Japan | Fixed Income | 19 December 2025
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Daiwa's Economic View

Dec BOJ meeting: Signaling intent to continue hiking rates

- Hiked policy interest rate from 0.5% to 0.75%
- Suggests rate-hiking pace expected to return to roughly once every six months
- Recognizes distance to terminal still remains, sticking to stance of continued rate hikes
- Press conference: While stressing continuation of rate hike policy, hurdle for hawkish measures remains high

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Rate hike preparations completed ahead of Dec meeting

On 1 December, BOJ Governor Kazuo Ueda revealed that the Bank has independently gathering additional information regarding the initial responses for the spring labor/management wage negotiations ahead of the December Monetary Policy Meeting. Indeed, he said, "We want to make an appropriate judgment regarding rate hikes." He also indicated that downside risks to the overall economy, including the impact of tariff policies, have diminished compared to earlier periods.

The "Firms' Stance on Wage Growth for Fiscal 2026" report released on 15 December indicated that most companies anticipate wage increases for FY26 at a level similar to FY25. This also completes the task of confirming the "initial momentum for the spring wage negotiations," which was identified as a key point for confirmation in Ueda's press conference following the October meeting. In particular, as inflation concerns intensify amid yen depreciation, the BOJ appears to have also advanced its communication with the government. As already indicated in media reports, the BOJ has been steadily preparing for a rate hike in December.

Hiked policy interest rate from 0.5% to 0.75%

Under these circumstances, the BOJ unanimously voted to further raise its policy interest rate at its 18-19 December Monetary Policy Meeting (raised uncollateralized overnight call rate from 0.5% to 0.75%).

The December statement featured a series of positive expressions such as "It is highly likely that firms will continue to raise wages steadily next year, following the solid wage increases this year, and the risk of firms' active wage-setting behavior being interrupted is expected to be low," "While uncertainties remain regarding the US economy and the impact of trade policy in each jurisdiction, these uncertainties have declined," and "Underlying CPI inflation has continued to rise moderately."

Specifically, the BOJ positioned the following three factors as the basis for its decision to raise interest rates: (1) Maintaining the momentum of spring labor/management wage negotiations, (2) Reduced uncertainty surrounding the US economy and tariff policies, (3) Rising underlying rate of inflation. Under these circumstances, the Bank's logic is that the baseline scenario has become more likely, prompting the decision to raise interest rates.

Also, the uncertainty surrounding overseas economic and price trends, described as "high" at the October meeting, was rephrased at the December meeting as "necessary to pay due attention," suggesting a decline in downside risks to the economy. During his December speech, Ueda cited three factors contributing to reduced downside risks: (1) diminished uncertainty surrounding trade negotiations, (2) moderate passing on of higher costs to selling prices in the US, and (3) rising demand for AI. These points are behind the wording revisions.

Changes in Wording of BOJ's Statement

		Bolded text indicates our points of focus
	Overall assessment	Based on these recent data and anecdotal information, it is highly likely that the mechanism in which both wages and prices rise moderately will be maintained. Against this backdrop, **the likelihood of realizing the baseline scenario that underlying CPI inflation will be at a level that is generally consistent with the price stability target of 2 percent** in the second half of the projection period of the October 2025 Outlook for Economic Activity and Prices (*Outlook Report*) has been rising.
	Economy	Japan's economy has recovered moderately, although some weakness has been seen in part. ⇒ Unchanged **While uncertainties remain regarding the U.S. economy and the impact of trade policy in each jurisdiction, these uncertainties have declined**.
	Wages	Labor market conditions have continued to be tight, and corporate profits are expected to remain at high levels on the whole, even after taking into account the impact of tariff policies. In this situation, considering factors such as the stances of labor and management on the annual spring labor management wage negotiations and anecdotal information gathered through the Bank's Head Office and branches, **it is highly likely that firms will continue to raise wages steadily next year, following the solid wage increases this year, and the risk of firms' active wage-setting behavior being interrupted is expected to be low.**
	Prices	Underlying CPI inflation has continued to rise moderately, with moves to pass on wage increases to selling prices continuing .
Outlook	Economy	**Japan's economic growth is likely to be moderate**, as trade and other policies in each jurisdiction lead to **some** 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 growth path**. ⇒ Suggests improved assessment of global economy as uncertainty eases
	Prices	The y/y rate of increase in the 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, and partly due to the effects of government measures to address rising prices.
Reasons for the rate hike		In view of these developments in economic activity and prices, the Bank judged it appropriate to adjust the degree of monetary accommodation from the perspective of sustainable and stable achievement of the price stability target of 2 percent. **Real interest rates are expected to remain significantly negative after the change in the policy interest rate, and accommodative financial conditions will continue to firmly support economic activity.**
	Risk factors	Risks to the outlook include developments in overseas economic activity and prices under the impact of trade and other policies in each jurisdiction, wage- and price-setting behavior of firms, and developments in financial and foreign exchange markets, and **it is necessary to pay due attention** to the impact of these risks on Japan's economic activity and prices.
	Conduct of monetary policy	As for the future conduct of monetary policy, **given that real interest rates are at significantly low levels, if the outlook for economic activity and prices presented in the October *Outlook Report* 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**. With the price stability target of 2 percent, it will conduct monetary policy as appropriate, in response to developments in economic activity and prices as well as financial conditions, from the perspective of sustainable and stable achievement of the target.

