

Daiwa's View

BOJ Outlook Report signals possible turning point

- Governor Ueda's press conference raised possibility of Jan rate hike
- *Outlook Report* changes suggest risk of slowdown for BOJ's rate-hiking pace
- 1% terminal rate scenario entails significant room for super-long JGB yields to decline

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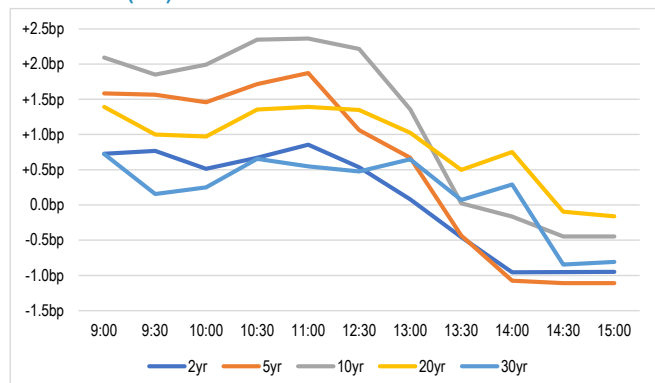
Votes in favor of rate hike did not increase; Dec rate hike hopes recede

At its 30 October Monetary Policy Meeting (MPM), the BOJ decided to leave its policy interest rate unchanged at 0.5% by a vote of 7 to 2. While some market participants expected an increase in votes against the status quo—anticipating a December rate hike—the number of dissenting votes remained at two (same as at previous meeting in Sep). Expectations for a December rate hike started to fade following that outcome. After the results were announced, JGB yields fell and the yen depreciated.

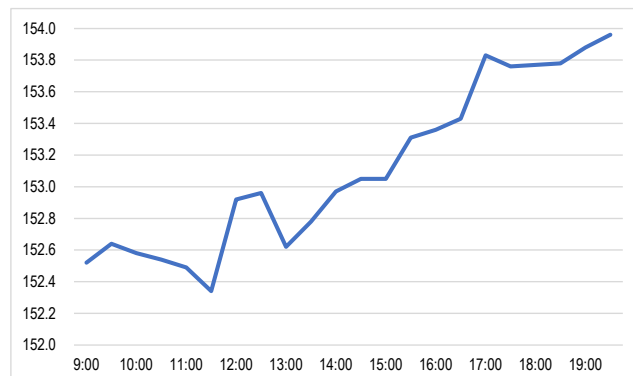
At his post-meeting press conference, BOJ Governor Kazuo Ueda cited momentum for the annual spring labor-management wage negotiations (*Shunto*) as a key factor for its next rate-hiking decision. The previous rate hike implemented in January 2025 likewise focused on wage trends, which has led market participants to anticipate a rate hike in January 2026. This in turn further dampened expectations for a December rate hike, which accelerated the yen's depreciation.

Key changes in *Outlook Report*: Emphasis on “CPI below 2%”

Daiwa economists will later cover this press conference in greater detail. Meanwhile, from a strategist's perspective, the most noteworthy aspect of this meeting was the change in the description of the BOJ's price outlook in its *Outlook for Economic Activity and Prices* report (*Outlook Report*).

JGB Yields (d/d)

Source: Compiled by Daiwa.

USD/JPY Rate

Source: Bloomberg; compiled by Daiwa.

This *Outlook Report* newly added the wording, “The y/y rate of increase in the CPI (all items less fresh food) is likely to decelerate to a level below 2% through the first half of fiscal 2026.” The previous *Outlook Report* (Jul) projected a full-year growth rate in the range of 1.5-2.0% for FY26, but this time it deliberately emphasized a drop below 2% in 1H FY26.

Furthermore, changes were made to the section describing the outlook for prices beyond the immediate future. This time the statement was, “It is expected that underlying CPI inflation and the rate of increase in the CPI (all items less fresh food) will increase gradually thereafter and, in the second half of the projection period, be at a level that is generally consistent with the price stability target.” Last time, only the underlying CPI inflation rate was mentioned, but this time CPI trends (all items less fresh food) were also included.

The CPI (all items less fresh food) forecasts for FY26 and beyond remain unchanged from the previous forecasts. However, we need to consider the significance of the BOJ deliberately emphasizing a possible CPI fall below 2% this time.

◆ Outlook for Economic Activity and Prices (Oct 2025)

The year-on-year rate of increase in the consumer price index (CPI, all items less fresh food) **is likely to decelerate to a level below 2 percent through the first half of fiscal 2026**, with the waning of the effects of the rise in food prices, such as rice prices. Meanwhile, underlying CPI inflation is likely to be sluggish, mainly affected by the growth pace of the economy. Thereafter, 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, it is expected that **underlying CPI inflation and the rate of increase in the CPI (all items less fresh food) will increase gradually** and, in the second half of the projection period, be at a level that is generally consistent with the price stability target.

