Daiwa Securities

Economic Commentary (Apr BOJ MPM)

Hawkish hold preserves path to June rate hike

- BOJ leaves monetary policy unchanged
- But more members call for rate hike; inflation outlook turns hawkish
- Press conference focus: how forcefully BOJ stresses upside risks to inflation

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BOJ now assessing Middle East impact

The US and Israeli strikes on Iran have triggered fresh exogenous shocks for the Japanese economy, including worsening terms of trade, deteriorating corporate and household sentiment, and disruptions to corporate manufacturing via the impact on supply chains. These shocks could push underlying inflation in either direction, and we think the Bank of Japan (BOJ) now faces a heightened need to carefully assess how the Middle East situation evolves and how it feeds through to economic and price conditions.

That said, at its previous March Monetary Policy Meeting (MPM) the BOJ continued to emphasize its concern about upside risks to inflation. Given this backdrop, the focus at the April meeting was the extent to which it would continue to signal June as the timing for its next rate hike. In particular, attention centered on how the *Outlook for Economic Activity and Prices* report (*Outlook Report*) would assess the impact on underlying inflation from heightened Middle East tensions, and how it would frame the balance of upside and downside risks.

Monetary policy stance: Outcome leaves path to June rate hike intact

At the 27-28 April MPM, the BOJ voted to leave monetary policy unchanged. Alongside policy board member Hajime Takata, who has proposed rate hikes since the January 2026 meeting, board members Junko Nakagawa and Naoki Tamura also dissented, with each proposing a hike in the policy rate to 1.0%. Ms. Nakagawa noted that “risks to prices are skewed to the upside under accommodative financial conditions,” while Mr. Tamura argued that “with risks to prices becoming significantly skewed to the upside, the Bank should set the policy interest rate as close to the neutral rate as possible.” The proposals were defeated by majority votes.

In a February 2026 speech, Mr. Tamura stated that “as early as this spring, the price stability target of 2 percent can be judged to have been achieved if it is confirmed with a high degree of certainty that wage growth in 2026 will be in line with the price stability target.” Given the strong wage growth confirmed by this year’s spring wage negotiations, his call for a rate hike is unsurprising.

Meanwhile, the fact that Ms. Nakagawa also proposed a rate hike is notable: even amid heightened uncertainty over the Middle East, it suggests the Policy Board is focusing more on upside risks to inflation and is seeking to maintain the momentum for rate hikes.

On policy conduct, in the latest *Outlook Report* the BOJ retained its commitment to continue with rate hikes, but added new language stating that "underlying CPI inflation has been approaching 2 percent," and now frames continued hikes as a response "to developments in economic activity and prices as well as financial conditions," explicitly adding financial conditions as a factor in its policy decisions. We think its intention was to formally incorporate the impact of market conditions and financial factors such as interest rates and exchange rates into its policy judgments during the current rate-hiking cycle, thereby giving it the flexibility to manage risk. With financial conditions accommodative and the yen prone to weakening, we see this as a relative upgrade in the importance of financial conditions, including forex trends.

On the timing for achieving the price stability target, the extension of the BOJ's forecast period to FY28 resulted in a change in the previous phrasing ("in the second half of the projection period") to state that underlying CPI inflation will come to a level "generally consistent with the price stability target between the second half of fiscal 2026 and fiscal 2027 and remaining at around that level thereafter." We had flagged this in our preview as one of the potential hawkish signals the BOJ could send. Despite the Middle East situation, the BOJ stuck with its prior assumption on when the price stability target will be achieved.

As we discuss below, the latest inflation outlook shows the BOJ's wariness about upside inflation risks. We think the hawkish content of this *Outlook Report* signals the BOJ's strong intention of continuing to raise rates.

Economic outlook: Growth revised down, but no major economic pullback

Reflecting the negative exogenous shock of heightened Middle East tensions, the median of board members' real GDP growth forecasts in the *Outlook Report* was revised down to +0.5% for FY26 (previously +1.0%) and +0.7% for FY27 (previously +0.8%). The risk balance for the economic outlook, previously described as broadly balanced, was revised to "skewed to the downside," centered on FY26.

