

Economic Commentary

December Tokyo CPI: Signs of disinflation are finally emerging

- Weak results even after excluding the effects of government's inflation measures
- Signs of disinflation are emerging in food prices
- While goods prices appear to have peaked out, services inflation remains solid

FICC Research Dept.

Kento Minami
81-3-5555-8789
kento.minami@daiwa.co.jp



Daiwa Securities Co. Ltd.

Results confirm disinflation

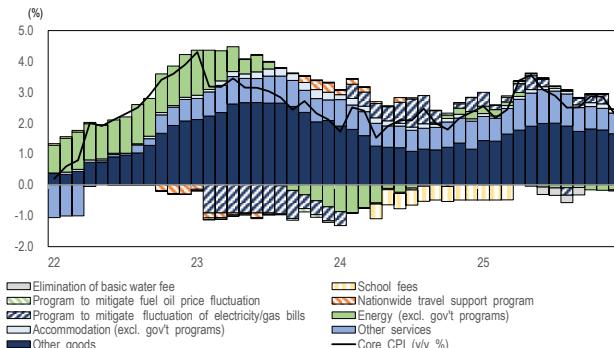
December core CPI (all items less fresh food) in the ward-area of Tokyo slowed from +2.8% for November to +2.3% y/y, undershooting the market consensus (+2.5%). Core-core CPI (all items excluding fresh food and energy) also slowed to +2.6% y/y (+2.8% for Nov).

Regarding the impact of the government's measures to address inflation, the absence of the base effect from the electricity and gas fee support implemented last year, along with the gradual expansion of gasoline subsidies from mid-November as a transitional step towards the abolition of the provisional gasoline tax rate at year-end, pushed down the y/y growth rate of core CPI. In total, these factors had a downward impact of approximately 0.35ppt in December compared to November CPI (y/y). Even after excluding this effect, the results of December Tokyo CPI were weak.

Core-core CPI (seasonally adjusted) was also flat m/m. By item, a decline in inflation rates was confirmed across a wide range of categories, including food products like rice and chocolate, goods such as clothes, footwear, furniture, and household items, as well as services related to communication and culture/recreation.

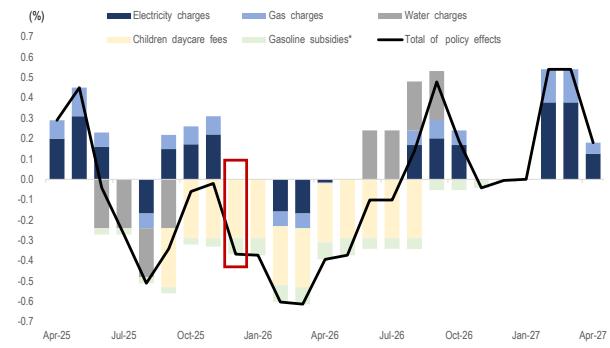
At the press conference following the December Monetary Policy Meeting, BOJ Governor Kazuo Ueda stated, "Several board members pointed to the possibility that the recent depreciation of the yen could affect underlying inflation," indicating a growing concern about the exchange rate. However, the December Tokyo CPI has reinforced the BOJ's view that the inflation rate will moderate going forward, suggesting a reduced likelihood that upside risks will be highlighted in the January *Outlook for Economic Activity and Prices* report.

Breakdown of Contributions to Core CPI in Ward-area of Tokyo



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

Impact of Inflation Measures on Tokyo CPI



Source: MIC, various media reports; compiled by Daiwa.

Note: Base effects are included.

*Indicates the impact on gasoline prices since implementation of the "flat-rate fuel oil price reduction measure" in late May 2025.

