

Daiwa's Economic View

BOJ March MPM Summary of Opinions: Focus still on upside risks to inflation amid Middle East tensions

- Most opinions emphasized upside risks to inflation, reinforcing impression that next rate hike nearing
- Rapidly laying groundwork for next hike

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The Bank of Japan (BOJ) is currently assessing both upward and downward pressures on underlying inflation from escalating Middle East tensions. However, Governor Kazuo Ueda stated at his regular press conference following the March Monetary Policy Meeting (MPM) that policy board members' opinions focused somewhat more on upside risks, suggesting that the board sees risk to inflation as skewed slightly to the upside.

Given Ueda's statement, the Summary of Opinions from the March meeting was important in assessing just how much policy board members' views are skewed toward upside risks to inflation.

Opinions on economic developments: Some concern about downside risks

In the opinions on economic developments, board members expressed the view that "it is highly likely that a wide range of firms will continue to raise wages steadily this year" in light of progress with the 2026 spring wage negotiations. However, the uncertain outlook for the Middle East also prompted a more cautious view about the need to "continue to monitor developments toward the final outcome of labor-management wage negotiations, including those at small and micro firms." Historically, smaller firms tend to decide on wage increases after confirming trends at large firms, with actual wage hikes typically not reflected until summer or later. We therefore see the risk that prolonged Middle East tensions could blunt the momentum of wage hikes at smaller firms.

In contrast, another opinion noted that "so far, excessive reactions have been contained in Japan, partly due to expectations surrounding the government's policies." While the current situation certainly warrants close attention, the government continues to pursue a high-pressure economy, including releasing petroleum reserves, raising operating rates at coal-fired power plants, and extending gasoline subsidies. We would also note that if these stopgap subsidies remain in place, they could fuel yen depreciation and push up long-term yields. From a monetary policy perspective, we therefore think the BOJ is right to focus on upside risks to inflation at this point.

◆ Opinions on Economic Developments in Summary of Opinions at Mar MPM (30 Mar 2026)

- Although large firms are likely to raise wages steadily, it is necessary, considering the situation in the Middle East, to continue to monitor developments toward the final outcome of labor management wage negotiations, including those at small and micro firms.
- The situation in the Middle East and the associated rise in crude oil prices should be considered as a risk scenario, and it is necessary to carefully examine their impact on markets and the economy. So far, excessive reactions have been contained in Japan, partly due to expectations surrounding the government's policies; in addition, the degree of the impact could vary depending on future developments. There is thus no need to revise the baseline scenario for economic activity and prices at this point.
- While Japan's economy has remained resilient, economic downside effects stemming from increased tension over the situation in the Middle East -- such as rising gasoline prices -- have started to emerge. Future developments will continue to warrant attention.

Opinions on prices: Majority focused on upside risks

The policy board's views on prices notably focused on upside risks. Specifically, board members flagged the "concern that the surge in crude oil prices and the depreciation of the yen will push up inflation significantly for an extended period," citing structural factors such as (1) rising inflation expectations, (2) firms' active price-setting behavior, and (3) supply shortages.

One opinion also noted that the government's measures to support cost pass-throughs and wage increases are adding momentum to inflation and that "inflation expectations are likely to rise." Another member expressed the view that given growing expectations for overseas central banks to raise interest rates, "downward pressure on the yen is therefore likely to emerge." These all indicate a focus on upside risks to underlying inflation.