That said, the *Outlook Report* attributes economic resilience to "the government's various measures…and accommodative financial conditions, in addition to...continued high levels of profits in the corporate sector," concluding that "Japan's economy will not enter a significant adjustment phase." We note that it does not currently assume economic conditions that would rule out continued rate hikes.

However, we would note that the latest projections rest on the assumption that "the impact of the situation in the Middle East eases". The *Outlook Report* indeed acknowledges that if the Middle East impact becomes prolonged, the terms of trade could deteriorate more than expected and large-scale supply-chain disruptions could materialize, in which case actual outcomes could diverge considerably from the current projections. Given that the BOJ has framed its policy path as "examining the likelihood of realizing the baseline scenario of the outlook for economic activity and prices and the risks to the outlook," continuing to assess Middle East developments will remain an important condition for its rate-hiking decisions.

FY25-28 Forecasts of Majority of Policy Board Members (y/y %)

	Real GDP	CPI (all items less fresh food)	(Ref) CPI (all items less fresh food and energy)
FY25	＋1.0 ～ ＋1.0 [＋1.0]	＋2.7	＋3.0
As of Jan	＋0.8 ～ ＋0.9 [＋0.9]	＋2.7 ～ ＋2.8 [＋2.7]	＋2.9 ～ ＋3.1 [＋3.0]
FY26	＋0.4 ～ ＋0.7 [＋0.5]	＋2.8 ～ ＋3.0 [＋2.8]	＋2.5 ～ ＋2.7 [＋2.6]
As of Jan	＋0.8 ～ ＋1.0 [＋1.0]	＋1.9 ～ ＋2.0 [＋1.9]	＋2.0 ～ ＋2.3 [＋2.2]
FY27	＋0.6 ～ ＋0.8 [＋0.7]	＋2.3 ～ ＋2.4 [＋2.3]	＋2.6 ～ ＋2.7 [＋2.6]
As of Jan	＋0.8 ～ ＋1.0 [＋0.8]	＋1.9 ～ ＋2.2 [＋2.0]	＋2.0 ～ ＋2.3 [＋2.1]
FY28	＋0.7 ～ ＋0.8 [＋0.8]	＋2.0 ～ ＋2.2 [＋2.0]	＋2.1 ～ ＋2.4 [＋2.2]

Source: BOJ; compiled by Daiwa

Notes: (1) Figures in brackets indicate the medians of the Policy Board members' forecasts (point estimates).

(2) The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate -- namely, the figure to which they attach the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.

(3) Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.

(4) The CPI figures for fiscal 2025 are actual values.

Distribution of Real GDP Forecasts (majority of policy board members)

(%)	FY26		FY27		FY28
	Jan-26	Apr-26	Jan-26	Apr-26	Apr-26
0.4		2			
0.5		5			
0.6				2	
0.7	1	2	1	5	2
0.8	2		4	2	7
0.9	1		1		
1.0	4		3		
1.1					
1.2	1				
Upside	2	1	0	2	0
Downside	1	5	0	2	0
Balanced	6	3	9	5	9

Source: BOJ; compiled by Daiwa.

Inflation outlook: Alert to upside risks

Reflecting higher energy prices, board members' median forecasts for the core CPI (excluding fresh food) were revised up considerably, to +2.8% for FY26 (previously +1.9%) and +2.3% for FY27 (+2.0%). Core-core CPI (excluding fresh food and energy) forecasts also rose substantially, to +2.6% for FY26 (+2.2%) and +2.6% for FY27 (+2.1%). As a result, the risk balance for the inflation outlook, previously described as broadly balanced, was revised to "skewed to the upside," particularly for FY26.