Source: BOJ; compiled by Daiwa.

Rate-hiking pace

That said, as we mentioned earlier, the December rate hike itself was generally expected. What drew more attention at this meeting were the hints regarding the rate-hiking pace going forward, as well as the terminal rate.

The statement, which contains many positive expressions, confirms that the BOJ's assessment of the current economic and price situation has clearly improved. These modified expressions suggest that the uncertainty surrounding tariff policies, which had been rising since April 2025, has decreased, while the outlook for the economy and prices seems to be gradually returning to pre-tariff expectations. In other words, from a fundamentals perspective, this suggests a return to the rate-hiking pace that had been anticipated prior to the introduction of tariff policies (previously, interest rate hiking pace was generally assumed to be about once every six months).

However, in the description of future monetary policy operations, the phrase "in accordance with improvement in economic activity and prices" was retained. This wording was added to the April 2025 *Outlook Report* to outline the path for interest rate hikes, taking into account the full implementation of tariff policies. Maintaining this expression likely indicates that economic recognition has improved, but overseas economies may slow somewhat.

Terminal rate implications: Distance to terminal still remains; maintaining interest rate hikes

The Bank's official statement maintained the expression "(current) real interest rates are at significantly low levels" and indicated recognition that "Real interest rates are expected to remain significantly negative even after the change in the policy interest rate, and accommodative financial conditions will continue."

When raising interest rates in January 2025 (0.25% → 0.5%), Ueda said, "Even if the neutral rate of interest were to reach 0.5%, there would still be a considerable distance." The decision to maintain this statement regarding the real interest rate suggests that the BOJ recognizes that there is still some distance to the short-term neutral rate of interest at this juncture.

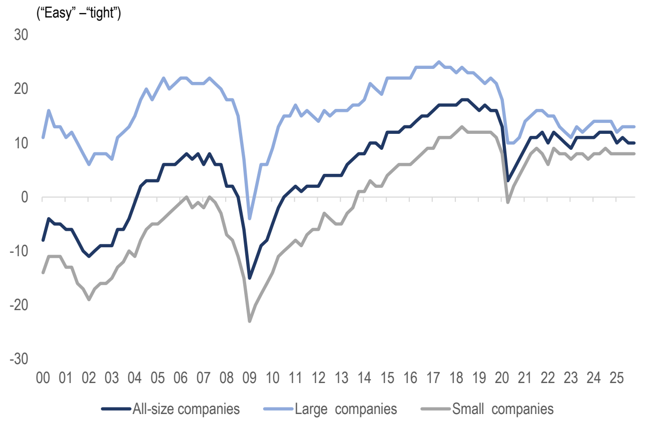
Furthermore, in the official statement indicated that, "If the outlook for economic activity and prices presented in the October *Outlook Report* will be realized, the Bank, in accordance with improvement in economic activity and prices, will continue to raise the policy interest rate and adjust the degree of monetary accommodation." In other words, as before, the stance is to continue raising interest rates as the likelihood of achieving the economic and price outlook increases, in order to adjust the degree of monetary easing.

