

# Daiwa's Economic View

## March MPM: Caution on Middle East risks, but BOJ's rate-hike momentum holds

- BOJ alert to Middle East situation but aware of two-way risks
- Two board members' dissenting votes suggest rate-hike momentum intact
- Press conference focus: Middle East risk balance, maintaining rate-hike expectations

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### March MPM focus: Risk assessment based on Middle East tensions, shifts in rate-hike momentum

Escalating tensions in the Middle East have prompted the Bank of Japan (BOJ) to assess the two-way risks to underlying inflation. It is weighing a downside scenario in which higher oil prices erode real purchasing power and weigh on the economy, dragging down underlying inflation, and an upside scenario in which rising oil prices push up inflation expectations and drive a sustained rise in prices.

The key question for markets heading into the March Monetary Policy Meeting (MPM) was therefore whether the BOJ would emphasize one or other risk scenario or continue to describe upside and downside risks as balanced.

Meanwhile, internal BOJ discussions since the start of the year have gradually moved closer to a next rate hike. At the previous January meeting, board member Hajime Takata proposed raising the policy rate to 1%. In a 13 February speech, board member Naoki Tamura stated that "it is quite possible that, as early as this spring, the price stability target of 2 percent can be judged to have been achieved" if the BOJ gains a high degree of certainty about wage growth from the 2026 spring labor negotiations.

The BOJ has thus been laying the groundwork for rate hikes since the beginning of the year. However, a key question for the March meeting was whether the emergence of fresh uncertainty from the Middle East had affected the impetus for rate hikes.

### Middle East tensions: Two-way risks in focus

The BOJ decided by an 8-1 majority to keep monetary policy unchanged at its 18–19 March MPM, as at the previous meeting. The meeting statement showed no major changes to the BOJ's baseline scenario, but noted that "in the wake of increased tension over the situation in the Middle East, global financial and capital markets have been volatile and crude oil prices have risen significantly," flagging that "future developments warrant attention."

On the price outlook, the BOJ noted that the rate of CPI increase "is then expected to come under upward pressure, affected by the recent rise in crude oil prices," while retaining the language that underlying CPI inflation is expected to increase gradually and, "in the second half of the projection period of the January 2026 *Outlook for Economic Activity and Prices (Outlook Report)*, be at a level that is generally consistent with the price stability target." In other words, the BOJ's economic and price outlook is largely unchanged, and its basic position remains that it will continue to raise interest rates if the economy and prices trend in line with its projections.

At the same time, the statement noted that "attention should also be paid to the impact of the rise in crude oil prices on the outlook for underlying CPI inflation," and added "the future course of the situation in the Middle East as well as developments in crude oil prices" as risk factors, signaling its vigilance about Middle East tensions. The statement did not, however, give a read on how it thinks the Middle East situation affects the balance of risks. We think the BOJ likely views risks as broadly balanced at this point given the limited information available.

In short, we think the BOJ is essentially in watch-and-wait mode: while uncertainty is extremely high, the lack of quantitative or qualitative information means that it has no choice but to stick with its existing baseline scenario. However, as per Fed Chair Jerome Powell's statement after the March FOMC that the Fed will "learn a lot" by the next meeting, the BOJ will also have accumulated considerable information through data releases and interviews by the time of the April MPM. We will be watching BOJ communications closely to assess whether it is beginning to put greater emphasis on upside or downside risks.

#### Current Assessment and Baseline Outlook for Japanese Economy and Prices (Mar 2026 BOJ MPM)

Current conditions	Red lettering indicates corrections and additions ⇒ indicates status of revisions from previous meeting
<p><b>Japan's economy</b></p> <p><b>Overseas economies</b></p> <p><b>Export/ Industrial production</b></p> <p><b>Business fixed investment</b></p> <p><b>Corporate profits</b></p> <p><b>Private consumption</b></p> <p><b>Public investment</b></p> <p><b>Housing investment</b></p> <p><b>Financial conditions</b></p> <p><b>Prices</b></p>	<p>Has recovered moderately, although some weakness has been seen in part. ⇒ Unchanged</p> <p>Have grown moderately on the whole, although some weakness has been seen in part, reflecting trade and other policies in each jurisdiction. ⇒ Unchanged</p> <p>Have continued to be more or less flat as a trend. ⇒ Removed wording on tariff impact</p> <p>Has been on a moderate increasing trend. ⇒ Unchanged</p> <p>Have remained at high levels on the whole, although downward effects due to tariffs have been seen in manufacturing. ⇒ Unchanged</p> <p>Has been resilient against the background of an improvement in the employment and income situation, although it has been affected by price rises. ⇒ Unchanged</p> <p>Has continued to be more or less flat. ⇒ Unchanged</p> <p>Has been on a declining trend. ⇒ Unchanged</p> <p>Have been accommodative. ⇒ Unchanged</p> <p>With moves to pass on wage increases to selling prices continuing, the y/y rate of increase in the consumer price index (CPI, all items less fresh food) <b>had been above 2%</b>, partly due to the effects of the rise in food prices, such as rice prices; however, <b>the rate of increase has recently fallen to around 2% due to factors such as the effects of the government's measures to reduce the household burden of higher energy prices.</b> Inflation expectations have risen moderately.</p> <p>⇒ Assessment of prices has been revised to reflect the current situation, while inflation expectations remain unchanged</p>
<p><b>Outlook</b></p> <p><b>Japan's economy</b></p> <p><b>Prices</b></p>	<p>Japan's economy is likely to continue growing moderately, with overseas economies returning to a growth path, and as a virtuous cycle from income to spending gradually intensifies, supported by factors such as the government's economic measures and accommodative financial conditions, while the economy is projected to be affected by trade and other policies in each jurisdiction. <b>However, in the wake of increased tension over the situation in the Middle East, global financial and capital markets have been volatile and crude oil prices have risen significantly; future developments warrant attention.</b></p> <p>The y/y rate of increase in the CPI (all items less fresh food) is likely to <b>temporarily</b> decelerate to a level below 2%, 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. <b>The rate of increase is then expected to come under upward pressure, affected by the recent rise in crude oil prices.</b> Meanwhile, the mechanism in which wages and prices rise moderately in interaction with each other is likely to be maintained. Thereafter, it is projected that a sense of labor shortage will grow as the economy continues to improve and that medium- to long-term inflation expectations will rise. In this situation, underlying CPI inflation is expected to increase gradually and, in the second half of the projection period of the January 2026 <i>Outlook for Economic Activity and Prices (Outlook Report)</i>, be at a level that is generally consistent with the price stability target. <b>Attention should also be paid to the impact of the rise in crude oil prices on the outlook for underlying CPI inflation.</b></p>
<p><b>Risk factors</b></p>	<p>Risks to the outlook include <b>the future course of the situation in the Middle East</b> as well as developments in crude oil prices, 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.</p>