Difficulties hiking rates in July 2026

Its emphasis on CPI (all items less fresh food) underscores the difficulties that the BOJ will face in terms of raising interest rates going forward. The prevailing view on the market is that once the BOJ makes its next interest rate hikes for the first time in a long while, it will return to its previous pace of raising rates once every six months.

However, if the next rate hike is made in January 2026, the next potential timing for another hike would be six months later in July 2026. However, as indicated by the BOJ, CPI (all items less fresh food) is expected to fall below 2% in the first half of FY26. The justification for raising interest rates at that time could be called into question.

The BOJ may have wanted to convey that CPI falling below 2% is likely a temporary phenomenon and that prices will rise back to 2% (so there is no cause for concern). However, with inflation actually falling, market expectations for interest rate hikes may become less likely.

By deliberately emphasizing a possible move below 2% this time, expectations for interest rate hikes will recede, especially among investors who have noticed this development. If the market starts to take that into account, an environment in which it is difficult for the BOJ itself to hike interest rates could emerge. In other words, there is a risk that the market's pricing in of rate hikes could decline in a self-defeating manner for the BOJ.

Likelihood of slowdown to one rate hike each year and terminal rate of 1%

If such a forecast materializes, we would not expect the next rate hike after January 2026 to occur six months later in July 2026, but rather in the latter half of FY26 when CPI (all items less fresh food) is projected to rise back to 2%, as indicated by the BOJ. Depending on the circumstances, if that decision once again hinges on the momentum for the FY27 annual spring labor-management wage negotiations, a rate hike in January 2027 could take place, potentially continuing the pace of one rate hike per year.

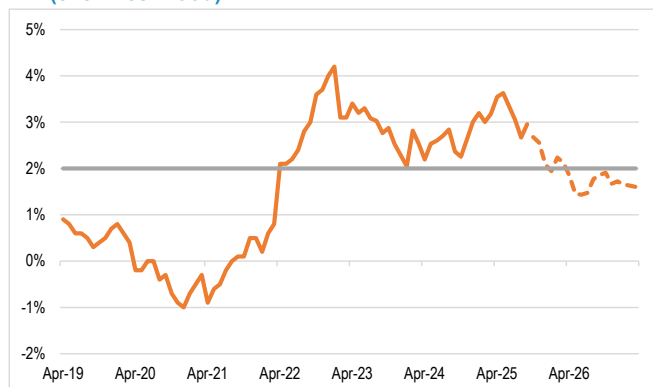
In that case, the policy interest rate would reach 1%, but this timing corresponds to the “latter part of the projection period” in the *Outlook Report* when the price target is expected to be achieved and 1% could become the terminal rate.

Logic explaining real interest rate rise

That said, such thinking may lead to indications that such low policy interest rates will not curb yen depreciation or US won't tolerate it from an exchange rate perspective (as mentioned by US Treasury Secretary Scott Bessent).

However, in reality, inflation will decline sharply from this point onward. So, even if the policy interest rate level is maintained, the real interest rate (real policy interest rate) would rise. Accordingly, this would have a tightening effect on the economy and, in some cases, generate upward pressure on the yen exchange rate, potentially alleviating those concerns. By explaining this mechanism of rising real interest rates, the BOJ can justify its stance of not rushing to raise rates. That position is consistent with views held by the Takaichi administration and could also be justified to the US to some extent.

CPI (excl. fresh food)



Source: Ministry of Internal Affairs and Communications (MIC); compiled by Daiwa.
 Note: Dotted line indicates forecasts by our Senior Economist Minami.

Real Policy Interest Rate



Source: MIC, BOJ; compiled by Daiwa.

Notes: (1) Real policy rate = Policy rate - CPI (excl. fresh food). Dotted line represents forecasts.
 (2) Calculated assuming policy rate of 0.75% from Jan 2026 and 1.0% from Jan 2027.

Hints for super-long JGB investing

In any event, there is still the risk that the BOJ will maintain its cautious stance. Here, the price target may be achieved at a terminal rate lower than the approximately 1.25% level currently priced in by the market. If such a forecast materializes, the current JGB yields could be viewed as excessively high, particularly among the longer maturities. If supply and demand align, such as through reduced JGB issuance by MOF, significant yield declines could materialize, especially in the super-long zone.

Of course, actual inflation has consistently exceeded the BOJ's projections. So, it is not surprising that the market is pricing in these conditions given the risk of the BOJ falling behind the curve. However, if headline inflation is finally set to decline, we could enter a phase in which it will also be important to be aware of the risk of declining yields, due to the shrinking of large term premiums, especially involving longer JGB maturities.

(Kawahara)

BOJ Governor Ueda's press conference raised likelihood of January rate hike (Minami)

At the regular press conference following the October meeting, Governor Kazuo Ueda stated that the economy and prices had been on track with regard to projections as of July, assessing the situation by saying that the accuracy of previous outlooks had increased. Ueda also seemed to adopt a more positive tone in light of the robust economies in Japan and the US.

