

Daiwa's View

Policy mix contradictions: Jan BOJ meeting and pressure to hike rates

- Conducted rate checks, rising JGB yields may pause over short term
- BOJ Ueda's press conference: Stressed importance of data, but also aware of potential early hike?
- High hurdles for BOJ's response to surging long-term yield

FICC Research Dept.

Ryoma Kawahara
81-3-5555-8777
ryoma.kawahara@daiwa.co.jp



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



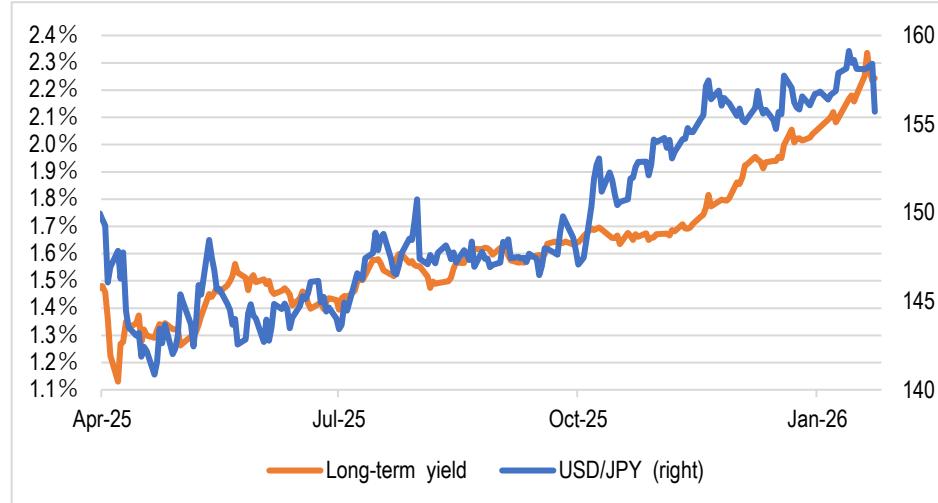
Daiwa Securities Co. Ltd.

Upward revision of price outlook, increased rate-hiking pressure

In its January *Outlook for Economic Activity and Prices (Outlook Report)* the BOJ revised its FY26 projection for core-core CPI (traditionally important reference indicator for underlying rate of inflation) from "y/y rate of increase in the CPI is likely to be temporarily below 2%" in October" to "y/y rate of increase is likely to decelerate to around 2%" in January. The median outlook was raised from 2.0% to 2.2%. Furthermore, despite this being the final year of the forecast period, the price outlook for FY27 is projected to exceed 2.0%, with an expected growth rate of 2.1%. The inflation rate has remained above 2% since the 3.0% level was reached in FY25 and it is now projected to exceed 2% even in the final year of the forecast period. This suggests achieving the price target ahead of schedule or the risk of overshooting it.

The primary cause of the upward revision in prices is believed to be the government's fiscal policies and the resulting yen depreciation. The *Outlook Report* now states, "Such moves could affect underlying CPI inflation through changes in inflation expectations." Ueda also stated, "Even if the magnitude is similar to before, we will pay close attention to small movements." This indicates that the impact of yen depreciation on interest rate hikes has become greater than before

Long-term Yield, USD/JPY Rate



Source: Bloomberg; compiled by Daiwa.

The premise of the exchange rate underlying the BOJ's price outlook is based on the assumption that the yen will strengthen toward around USD/JPY150 by the end of the fiscal year. If the yen exchange rate remains flat or weakens against the dollar, the BOJ may be forced to again revise upward its price outlook. To prevent inflation from overshooting the 2% anchor, the Bank could be compelled to raise interest rates at a faster pace.

Policy mix contradictions and mechanism behind rising yields

The background driving these inflation and rate hike pressures lies in the issue of the policy mix. The Takaichi administration's "responsible expansionary fiscal policy" is a high-pressure economic policy that aims to increase future supply by stimulating demand. Over the short term, it tends to lead to currency depreciation through inflation caused by an overheated economy. At her 19 January press conference, Takaichi said that she would end "excessive austerity." That has led to increased market concerns about an expansion in policy scale and accelerated or prolonged execution.

In this situation we can anticipate a scenario in which inflation concerns trigger yen depreciation, which in turn fuels further inflation concerns, creating a vicious cycle that pressures central banks to raise interest rates. By simultaneously pressing the accelerator of fiscal policy and the brake of interest rate hikes, a scenario could unfold where yields rise while the tightening effect remains scarce.

In addition to these yen depreciation pressures, the terminal for US policy interest rates priced into the market has risen since December 2025 and the US/Japan interest rate gap has narrowed. This has made it harder for fundamental factors to curb yen depreciation. Addressing such yen depreciation pressure is difficult through just domestic policy measures.

