

Daiwa's View

FICC Research Dept.

Takaichi's Inauguration as PM suggests BOJ will forgo rate hike in October

- October rate hike is now off the table due to media reports based on sources in the know
- Japan's economy is largely on track with regard to BOJ projections; concerns about domestic factors would be minor if fiscal support were added
- If new factors were to impede additional rate hike by BOJ, they would likely be overseas factors

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We would like to extend our congratulations to Ms. Sanae Takaichi on her appointment as Japan's first female prime minister. However, the recent chaotic series of events has been a stark reminder of the complexities of politics, as expressed by the saying, "You never know what will happen in politics." Few could have predicted the recent sequence of events: (1) Takaichi winning the Liberal Democratic Party (LDP) presidential election (instead of Shinjiro Koizumi, who had been reported to be the most likely candidate for the position), (2) the LDP-Komeito coalition dissolving, (3) the possibility emerging that an opposition coalition government could be formed with Yuichiro Tamaki as Prime Minister, and 4) the Japan Innovation Party (JIP) offering cooperation to the LDP from outside the cabinet.

Yesterday, around the same time as Takaichi's official inauguration as prime minister, media reports based on sources in the know emerged claiming that there was little need to rush the decision about a rate hike at the October Monetary Policy Meeting (MPM). This has effectively settled the matter, meaning that the BOJ will forgo a rate hike in October. In our report [Daiwa's View "Benefits vs costs of waiting: Re-examining December rate-hike argument"](#) on 1 October, we pointed out the following five benefits of waiting until December, and the third point appears to have played the decisive role. Authorities are likely prioritizing considerations that reflect concerns that it would be inappropriate for the new prime minister, with whom the BOJ must coordinate economic policy, to make a decision about implementing an additional rate hike the week immediately following her election.

(Reposting) Benefits of waiting until December

- (1) The biggest benefit to come from waiting until the December MPM is that the BOJ would have one more opportunity to review a Tankan survey before making a rate hike decision. The BOJ's December Tankan survey is scheduled to be released on 15 December, with the full survey results scheduled for release on the 16 December. This Tankan schedule was designed to come out just before the December MPM scheduled for 18-19 December. As such, if there are any remaining concerns from the September survey (released on 1 Oct), the benefits of waiting until the December MPM, when the December survey can be confirmed, may become more apparent.
- (2) The BOJ can also check the first and second preliminary estimates for the Jul-Sep GDP. If the September Tankan survey or information from hearings is weak, the benefit of confirming the Jul-Sep GDP would become more significant.
- (3) **This would allow the BOJ to take more time to confirm the situation surrounding domestic politics.**
- (4) Likelihood of avoiding any overlap with the Fed's rate cuts increases. The probability of a rate cut at the December FOMC meeting, currently priced into the OIS market, is around 37%. This means there is a 63% chance of avoiding an overlap (Japan rate hike at same time as Fed rate cut). Moreover, the December FOMC meeting is scheduled for 9-10 December, meaning it is more than a week apart from the BOJ's MPM.
- (5) If the release of September US employment statistics is postponed due to a US government shutdown, the BOJ will have time to wait for the data to be released.

At her inaugural press conference yesterday, Prime Minister Takaichi reaffirmed that the government held the ultimate responsibility for macroeconomic policy, and that, based on the fact that it [monetary policy] was a component of economic policy, it was of the utmost importance that the BOJ worked in close cooperation and communicated thoroughly with the government. While such comments are reasonable and in line with the Bank of Japan Act (i.e., not a challenge to the bank's independence), it is also true that they convey a greater sense of pressure compared to the previous administration. We anticipate that Prime Minister Takaichi will adopt a stance of not meddling in the nitty-gritty details (by which we essentially mean the specific timing of rate hikes or cuts) but being very particular about "etiquette" (by which we essentially mean having strong views regarding the stance, coordination, and communication of monetary policy as a component of economic policy).

◆Bank of Japan Act (The so-called New Bank of Japan Act)

- Article 3: (1) **The Bank of Japan's autonomy regarding currency and monetary control must be respected.**
- Article 4: Taking into account the fact that currency and monetary control is a component of overall economic policy, **the Bank of Japan must always maintain close contact with the government and exchange views sufficiently, so that its currency and monetary control and the basic stance of the government's economic policy are mutually compatible.**

We have confirmed that there was another leak yesterday claiming that the ground was being laid for an early rate hike, including one in December. Consequently, market pricing for a December rate hike has increased significantly. However, we are somewhat concerned that a December hike was described as an "early rate hike." Hinting at a rate hike in December may be intended to emphasize that forgoing a rate hike in October is merely a "hawkish skip," but it could also be a signal that the main scenario will be a rate hike from January 2026 (when the *Outlook Report* is released) onwards. The day before yesterday, another news leak claimed that the balance of risks regarding the economic and price outlook was also seen as remaining unchanged. If the wording "risks are skewed to the downside" is actually left in the October *Outlook Report*, it would feel odd for an additional rate hike to be implemented before that wording was removed. And, if the BOJ were to wait until that wording in the *Outlook Report* was revised, a hike would not take place until January 2026 or later.

That said, the Tankan results and information from hearings already indicate that Japan's economy is largely on track with regard to BOJ projections (which was clearly indicated by the fact that multiple board members argued for a hike in September). Therefore, if measures based on the "responsible, expansionary fiscal policy" of the Takaichi administration were added to the equation, it would be reasonable to think that the wording in the *Outlook Report* would no longer serve as a major constraint on a rate hike. It may be that, with the BOJ no longer concerned about the domestic economy, it actually intends to proceed with a rate hike once it has carefully assessed overseas factors and coordinated matters with the government.