He expressed the view that the US economy remained solid, in light of the strength of AI-related sectors and the prolonged impact of tariffs. However, he noted that the impact of tariffs on corporate earnings, employment, and income formation, as well as on personal consumption via the passing through of tariff costs to prices, would gradually become clear, but pointed out that these uncertainties would not become clear for the time being. However, he also indicated that he determined that the downside risks would be somewhat limited, despite these uncertainties. Therefore, he seems to expect the impact from tariffs to be limited.

Data that will be available by Dec meeting regarding momentum behind *Shunto* will be limited

However, he stated at the press conference that the important point was whether, or not, corporations' positive approach to setting wages would continue, even with downward pressure on profits due to tariff policies, and indicated a stance of putting particular emphasis on the importance of the initial momentum behind spring management-labor wage negotiations (*Shunto*).

The initial momentum behind *Shunto* between now and the December meeting is expected to become clearer based on the stance taken by labor unions that will be indicated by the "2026 *Shunto* policy" to be released on 28 November and trends with corporate profits, which will be the source of funding for wage increases, to be disclosed in the BOJ Tankan (Dec survey) to be released on 15 December. However, the momentum behind labor unions has already been confirmed to some extent by the "[2026 *Shunto* basic concept](#)" released on 23 October, and solid corporate performance was also confirmed by [the BOJ Tankan \(Sep survey\)](#) released on 1 October. Therefore, while the wage-related data that will become available between now and the December meeting might end up serving as a source of reassurance for the BOJ, it is questionable whether we will be able to call it "sufficient," compared to what is presently known.

At the press conference, Governor Ueda commented about corporate wage-setting behavior, stating that the stance taken by both labor and management towards next year's spring labor-management negotiations with earnings plans assuming a 15% tariff rate would become clearer, and that information from hearings made through the bank's head office and branches would also accumulate steadily. However, it is highly likely that the information regarding the 2026 *Shunto* that will become available between now and the December meeting will not be sufficient if the BOJ also intends to go so far as to determine how the management side intends to respond.

Schedule Leading up to 2026 *Shunto*

		<i>Shunto</i>	BOJ	Government
2025	Oct	23rd: Rengo: Basic Concept for <i>Shunto</i> 29th: Keidanren: Draft of Committee on Management and Labor Policy report covered in the news	29th-30th: MPM	21st: Opening of extraordinary Diet session
	Nov	28th: Rengo: Basic Policy for <i>Shunto</i>		
	Dec	Government, labor, and management meeting?	15th: BOJ Tankan (Dec survey) 18th-19th: MPM	17th: End of extraordinary Diet session ※ Passage of supplementary budget bill End-Dec: Cabinet decision on FY26 budget draft
2026	Jan	Mid/late-Jan: Keidanren: Committee on Management and Labor Policy report	Early/mid Jan: Branch managers' meeting 22nd-23rd: MPM	Opening of Ordinary Diet session (deliberation on FY26 budget)
	Feb	Full-scale labor-management negotiations at large companies		
	Mar	Early Mar: Rengo: Tally of demands Mid-Mar: Rengo: Tally of first response (from management) Full-scale labor-management negotiations at SMEs	18th-19th: MPM	

Source: Japanese Trade Union Confederation (Rengo), Japan Business Federation (Keidanren), BOJ, various media reports; compiled by Daiwa.

Governor Ueda also stated that the BOJ wanted to gather information on the initial momentum, rather than wait until it had an idea of what the final rate of increase in wages would be at the *Shunto*. This likely means that he will not wait until March, when the first tally of *Shunto* will be released. It is clear that the timing of the rate hike envisioned by Governor Ueda will be narrowed down to either December or January.

Variables regarding timing of rate hike are still US economy and prices

Governor Ueda identified the initial momentum of next year's wage increases as the key focus, and said that the important point will be whether we see any larger-than-anticipated negative news occur in the US in the meantime. As such, the absence of any major downturn in the US economy will, of course, be a prerequisite. Furthermore, Governor Ueda commented on the recent weakness of the yen, stating that the BOJ wanted to carefully examine the impact on the economy and prices, including the factors causing forex fluctuations. Therefore, price trends, including forex rates, will also be an important point for deciding on the timing—December or January.

In other words, we expect that the timing of the next rate hike will be based on the following conditions:

- The US economy remaining solid
- Corporate price-setting behavior remaining firm (initial momentum for *Shunto*)
- Price trends, including forex rates

Unless a major shock occurs, [we think that the domestic economy, including corporate price-setting behavior, will likely remain solid](#). Therefore, we think that the US economy and price trends are still the main variables influencing the timing of the next rate hike.

However, it may become difficult to assess short-term US economic trends due to the temporary US government shutdown. Commenting at the press conference in regard to the lack of statistics due to the government shutdown, Governor Ueda stated that the BOJ would make its decisions while checking to see whether any larger-than-expected negative news emerged. As indicated by this comment, we must keep in mind that delays in statistical information from the US could also easily result in a delay in the clearing of Governor Ueda's "fog of uncertainty."

(Minami)

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