The y/y increase for food prices is likely to slow going forward

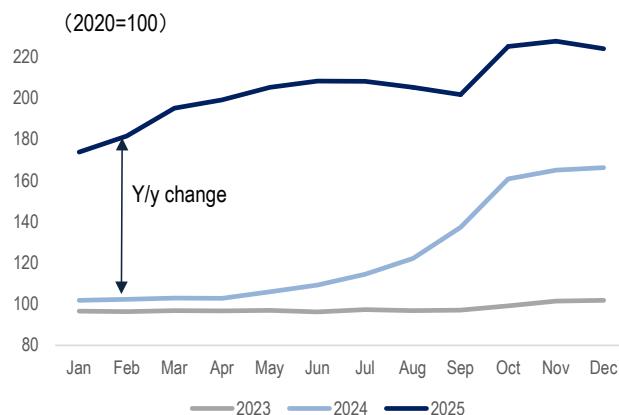
The y/y increase for food excluding fresh food slowed to +6.2% (+6.5% for Nov). The y/y increase for rice also declined to +34.7% (+37.9%), with its contribution to the overall index falling to +0.25ppt (+0.28ppt). Furthermore, the y/y increase for processed food products slowed to +5.4% (+5.7%), confirming that broad-based food inflation is subsiding.

By item, prices appear to be falling for a wide range of products, including chocolate, rice crackers, cup noodles, and sweet red-bean bread. Fresh food also saw a sharp drop in prices, with the y/y rate falling to -4.4% (+0.5% for Nov), in reaction to the large price hikes in December 2024.

Going forward, it is highly likely that y/y food price inflation will continue to decline due to several factors: (1) Teikoku Databank's survey on food price hikes indicates that price pass-through for food products is expected to calm down in 2026; (2) an increase in rice inventories makes it highly probable that rice prices will follow a flat or slight downtrend; and (3) costs of raw materials, including fresh food, are settling down.

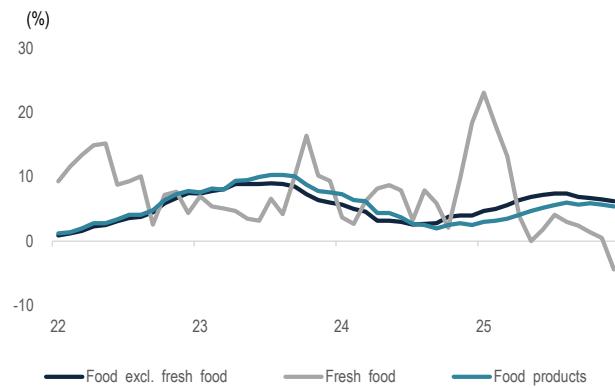
That said, continued vigilance is warranted, as the recent yen depreciation could trigger another wave of price pass-through with a time lag.

Price Levels for Rice



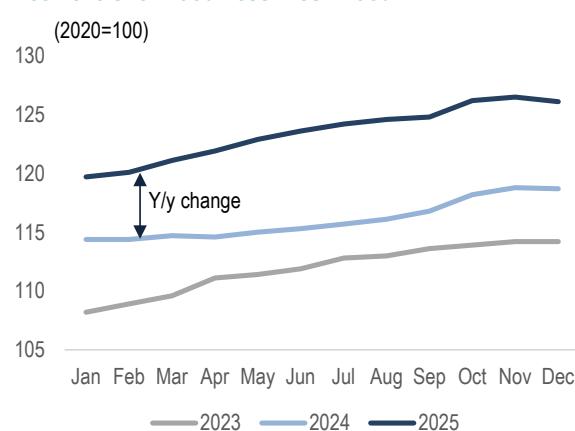
Source: MIC; compiled by Daiwa.