Source: BOJ; compiled by Daiwa.

## Rate-hike momentum within the BOJ

In view of the above positions expressed by BOJ executives, the next point of focus is what the actions and statements of individual policy board members say about the momentum for rate hikes.

Mr. Takata, seen as the most hawkish member of the board, opposed the BOJ's description of the inflation outlook and again proposed raising the policy rate to 1% on the grounds that "risks to prices in Japan were skewed to the upside due to the second-round effects of price rises stemming from overseas developments," despite escalating Middle East tensions. The proposal was voted down. Mr. Tamura did not propose a rate hike this time, but he opposed the description of the inflation outlook, considering that "underlying CPI inflation was likely to be at a level that was generally consistent with the price stability target from the beginning of fiscal 2026."

The fact that Takata and Tamura maintain their hawkish views of inflation and continue to push for rate hikes despite rising external uncertainty suggests that the impetus for rate hikes within the BOJ remains at least unchanged. What matters more, however, is not the stance of individual members but whether the overall policy board's appetite for rate hikes has shifted.

The Summary of Opinions from the March meeting (due 30 Mar) will be an important gauge of how many board members continue to favor rate hikes, and will offer valuable clues to future policy decisions. We would also note that Minister of State for Economic and Fiscal Policy Minoru Kiuchi, who serves as an adviser to the caucus for responsible proactive fiscal policy, attended the meeting. With government pressure on the BOJ increasing, the stance it expressed at the meeting and the tone of its comments are also worth watching.

## Press conference focus: risk balance, maintaining rate-hike expectations

18 March marked the day when many employers responded to union demands in the spring wage negotiations. A string of companies acceded in full to unions' demands, making it more likely that 2026 wages will rise by a similarly high level to 2025. This confirms continued progress toward achieving the feedback loop the BOJ views as key, in which "wages and prices rise moderately in interaction with each other." We expect today's press conference to affirm that economic and price developments have been broadly in line with expectations.

However, we doubt that the BOJ has been able as yet to fully assess the economic and inflation impact from the new uncertainty created by the Middle East situation. It is therefore unlikely to provide a clear directional steer on the balance of risks at this point.

We therefore think the BOJ will emphasize a neutral stance at the press conference, citing two-way risks in light of the Middle East situation to preserve its flexibility to respond to changing conditions. If the BOJ were to overemphasize downside risks or a watch-and-wait posture, markets could interpret this as telegraphing a more cautious monetary policy stance, triggering yen weakness and ultimately constraining the BOJ's freedom to implement policy. The press conference requires careful communication that does not inadvertently roll back rate-hike expectations.

We also expect questions at the press conference about checkpoints (specific data) for future policy decisions. We expect the BOJ to explain that it will assess corporate behavior and the initial impact through upcoming interviews, including the Tankan survey and the branch managers' meeting report, thereby leaving scope for a policy decision at the April MPM.

## April MPM as major inflection point

The BOJ is at the stage of assessing how the Middle East situation will unfold and its impact on the economy and prices. The Tankan survey (due 1 Apr) and the branch managers' meeting report (due 6 Apr) will be particularly important in gauging the impact on the corporate sector.

The April MPM will also bring the release of a new *Outlook Report*, with the projection period extended by one year to FY28. We will be watching for revisions to the BOJ's economic and price

forecasts in light of the Middle East situation and for its FY28 inflation projection. In the event of significant market turbulence heading into the April MPM, the language on the timing of achieving the price stability target will also be a key focus.

At the April 2025 MPM, when concerns over US tariff policy were mounting, the BOJ retained the language stating that its target would be achieved in the second half of the projection period, effectively implying that the timeline had been pushed back. The upcoming April MPM thus marks the point where the BOJ will reassess its economic and price scenario from a longer-term perspective, and according to BOJ sources quoted by Bloomberg, whether to revise its scenario could also become a focal point.

At this point, we expect the BOJ to maintain its rate-hiking path but think it views the April MPM as a critical decision point given heightened uncertainty. To gauge the BOJ's stance on the Middle East situation, we would watch (1) the impetus for rate hikes among board members revealed by the Summary of Opinions from the March meeting (due 30 Mar), (2) evidence of the impact mainly on the corporate sector in the Tankan and branch managers' meeting report, and (3) BOJ communications ahead of the April MPM, including speeches and media reports citing BOJ sources.

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