Changing circumstances due to rate checks

Amid this situation, it was reported that the New York Fed recently conducted a rate check. The US, concerned that turmoil in the JGB market could spread to the US Treasury market, appears to have indicated its willingness to cooperate in stabilizing the market. Given these movements, yields have been rising at a "fairly rapid pace" over just a short time and a considerable amount of future increases have already priced in. So, the possibility of a correction for the recent sharp rise in yields cannot be ruled out.

That said, in exchange for the US cooperating to stabilize the market, Japan may face certain demands. Treasury Secretary Scott Bessent has long called for interest rate hikes rather than intervention to correct the weak yen. If an accelerated rate-hiking pace is required, the tightening effect would be greater than previously anticipated, acting as a factor for yen appreciation (tightening + inflation suppression). In that case, the changing perspective regarding "behind the curve" concerns will become a flattening factor.

Meanwhile, reports also indicate that a demand for a 5% defense spending target may be made during Under Secretary of Defense Elbridge Colby's visit to Japan. If this comes about at an early stage, it will act as a factor for fiscal expansion and yen depreciation (economic stimulus + inflation), as well as a yield rise steepening factor.

Outlook

Fundamentally, we anticipate that rates will rise while remaining difficult to tighten due to contradictions within the policy mix. However, if the pace of rate hikes in Japan accelerates at the request of the US, that scenario could change. In any case, the long-term upward trend for yields is expected to persist. That said, over the short term there is potential for adjustment as yields may have risen too much. Yield volatility is likely to remain elevated as currency sentiment fluctuates.

(Kawahara)

BOJ Gov Ueda's press conference: Acceleration of rate-hiking timeline? (Minami)

At his press conference following [the January Monetary Policy Meeting \(MPM\)](#), BOJ Governor Kazuo Ueda made such statements as, "The future path and pace for interest rates will depend on future developments" and "At each meeting we will make appropriate judgments based on the various data and information available at that time." These statements demonstrated a data-driven stance and a continuation of the Bank's free rein approach to policy. Meanwhile, his remarks also included expressions suggesting an awareness of a potential early interest rate hike.

Forex concerns

Regarding the impact of yen depreciation on prices, Ueda indicated that, "Domestic prices may be reacting more strongly to exchange rate movements." This point was even raised during the regular press conference following the December meeting and so cannot be viewed as a more hawkish statement. However, he noted that the underlying rate of inflation is approaching the 2% target and said, "Even if it's the same size as before, we must pay attention to small movements." Here, he reiterated his sense of caution regarding the weak yen.

This is seen as the Bank's stance in terms of allowing a certain higher-than-expected upside to raise the underlying rate of inflation to 2% at a time when it is well below 2%. Meanwhile, this indicates the Bank's stance that it should respond more rigorously to higher-than-expected price pressures when underlying inflation approaches 2%.

Also, In the January *Outlook Report*, the BOJ revised its views on the prices to a more hawkish stance, projecting core-core CPI for FY27 at +2.1% (up from +2.0% previously), exceeding the 2% target. Given that the price outlook already exceeds 2%, there is little room to tolerate further yen depreciation or the risk of upward price pressures stemming from a prolonged yen depreciation.

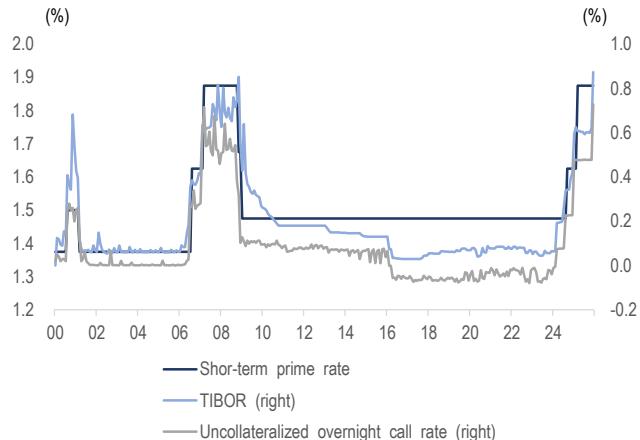
Conditions for next rate hike

Regarding the next interest rate hike decision, Ueda said, "As prices and wages rise slowly, now is time to use various indicators to determine whether this will continue." He added, "We want to consider the impact of the previous rate hike as well." Meanwhile, regarding the impact of rate hikes, Ueda conveyed his understanding that, "The Bank should not wait for the effects to appear in the final data" and expressed the Bank's intention to gather information through interviews with companies regarding financial conditions, equipment, and housing investment.

While market interest rates such as TIBOR, which serve as reference rates for corporate lending, have already risen, the short-term prime rate is expected to be raised by many financial institutions in February. Also, many variable-rate mortgages are likely to see higher rates in April, which is the typical adjustment period. As such, if the BOJ wants to wait for data on rate-hike impacts, a certain observation period would be required.