Y/y Change in Food-related Prices



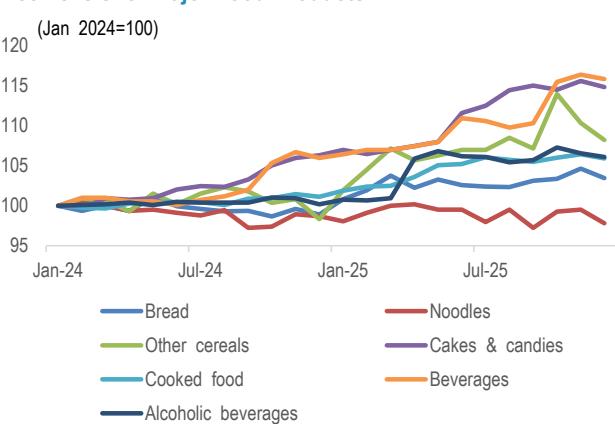
Source: MIC; compiled by Daiwa.

Price Levels for Food Less Fresh Food



Source: MIC; compiled by Daiwa.

Price Levels for Major Food Products



Source: MIC; compiled by Daiwa.

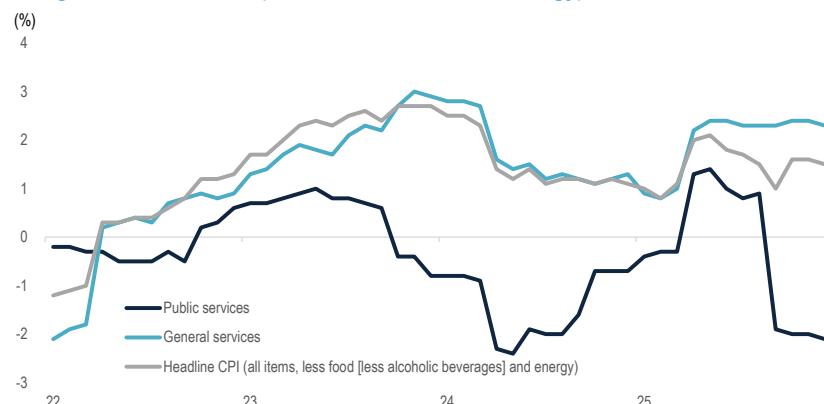
Service inflation likely to continue

The y/y increase for headline CPI (all items, less food [less alcoholic beverages] and energy) slowed to +1.5% (+1.6% for Nov). This was due to a decline in both goods and services prices. By item, lower price levels for women's long-sleeved sweaters and women's coats contributed to the overall slowdown. In addition, mobile phone communication fees declined y/y in reaction to price increases last year, and a drop in accommodation fees contributed to the decline in communication and culture/recreation-related service prices. On the other hand, items such as private rent, imputed rent for owner-occupied housing, fire/earthquake insurance premiums, and mobile phone handsets contributed to the increase.

As a result, the y/y increase for general service prices slowed to +2.3% (+2.4% for Nov). However, the growth rate of general service prices remains high, and we still think that endogenous service inflation, driven by rising labor costs, is continuing and taking hold. Notably, in the Tokyo area, the growth rate of private rent reached 2% y/y (+1.8% for Nov). While nationwide spillover may still be some way off, the uptrend in rents—a high-weight component—raises the probability of achieving a sustainable and stable 2% inflation rate.

In the 2026 spring labor/management wage negotiations, wage increases are likely to remain high, similar to 2025. In addition, under the Takaichi administration, measures such as raising medical service fees have been implemented. Accordingly, we expect services price inflation to continue going forward.

Y/y Changes in Headline CPI (all items, less food and energy), Service Prices



Source: MIC; compiled by Daiwa.

