

Daiwa's View

BOJ likely to hike rates within this year

- Yen pushed up to USD/JPY150 level as BOJ decision to maintain status quo disappoints markets
- This yen depreciation now biggest force for moving forward timing of interest rate hike within this year
- BOJ Governor Ueda's press conference left dovish impression, but our forecast for rate hike in Oct-Dec remains unchanged

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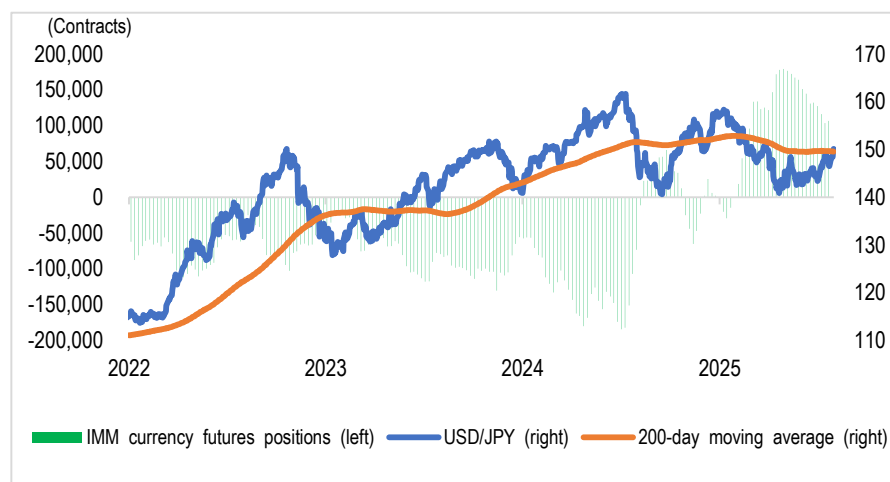
Daiwa Securities Co. Ltd.

At its 31 July Monetary Policy Meeting, the BOJ left its policy interest rate unchanged at 0.5% and significantly revised upward its price outlook for FY25 to 2.7%. However, the content of this meeting was largely in step with the speech delivered by BOJ Deputy Governor Shinichi Uchida on 23 July. As such, there were few surprises.

During his post-meeting press conference, BOJ Governor Kazuo Ueda praised the US/Japan tariff agreement as a “big step forward,” which was in line with comments in Uchida’s speech. Ueda recognized that uncertainty has decreased and the likelihood of achieving price targets has increased as a result of the US/Japan tariff agreement. This too fell in line with Uchida’s speech. This recognition also was reflected in the July *Outlook Report* with the previous expression “extremely high uncertainties” softened to simply “high uncertainties.” The upward revision for the FY25 price forecast and changes for the balance of risks to prices were also as reported prior to the meeting.

One noteworthy point is that despite the 2.7% price forecast for FY25 exceeding the expectations of many market participants, Ueda dismissed that rate as a temporary factor. The rise in food prices, particularly rice, was clearly reflected in the 2.7% forecast and Ueda said, “This upward revision alone will not impact our monetary policy decisions.”

USD/JPY Rate Trends



Source: Bloomberg; compiled by Daiwa.

Note: The IMM currency futures positions is the net position calculated as “long position – short position.”

The market perceived that statement as dovish. During his 23 July speech, Uchida indicated that, "Consumer prices have risen by more than what the Bank or market participants had expected" and he noted that changes in corporate price-setting behavior are spreading to related fields such as restaurants. As such, the market had been increasingly expecting a risk management-oriented interest rate hike to address the risk of sustained price increases. Given that the possibility of preventive policy changes to avoid falling behind the curve had been recognized, Ueda's cautious stance was disappointing.

As a result, yen selling accelerated on the foreign exchange market with the yen depreciating to the USD/JPY150 level. This could be more than just a temporary reaction. The yen clearly depreciated beyond the upper USD/JPY148 range, which had served as the upper end of its trading range since February 2025, while also breaking above its 200-day moving average. Technically speaking, there is a strong possibility for a trend reversal due to the USD/JPY breaking out of its range.

Another concern is the unwinding of yen long positions accumulated since February 2025. These positions were entered at a stronger yen level than the current level and, considering the negative carry due to the US/Japan interest rate gap, the break-even point could be at an even stronger yen level. There is a risk that the unwinding of positions in response to the BOJ's decision will become a self-fulfilling prophecy, leading to further yen depreciation.

