected to provide support. Thereafter, Japan's economic growth rate is likely to rise, with overseas economies returning to a moderate growth path.
(Apr 2025)	Japan's economic growth is likely to moderate, as trade and other policies in each jurisdiction lead to a slowdown in overseas economies and to a decline in domestic corporate profits and other factors, although factors such as accommodative financial conditions are expected to provide support. Thereafter, Japan's economic growth rate is likely to rise, with overseas economies returning to a moderate growth path.
<Risk balance>	
Jul 2025	Risks to economic activity are skewed to the downside for fiscal 2025 and 2026.
(Apr 2025)	Risks to economic activity are skewed to the downside for fiscal 2025 and 2026.
<b>● Baseline Scenario of the Outlook for Prices</b>	
Jul 2025	Underlying CPI inflation is likely to be sluggish, mainly due to the deceleration in the economy. Thereafter, however, underlying CPI inflation is expected to increase gradually, since it is projected that a sense of labor shortage will grow as the economic growth rate rises, and that medium- to long-term inflation expectations will rise. In the second half of the projection period, underlying CPI inflation is likely to be at a level that is generally consistent with the price stability target.
(Apr 2025)	Underlying CPI inflation is likely to be sluggish, mainly due to the deceleration in the economy. Thereafter, however, underlying CPI inflation is expected to increase gradually, since it is projected that a sense of labor shortage will grow as the economic growth rate rises, and that medium- to long-term inflation expectations will rise. In the second half of the projection period, underlying CPI inflation is likely to be at a level that is generally consistent with the price stability target.
<Risk balance>	
Jul 2025	<b>Risks to prices are generally balanced.</b>
(Apr 2025)	Risks to prices are also skewed to the downside for fiscal 2025 and 2026.
<b>● Conduct of Monetary Policy</b>	
Jul 2025	Given that real interest rates are at significantly low levels, if the aforementioned outlook for economic activity and prices will be realized, the Bank, in accordance with improvement in economic activity and prices, will continue to raise the policy interest rate and adjust the degree of monetary accommodation.
(Apr 2025)	Given that real interest rates are at significantly low levels, if the aforementioned outlook for economic activity and prices will be realized, the Bank, in accordance with improvement in economic activity and prices, will continue to raise the policy interest rate and adjust the degree of monetary accommodation.

Source: BOJ; compiled by Daiwa.

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