These upward revisions were larger than we expected and show that the BOJ's inflation assessment is considerably hawkish. We would particularly note that it expects the core-core CPI to remain elevated both in FY26 and in FY27, with FY28 still above 2% at +2.2%. We note this suggests the BOJ does not view the current supply shock as merely a transitory energy-price factor; rather, it is likely to feed into more persistent inflation through broader cost pass-throughs and entrenched inflation expectations.

We would also highlight that, even after these substantial upward revisions, the number of board members flagging additional upside risks to the FY26 and FY27 core CPI rose to seven, from three at the previous meeting. Three members also expect the core CPI to exceed 2% even in FY28, suggesting the BOJ is not lightly dismissing the supply shock as temporary.

Importantly, on price risks the report notes that, "considering the current situation of Japan's economy that, for example, firms' behavior has shifted more toward raising wages and prices...it is possible that the rise in crude oil prices is passed on to the price of various goods and services more easily than before." This is a clear signal of the BOJ's wariness about upside risks to inflation.

On the impact of production stoppages from supply-chain disruptions, the *Outlook Report* acknowledges the possibility of substantial economic downside, but only discusses two-sided risks to underlying inflation. We think this suggests that the BOJ does not position the economic shock from production stoppages per se as a key factor behind its decision on whether to raise interest rates; even if the effects begin to show up in economic data, that alone would not necessarily preclude a rate hike.

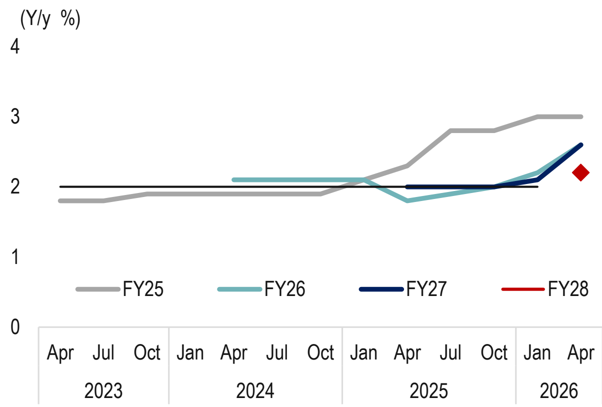
Overall, under the assumption that tension over the situation in the Middle East eases, the BOJ sees downside risks to the economy as contained, while on inflation the Policy Board is more keenly aware of upside risks and their persistence. We think the BOJ's economic and inflation outlook reaffirms that, once Middle East-related uncertainty recedes, the BOJ would be prepared to go ahead with a rate hike.

Distribution of Core CPI Forecasts (majority of policy board members)

(%)	FY26		FY27		FY28
	Jan-26	Apr-26	Jan-26	Apr-26	Apr-26
1.8	1				
1.9	4		2		
2.0	3		3		6
2.1	1		2		1
2.2			2	1	2
2.3				5	
2.4				2	
2.5		1			
2.6				1	
2.7					
2.8		5			
2.9		1			
3.0		2			
Upside	3	7	3	7	2
Downside	2	0	2	0	0
Balanced	4	2	4	2	7

Source: BOJ; compiled by Daiwa,

Core-core CPI Forecasts as of Each MPM (majority of policy board members)



Source: BOJ; compiled by Daiwa.

Governor Ueda's press conference: What would count as hawkish signal

We think developments in the Middle East are naturally an important precondition for the BOJ's rate-hike decision. While the latest *Outlook Report* emphasizes upside risks to inflation, that assessment does not factor in a prolonged Middle East crisis; it rests on the assumption that the impact eases. The BOJ likely positions the future course of the situation in the Middle East as one of the key conditions for a rate hike.

Given this, a key question for the timing of the next hike will be what level of certainty the BOJ thinks it needs about Middle East developments before it can act. For example, the timing of its decision will likely be heavily affected by whether it sees the easing of risks around the Strait of Hormuz as sufficient, or it also wants to confirm that the impact on the real economy (such as corporate production stoppages and supply constraints) has been contained.