◆ Opinions on Prices in Summary of Opinions at Mar MPM (30 Mar 2026)

- The rate of increase in the price of goods excluding food and energy and of services has been at around 1.5 percent, remaining stable below 2 percent. Underlying inflation appears still to be below 2 percent, and this is not a situation where a sharp increase in inflation should be of concern, assuming that the rise in food prices will subside.
- Underlying inflation has not been sufficiently anchored at 2 percent yet. While downside risks remain, there is also the possibility that underlying inflation will exceed 2 percent, depending on the future course of the situation in the Middle East.
- Should tension over the situation in the Middle East be prolonged, the direct impact is likely to be far greater than that stemming from the surge in rice prices. However, it is difficult to assess at this point whether the direct impact will be greater than that arising from the rise in import prices after Russia's invasion of Ukraine. That said, compared with the period following the invasion of Ukraine, greater attention is warranted on the spillovers and second-round effects of shocks on both prices and growth.
- There is concern that the surge in crude oil prices and the depreciation of the yen will push up inflation significantly for an extended period, given factors such as (1) inflation expectations having risen to around 2 percent, (2) firms' active price-setting behavior, and (3) supply shortages.
- Even during a phase when actual prices rise with an increase in crude oil prices, as seen today, inflation inertia is likely to remain, due to the government's measures to support passing on price and wage increases, and inflation expectations are likely to rise.
- Having learned from the criticism for "looking through" the rise in inflation in 2022, expectations for policy interest rate hikes have been emerging recently in Europe and other countries. Downward pressure on the yen is therefore likely to emerge.

Opinions on monetary policy: Rapidly laying groundwork for next hike

Given the above views on the economy and inflation, we think a relatively large percentage of opinions continued to assume a faster pace of rate hikes despite heightened Middle East tensions.

In the opinions on monetary policy, one member stated that while "the situation in the Middle East could result in upward pressure on prices and downward pressure on the economy," "under current financial conditions, the uptrend in prices is likely to be maintained," and that given continued wage increases amid labor shortages and firms' strong appetite for investment, "the Bank would need to consider adjusting the degree of monetary accommodation without long intervals between adjustments." While this view acknowledges risks in both directions, the argument in favor of raising rates in line with underlying inflation is close to BOJ leaders' baseline position.

Another board member expressed the view that "despite the policy interest rate hikes so far, accommodative financial conditions have been maintained." This is consistent with the assessment in the 27 March Bank of Japan Review paper "Developments in the Natural Rate of Interest and the Assessment of the Degree of Monetary Accommodation". We think the BOJ's baseline view is roughly that it should maintain the freedom to decide the timing of rate hikes, but sees no need for an excessively long interval between them given that hikes thus far have had a limited impact.

Several views emphasized upside risks to inflation, with one arguing that "it would also be appropriate to pay attention to whether it is necessary to accelerate the pace of policy interest rate hikes beyond previous projections and shift toward neutral or restrictive financial conditions, if

tension over the situation in the Middle East were to become prolonged,” while another stated that “the Bank should focus for the time being on addressing higher prices driven by the second-round effects and the rise in inflation expectations.” Some members also mentioned the size of rate hikes given the need to avoid falling behind the curve.

Given the emphasis policy board members placed on upside risks to inflation, we think the Summary of Opinions at the March meeting reinforces the sense that the BOJ intends to raise interest rates again in the near future. Together with last week’s output gap revision, the release of the CPI excluding institutional factors, and the update to the natural rate of interest, our sense is that the BOJ is rapidly laying the groundwork for its next rate hike. We therefore think a rate-hike decision at the April meeting is likely on the table.

That said, the remarks by the Ministry of Finance (MOF) representative at the March meeting did emphasize downside risks to the economy, which is a cause for some concern. However, the comments also noted MOF’s vigilance regarding financial market developments, suggesting that the government would find it difficult to explicitly block a rate hike amid the yen’s ongoing slide.

One member of the policy board also noted that “monetary tightening could become necessary if the cost-push pressure is likely to intensify due to an excessive depreciation of the yen.” This implies that the BOJ would also find it difficult to put off a policy response on the basis that inflation is “transitory” while the yen continues to weaken.

The remaining data points ahead of the April meeting are the Tankan survey (due 1 Apr) and the report from the meeting of the Bank’s branch managers (due 6 Apr). The views of regional firms at the branch managers’ meeting will be particularly important, as they will shed light on the depth of concern over the Middle East situation and the extent to which wage-hike momentum at smaller firms is holding up.