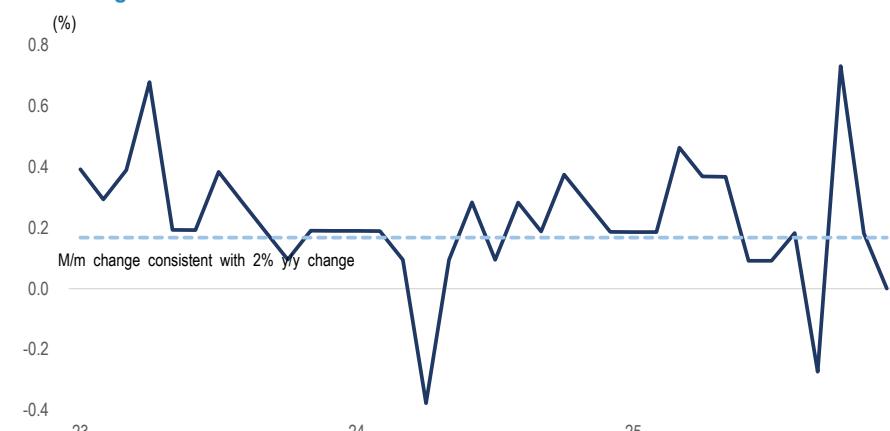
Inflation of goods (incl. food) has peaked; focus on price trends in early 2026

Also, in order to gauge the progress for passing on higher costs to prices, we looked at the proportion of items with rising and falling prices. The proportion for items with rising prices in the December core CPI decreased to 64.2% (66.5% for Nov). The proportion of items with price increases was 76.1% for food excluding fresh food (79.5%), 55.8% for goods excluding food (58.0%), and 61.4% for services excluding dining out (62.3%). As such, all categories showed a decline.

In terms of the number of items with rising and falling prices, the breadth of service price increases remains solid, while price increases in food and other goods appear to be moderating.

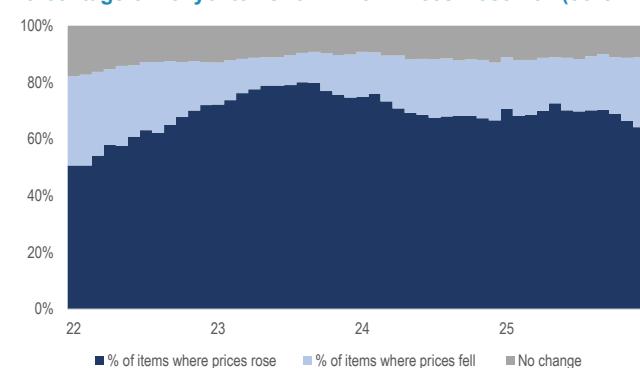
Overall, the December Tokyo CPI results have reinforced the BOJ's view that inflation will settle down going forward. The key question will be whether this is merely a single-month move or whether the disinflation trend becomes clearer as we move into early 2026. However, if yen depreciation accelerates, another wave of price pass-through could arrive with a time lag. We should pay particularly close attention to inflation and forex trends in Jan-Mar 2026.

M/m Change in Core-Core CPI



Source: MIC; compiled by Daiwa.

Percentage of Tokyo Items for Which Prices Rose/Fell (core CPI)



Source: MIC; compiled by Daiwa.

Percentage of Tokyo Items for Which Prices Rose/Fell (food excl. fresh food)



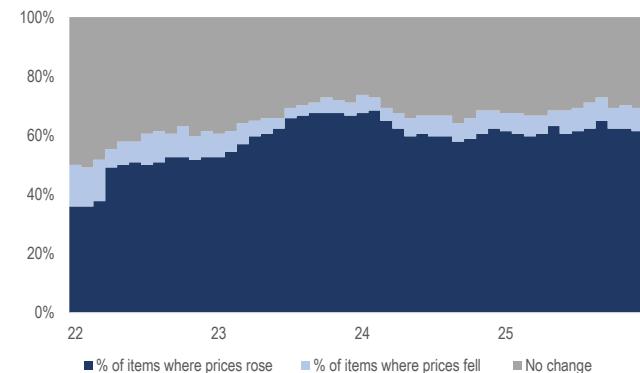
Source: MIC; compiled by Daiwa.

Percentage of Tokyo Items for Which Prices Rose/Fell (goods excl. food)



Source: MIC; compiled by Daiwa.

Percentage of Tokyo Items for Which Prices Rose/Fell (services excl. eating out)



Source: MIC; compiled by Daiwa.

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