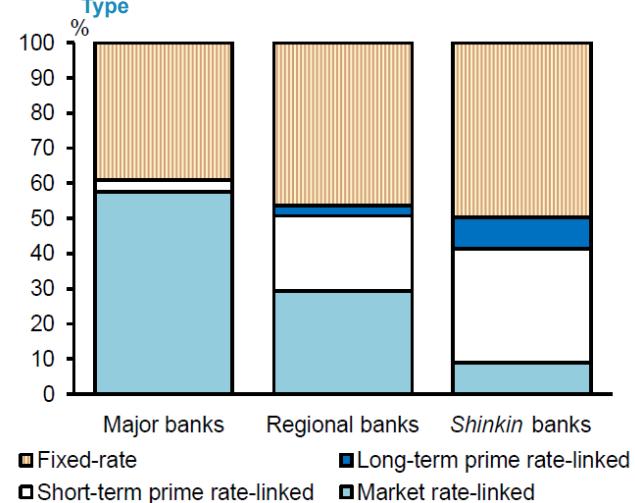
Governor Ueda has indicated his intention to confirm initial signs during corporate hearings. Such trends could possibly be confirmed from the Tankan survey due out on 1 April, as well as reports from the BOJ's branch managers' meeting reports in early April. Furthermore, during his post-meeting press conference, Ueda said, "We will conduct monetary policy appropriately to ensure we do not fall behind the curve." Given these considerations, the timing of the next rate hike is likely to be moved forward.

TIBOR, Short-term Prime Rate



Source: Bloomberg; compiled by Daiwa.

Composition of Corporate Loans Outstanding by Interest Rate



Proposals for April rate hike could be growing

At the BOJ's January meeting, policy board member Hajime Takata proposed raising the policy interest rate to 1%. He argued that, "Considering that the 'price stability target' had been more or less achieved and that, with overseas economies being in a recovery phase, risks to prices in Japan were skewed to the upside." If we conclude that the 2% price stability target has been achieved, the logic follows that the policy interest rate should be aligned with the neutral rate of interest to respond flexibly to upward or downward price fluctuations. We expect Takata to continue proposing rate hikes as long as the financial environment is viewed as remaining accommodative.

Meanwhile, the Summary of Opinions for the December 2025 meeting included the view that if wage increases remain at a high level during the 2026 spring labor-management wage negotiations, that could be viewed as "underlying inflation trend has reached 2%." This view at least is probably not Takata's assertion that the "price stability target" has already been reached.

◆ Opinions on Prices in Summary of Opinions at Dec MPM (29 Dec 2025)

- If it is confirmed next spring that the wage growth rate will be at a level in line with the price stability target for the third consecutive year, it can be judged that the underlying trend in prices has reached 2 percent.

In other words, if the first tally for the 2026 spring labor-management negotiations, announced on 23 March, confirms high-level wage increases, the BOJ may conclude that the underlying rate of inflation trend has indeed reached 2%. This could lead to a proposal for an additional rate hike at the April meeting. If proposals for early rate hikes gain traction, the timing for such rate hikes could also move toward earlier dates.

Based on Ueda's press conference, if upside risks to prices via exchange rates materialize, the BOJ could implement an interest rate hike as early as April. Meanwhile, if upside risks recede, we could expect a rate-hiking pace of roughly once every six months, in order to assess the impact of previous hikes. Barring any major shocks that would significantly alter the outlook, the timing of the next rate hike is now largely narrowed down to April through July.

High hurdles for BOJ's response to surging long-term yield

At the press conference, there were also questions regarding the BOJ's awareness of the current surging yields and its response. Ueda described the recent upswing for yields as "rising at a fairly fast pace." This reflected a heightened sense of caution compared to his "somewhat fast pace"

assessment" in December 2025. Meanwhile, Ueda simply stated the Bank's basic view that "In the case of exceptional circumstances, we may also nimbly conduct (open market) operations."

◆ **Ueda's testimony at lower house budget meeting (9 Dec 2025)**

- Long-term yields have been rising at a somewhat faster pace recently. I understand that market participants attribute this movement to the various factors I just mentioned.

Also, in terms of the background factors driving yields higher this time, Ueda cited, "Market views on the outlook for the economy and prices, fiscal policy, and monetary policy, along with the unstable supply and demand for super-long JGBs associated with the fiscal year-end."

Meanwhile, if the rising yields are primarily driven by inflation risk premiums stemming from fiscal policy, implementing unscheduled JGB purchasing operations to lower real yields could accelerate yen depreciation, potentially creating a vicious cycle that further heightens inflation risks. Given these circumstances, we can say that the hurdle for the BOJ to proceed with unscheduled JGB purchasing operations is quite high at this juncture.

(Minami)

IMPORTANT DISCLOSURES

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

Ratings

Issues are rated 1, 2, 3, 4, or 5 as follows:

- 1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
- 2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
- 4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices

Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities

Please refer to https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at:

https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association