Opinions on Monetary Policy in Summary of Opinions at Mar 2026 MPM

Opinions on Monetary Policy	
1	Given that real interest rates are at significantly low levels, if the Bank's outlook for economic activity and prices will be realized, it is appropriate that the Bank, in accordance with improvement in economic activity and prices, continue to raise the policy interest rate and adjust the degree of monetary accommodation.
2	Despite the policy interest rate hikes so far, accommodative financial conditions have been maintained. Even with regard to the impact of rate hikes on domestic investment, there have been few cases where the rise in interest rates was the reason for firms to withdraw investment; in many cases, withdrawal was caused by labor shortages and increased material prices.
3	Uncertainties surrounding the situation in the Middle East have heightened recently, and market sentiment has deteriorated significantly. Given these circumstances, the Bank should maintain the current policy interest rate at this meeting.
4	The timing for raising the policy interest rate will be determined by assessing factors such as developments in wages, prices, and financial conditions, in addition to the impact of the situation in the Middle East. Specifically, from the next MPM onwards, it will be appropriate to assess in detail whether financial conditions remain accommodative after the last rate hike, while examining, for example, the extent to which wage increases and "beginning-of-the period price hikes" are widespread.
5	The situation in the Middle East could result in upward pressure on prices and downward pressure on the economy. However, under current financial conditions, the uptrend in prices is likely to be maintained. Moreover, given that, for example, moves to raise wages have continued amid labor shortages, and firms' appetite for investment has been strong, the Bank would need to consider adjusting the degree of monetary accommodation without long intervals between adjustments.
6	It is necessary to avoid a situation where underlying inflation continues to rise above 2 percent. If there are no signs of a significant deterioration in the economic environment or in the wage setting stance of small and medium-sized firms, the Bank will need to raise the policy interest rate without hesitation.
7	With the policy interest rate still far away from the neutral interest rate, falling behind the curve would compel the Bank to pursue rapid and significant monetary tightening, which would cause a major shock to Japan's economy. A policy rate hike, including the size of the hike, needs to be considered, taking into account factors such as the course of the situation in the Middle East, the Tankan (Short-Term Economic Survey of Enterprises in Japan), reports at the meeting of the general managers of the Bank's branches, and anecdotal information from firms.
8	The cost-push pressure stemming from high crude oil prices could bring about economic stagnation accompanied by price rises; in other words, 1970s-type stagflation. When inflation is temporary, the basic response for the Bank would be to wait until the cost-push factor dissipates, without taking hasty actions. However, monetary tightening could become necessary if the cost-push pressure is likely to intensify due to an excessive depreciation of the yen, or if the second-round effects become more pronounced and cause wages to increase more than expected.
9	While having the main option of gradually proceeding with rate hikes and adjusting the degree of monetary accommodation in line with previous projections, it would also be appropriate to pay attention to whether it is necessary to accelerate the pace of policy interest rate hikes beyond previous projections and shift toward neutral or restrictive financial conditions, if tension over the situation in the Middle East were to become prolonged.
10	Firms' wage- and price-setting behavior has become more active, with the norm for prices changing and the pass-through of the yen's depreciation becoming more pronounced. Against this background, there is a risk that the Bank may unintentionally fall behind the curve, since the second-round effects and the rise in underlying inflation that stem from overseas developments are more likely to emerge. While uncertainties due to the rise in crude oil prices may exert downward pressure on economic activity over time, the Bank should focus for the time being on addressing higher prices driven by the second-round effects and the rise in inflation expectations.
11	Maintaining price stability through monetary policy, and thus minimizing downside risks to economic activity, are actions aligned with the principle that the Bank's policy should be "aimed at achieving price stability, thereby contributing to the sound development of the national economy."

Source: BOJ; compiled by Daiwa.

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