Also, the official statement maintained its view that, "CPI inflation will be at a level that is generally consistent with the price stability target of 2% in the second half of the projection period provided in the October 2025 *Outlook Report*." However, board members Hajime Takata and Naoki Tamura were apparently against that wording[1]. With consumer price growth continuing to exceed 2% y/y, there is a divergence of opinion among policy board members regarding the assessment of underlying inflation.

Actually, no significant impacts from the previous rate hikes have been seen in the macroeconomy. The BOJ's Tankan survey continues to assess the financial position DI and the lending attitude DI as accommodative. Furthermore, there have been movements to expand credit for real estate and bank lending. Private consumption and capex also remain solid.

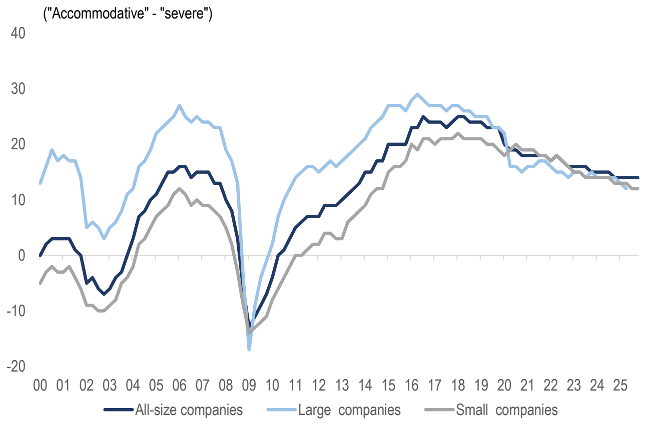
[1] Takata Hajime opposed the description regarding the outlook for prices, considering that the level of the rate of increase in the CPI, including underlying CPI inflation, already had generally reached the price stability target. Tamura Naoki opposed the description regarding the outlook for underlying CPI inflation, considering that underlying CPI inflation was likely to be at a level that was generally consistent with the price stability target from the middle of the projection period.

Financial Position DIs



Source: BOJ; compiled by Daiwa.

DIs on Lending Attitude of Financial institutions

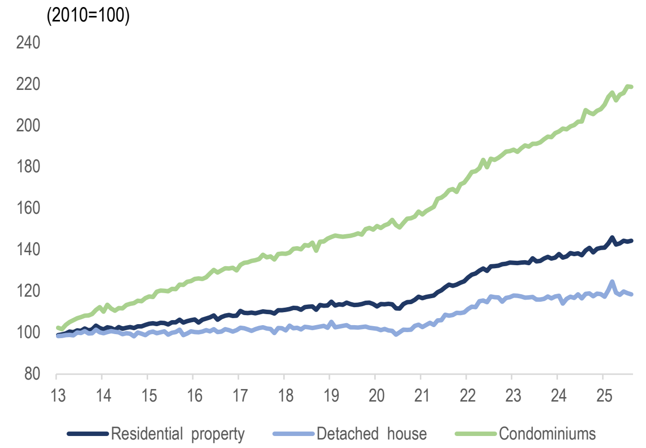


Source: BOJ; compiled by Daiwa.

Y/y Change in Average Outstanding Loans (total of major, regional, and *shinkin* banks)

Source: BOJ; compiled by Daiwa.

Property Price Index (residential)



Source: Ministry of Land, Infrastructure, Transport and Tourism; compiled by Daiwa.

Ueda stresses more rate hikes at press conference, but hawkish stance faces high bar vs expectations

The key points of interest in Ueda's press conference are also the pace of interest rate hikes and terminal rate implications. In particular, as Ueda stated in his *Financial Times* interview on 9 December that, "We are closely monitoring the impact of exchange rates on prices." As such, the BOJ is especially concerned about the current yen depreciation. Under these circumstances, Ueda is expected to stress a policy of continuing interest rate hikes during his post-meeting press conference, while carefully choosing his words to avoid triggering excessive yen depreciation.

Regarding the pace of rate hikes, at his press conference Ueda will likely stress confidence in the current economic and price outlook (= on track) centered on "reduced tariff uncertainty" and "strong wage momentum." Also, he will probably indicate that that the underlying inflation rate is rising toward 2%. We expect the BOJ to indicate confidence with the current situation, while signaling its stance to raise interest rates if the outlook remains on track.