Ironically, this yen depreciation may prompt the BOJ to move forward the timing for its next interest rate hike. This is because the BOJ will be forced to take early policy measures due to rising import prices and higher profits for exporters. The possibility of an interest rate hike within this year had already been high following the US/Japan tariff agreement, but the possibility of bringing a rate hike forward from December to October has also become more realistic.

US-side factors are also important to consider. At the recent FOMC meeting, Fed Chairman Jerome Powell maintained his cautious stance on interest rate cuts and market expectations for interest rate cuts were revised downward from 1.8 times to 1.3 times this year. If the US employment statistics due out on 1 August are solid, expectations for a rate cut will recede even further and upward pressure on the USD/JPY may strengthen further. Given that forecasts among FOMC members are currently split between zero and two rate cuts this year, there is considerable room for significant fluctuations depending on the data.

Even though the tone of Ueda's press conference was relatively dovish, the resulting yen depreciation could paradoxically serve as a catalyst for the Bank to raise interest rates sooner than expected. Market attention will now focus on the 1 August US employment statistics and subsequent currency movements. The yen depreciation pressure unintentionally created by the BOJ may end up constraining its own policy decisions.

(Kawahara)

Ueda's press conference: BOJ seems to be aware of upside risks despite dovish impression (Minami)

Following [the 30-31 July Monetary Policy Meeting](#), Ueda held his regular press conference. He described the US/Japan tariff agreement as a "big step forward" and said that "uncertainties have receded," but he also expressed the view that, "Uncertainty surrounding each country's trade policy remains high." This view is consistent with that in the July *Outlook Report*.

On top of that, Ueda expressed the view that rising food prices are temporary. Here he said, "What's happening in Japan now is that a considerable portion of higher prices is driven by supply factors." He did not mention risks described in the *Outlook Report* as, "It is possible that the price rises will persist for longer than expected, depending on firms' wage- and price-setting behavior." Here, Ueda said, "This upward revision alone will not impact our monetary policy decisions."

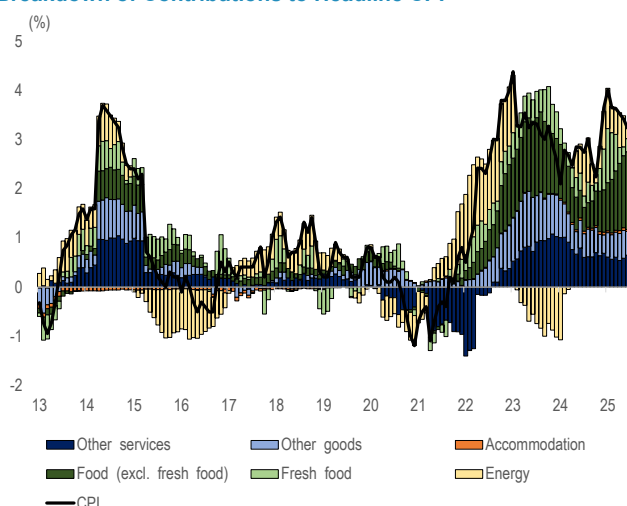
We believe that the risk of continued food price increases becoming apparent and impacting underlying inflation is reasonably high. Furthermore, the fact that upside risks were not stressed made the press conference seem more dovish compared to our expectations.

However, Ueda's view was limited to simply stating the basic scenario of, "The impact of rising food prices, such as rice, will subside." Actually, as stated for the first time in the *Outlook Report*, the BOJ also recognizes the risk that food prices could continue to rise. Meanwhile, rising food prices pose a two-way risk, acting as a downward factor that suppresses consumption and cools the economy, while also acting as an upward factor that impacts companies' wage and price-setting behaviors and inflation expectations.

That said, there is a strong likelihood that consumers are beginning to accept price increases to a certain extent and rising food prices are likely to pose upside risks for underlying inflation. In addition to the above-mentioned exchange rate trends, food price trends could be one reason to adjust future policy interest rates earlier rather than later.