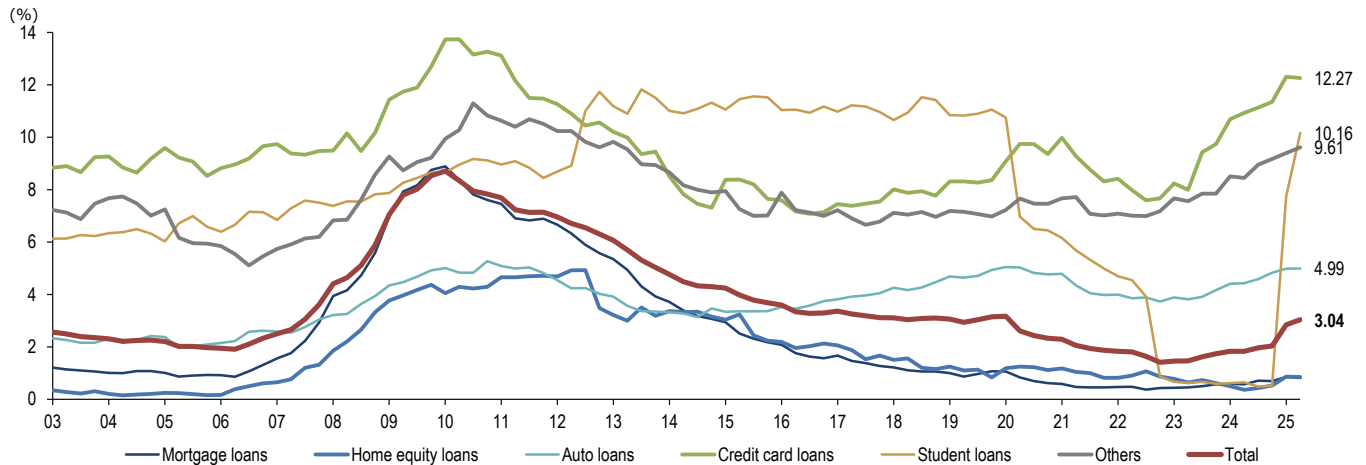
Overseas factors

To put it another way, if factors impeding a further BOJ rate hike do emerge going forward, they will likely be overseas factors—particularly factors in the US. In this respect, it is noteworthy that the US long-term yield has once again fallen below 4%, to the 3.9% range, while the stock market remains solid. Until recently, almost no market participants were talking about the 10-year US yield falling below 4%, but the yield is now staying below 4%. The 5-year forward 5-year US breakeven inflation rate, an indicator of underlying inflation, has fallen to 2.24%, which clearly indicates that lower yields are not driven by concerns about an inflationary spiral caused by tariffs. It is a fact that price movements are occurring that market participants have not expected, so we need to take time to determine what the background factors are.

In my personal view, I think that, with delinquency rates rising in the US, some prudent investors may not be underestimating the changes occurring in the depths of the credit market. For example, fundamental indicators are now showing changes, with delinquency rates (90 or more days past due) for auto loans rising to 4.99%, and those for credit card loans rising to 12.27% in

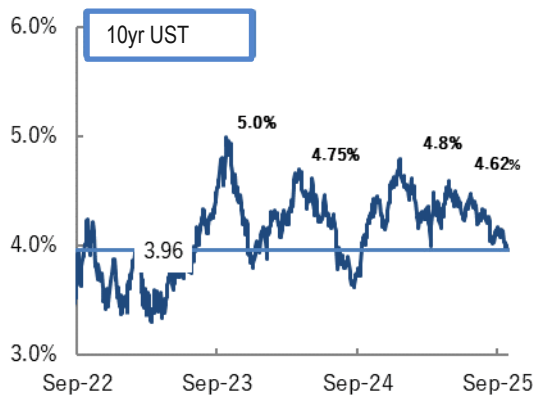
the US. It is hard to imagine that the bankruptcy filing of Tricolor Holdings, a US auto lender to subprime borrowers, is unrelated to the rise in auto loan delinquency rates in the US. Therefore, we must admit that there is a possibility that the credit cycle has begun to turn.

Trends with US Household Delinquency Rates (90 or more days past due)

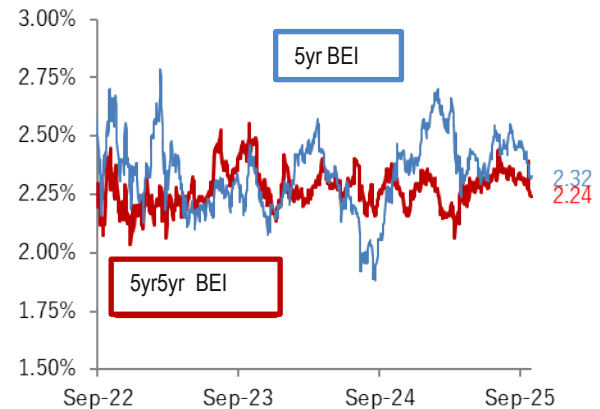


If some kind of irregularity were to emerge in the US—which is the top item in Governor Kazuo Ueda's checklist for the next rate hike—the additional rate hike could be postponed even further. The factors that potentially endanger an additional rate hike by the BOJ lie in the US, not Japan.

10yr US Yield



US 5yr BEI, 5yr5yr BEI



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