That said, these criteria are not fixed and will likely shift along with the balance of risks to the economy and prices. The outlook for the Middle East situation also remains uncertain, and it is difficult at this point to be definitive about its economic and inflation impact. In our view, it is therefore unrealistic to think that Governor Ueda will be able to spell out clear criteria for assessing developments in the Middle East at today’s press conference.

As a result, the focus at the press conference will be the economic and inflation assumptions under which the BOJ seeks to justify continuing rate hikes. Specifically, market interpretations of the press conference will likely be determined by how strongly Mr. Ueda emphasizes “upside inflation risks” and “stronger second-round effects” as central to the BOJ’s policy decisions.

If he limits his messaging to making the rate path contingent on future developments in the Middle East, then even confirmation of the BOJ's commitment to continue rate hikes would likely come across as relatively dovish. In contrast, if he clearly puts more emphasis on inflation risks, that could deliver a hawkish impression relative to current market pricing.

At a minimum, Governor Ueda will likely reiterate that real interest rates remain at significantly low levels and that the degree of monetary accommodation remains large, underscoring that there is scope to continue raising rates. However, that confirmation alone would probably be insufficient to push market expectations for further hikes meaningfully higher. To go further, we think it would be important for him to reinforce the resilience of underlying trends by noting that high corporate profits and government economic measures are functioning as a cushion against the exogenous shock, and to lean into the view that elevated crude oil prices and a weaker yen are increasingly likely to be passed on to a wider range of goods and services through firms' more aggressive wage- and price-setting behavior.

A stronger hawkish signal would be a statement similar to that at the March meeting, indicating that "many on the Board emphasized upside inflation risks," suggesting the risk balance is tilted toward inflation. Given the content of today's *Outlook Report*, we think it is entirely possible that Governor Ueda may speak directly about how views of risks are balanced among Policy Board members.

Main Contents of *Outlook Report*

● Baseline Scenario of the Outlook for Economic Activity	
Apr 2026	Japan's economic growth is likely to decelerate in fiscal 2026, since the rise in crude oil prices reflecting the impact of the situation in the Middle East is expected to push down corporate profits and households' real income through factors such as a deterioration in the terms of trade. However, the economy is expected to continue growing moderately, albeit at a decelerated rate, since it is likely to be underpinned by factors such as the government's various measures and accommodative financial conditions, in addition to developments such as continued high levels of profits in the corporate sector. Japan's economic growth rate is likely to rise moderately from fiscal 2027 onward, since it is projected that the adverse effects of high crude oil prices will wane and that a virtuous cycle from income to spending will gradually intensify.
(Jan 2026)	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.
<Risk balance>	
Apr 2026	Particularly for fiscal 2026 -- risks to economic activity are skewed to the downside.
(Jan 2026)	Risks are generally balanced.
● Baseline Scenario of the Outlook for Prices	
Apr 2026	Underlying CPI inflation is expected to increase gradually, coming to a level that is generally consistent with the price stability target between the second half of fiscal 2026 and fiscal 2027 and remaining at around that level thereafter.
(Jan 2026)	It is likely …that underlying CPI inflation will continue rising moderately. Thereafter, since 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, it is expected that underlying CPI inflation and the rate of increase in the CPI (all items less fresh food) will increase gradually and, in the second half of the projection period, be at a level that is generally consistent with the price stability target.
<Risk balance>	
Apr 2026	Particularly for fiscal 2026, risks to prices are skewed to the upside.
(Jan 2026)	Risks are generally balanced.
● Conduct of Monetary Policy	
Apr 2026	As for the conduct of monetary policy, given that underlying CPI inflation has been approaching 2 percent and real interest rates are at significantly low levels, the Bank will continue to raise the policy interest rate and adjust the degree of monetary accommodation, in response to developments in economic activity and prices as well as financial conditions.
(Jan 2026)	Given that real interest rates are at significantly low levels, if the aforementioned outlook for economic activity and prices 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.

Source: BOJ; compiled by Daiwa.

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