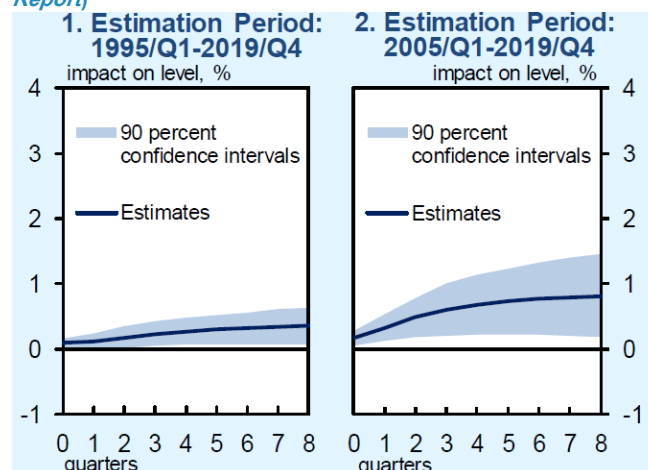
According to the BOJ's analysis in its January 2022 *Outlook Report*, 10% yen depreciation would have an impact of around 1% on core CPI after a certain time lag. Furthermore, the impact on CPI could be even greater when considering the possibility of "Exchange rate fluctuations having a greater impact on prices than in the past as companies become more aggressive in their wage- and price-setting behaviors."

Breakdown of Contributions to Headline CPI



Source: Ministry of Internal Affairs and Communications; compiled by Daiwa.

Impact of 10% Yen Depreciation on CPI (Jan 2022 *Outlook Report*)



Source: Reprinted from BOJ materials.

Key points to consider when assessing tariff impacts

In determining future interest rate hikes, the key factors to watch in terms of the real economy are (1) Outcome of tariff negotiations between US/China, others and (2) Domestic/international economic trends taking into account tariffs. Ueda also said during his press conference, "I would like to see what kind of impact this will have on (Japanese) exports and production, US employment, and other hard data."

Ueda stated, "We expect some negative impacts to occur in the second half of the year." As for that assessment period, he indicated the importance of a data-driven approach and said, "At this point, nothing definitive can be said. We will carefully monitor the situation without making any assumptions." However, positive factors for the Japanese economy are now increasing.

The first positive factor is the "big step forward" represented by the US/Japan tariff agreement, coupled with the US/EU and US/South Korea tariff agreements, which were finalized at the same level as the US/Japan agreement. This clearly mitigates the shock to the global economy caused by tariffs, which is a positive development. The second positive factor is that, as stated in the

Outlook Report, fiscal expansion centered on the US and Europe is likely to support the global economy and mitigate the impact of any tariff shocks. In addition, Japan's own expansionary fiscal policy is increasingly likely to underpin the Japanese economy.

These growing expectation for a soft landing globally is also expected to contribute to the resilience of the Japanese economy. Based on these points, the impact of the recent tariff policy on the Japanese economy is likely to be limited to, "The mechanism whereby wages and prices positively influence each other will continue unabated."

As mentioned earlier, amid growing risks of upward pressure on prices, expectations for a soft landing for the US economy are rising and, if Japan's exports, production, capex, and corporate earnings remain strong during the Oct-Dec quarter, the BOJ will become even more confident about raising interest rates. There is no change to our outlook that the Bank's next interest rate hike will occur during the Oct-Dec quarter.

(Minami)

◆ Jul Outlook Report (31 Jul 2025)

Baseline Scenario of the Outlook for Prices

- The effects of the recent rise in food prices, such as rice prices, are expected to wane.

Risks to Prices

- (Regarding food prices, such as rice prices), 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. Since consumers purchase food items on a frequent basis, if the price rises persist, attention is warranted on the possibility that this may induce second-round effects on underlying CPI inflation through changes in household sentiment and inflation expectations.
- With firms' behavior shifting more toward raising wages and prices recently, exchange rate developments are, compared to the past, more likely to affect prices.

Risks to Economic Activity

- There have been positive developments in trade and other policies, such as negotiations between Japan and the United States resulting in an agreement. That said, high uncertainties remain regarding negotiations between jurisdictions and the impact of trade and other policies on economic activity and prices at home and abroad.
- Attention needs to be paid to the possibility that developments such as recent moves toward fiscal expansion, particularly in the United States and Europe, could push up the global economy.

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