Also, Ueda will likely express caution regarding exchange rates. However, the wording is expected to be limited to, "We are closely monitoring the impact on prices." We think this is unlikely to reach the point of suggesting that upside risks to prices are high at this juncture. Actually, the 19 December release of nationwide CPI fell within the Bank's on-track range and did not strongly indicate upside risks.

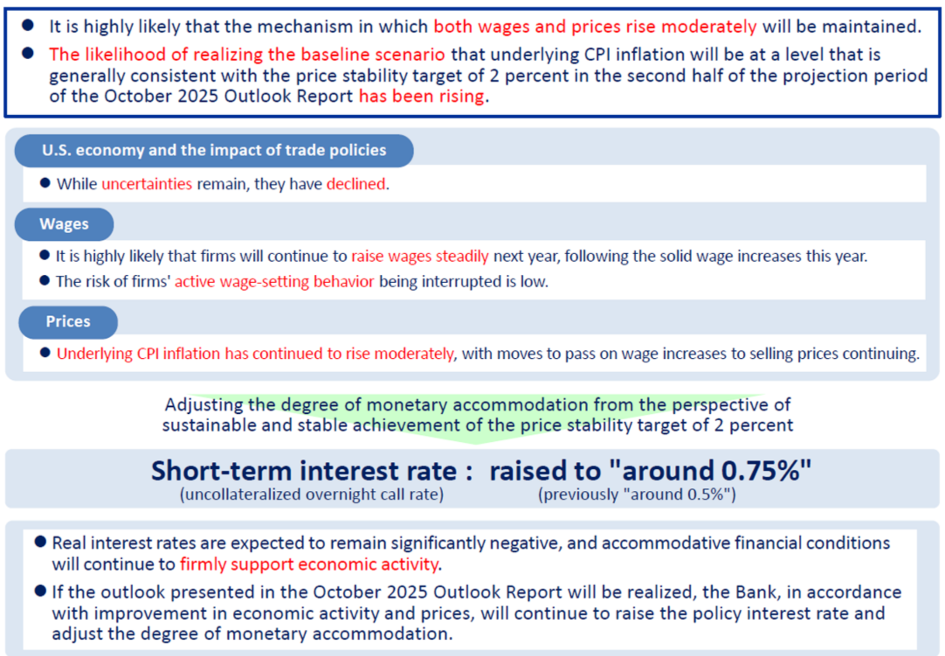
Particular attention will likely be paid to remarks regarding the terminal rate (peak of rate hiking cycle), specifically those hinting at the neutral rate of interest. Clarifying the neutral rate of interest level to some extent offers the benefit of enhancing the predictability of monetary policy (market consideration). However, this also carries the risk of constraining the flexibility of future policy operations. This communication tool has both advantages and disadvantages. In particular, for the BOJ, which has maintained accommodative monetary policy for an extended period and has not raised interest rates to levels viewed as "tightening," clarifying the neutral rate of interest is no easy task. Compared to major central banks like the Fed and ECB, the hurdle is considered relatively high for the BOJ.

We believe that new expressions suggesting an increase in the neutral rate of interest or its specific level should not be used as a communication tool, as that could constrain the flexibility of future monetary policy. In other words, it is understood that the determination of the terminal rate for interest rate hikes will be made in a data-dependent manner, based on economic and price trends.

Meanwhile, the recognition that real interest rates are extremely low and that the real economy has not been significantly impacted will likely be expressed, indicating that there is still a certain distance to the neutral rate of interest at this juncture. Also, we anticipate that statements will be made to the effect that the policy interest rate of 1%, which is considered the lower bound of the neutral rate of interest, should not be regarded as the upper bound of the policy interest rate.

Overall, we expect Ueda to signal a continued stance of raising interest rates, while maintaining a data-dependent approach for subsequent decisions. Meanwhile, since Ueda's speech on 1 December, the BOJ has been releasing hawkish signals one after another. The market has already priced in this hawkishness to a considerable degree. However, it is important to note that any hawkishness exceeding expectations faces a significant hurdle.

Decision at Dec 2025 MPM



Source: Reprinted from BOJ materials.

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