Japan | Fixed Income

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Daiwa Securities

Daiwa's View

FICC Research Dept.

April BOJ meeting and market reactions—Key issues for June meeting: Pressure on the central bank's decision-making

- April meeting delivered hawkish surprise, but rate-hike pricing did not advance
- Risk of falling substantially behind the curve or slightly behind the curve
- Slight upside risk for JGB yields; central bank's independence under pressure heading into June meeting

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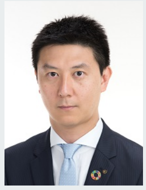

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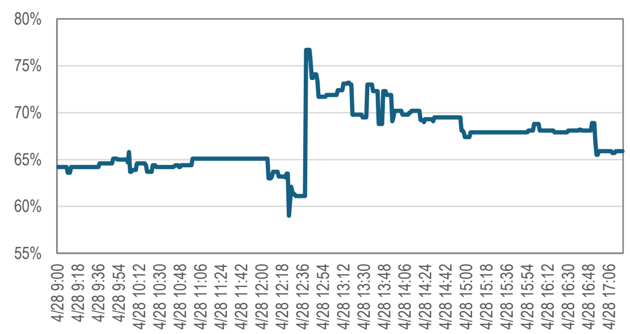
April MPM and market reactions

As widely expected, at its 27-28 April Monetary Policy Meeting (MPM), the BOJ kept its policy rate unchanged for the third consecutive meeting since the rate hike last December[1]. The decision to hold rates was accompanied by the most hawkish framing possible—a significant upward revision of the inflation forecast: the *Outlook for Economic Activity and Prices* report (*Outlook Report)* included the maintenance of the timeline for achieving the inflation target[2], and the removal of conditions that had constrained rate hikes[3]. Moreover, dissenting votes in favor of a rate hike came from not only board members Hajime Takata and Naoki Tamura but also from Junko Nakagawa, who had been perceived by the market as neutral.

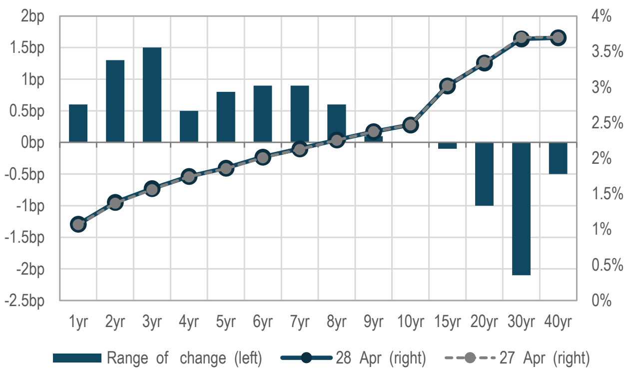
Following the meeting's outcome, the market's pricing of a June rate hike temporarily rose to nearly 80%, and the forex market reacted with a stronger yen. However, by around 4:00 p.m. Tokyo time, rate hike expectations had fallen back to about 65%, roughly the pre-meeting level, and the yen had also almost fully retraced its move. The flattening of the JGB yield curve was also limited. Some market participants apparently viewed Governor Kazuo Ueda's press conference, which began at 3:30 p.m. as "dovish." However, during the press conference, he remarked that the three dissenting votes "must be taken seriously," and regarding the market's "behind the curve" concerns, he carefully explained the risk of inflation rising due to companies' more aggressive price-setting behavior. While it is true that the press conference did not carry the same degree of surprise as the *Outlook Report*, the author believes its content was highly credible from the JGB market's perspective.

Chart 1: Probability of June Rate Hike Derived from OIS Market on 28 Apr (minute chart)



Source: Bloomberg; compiled by Daiwa.

Chart 2: Changes in JGB Yield Curve (27 → 28 Apr)



Source: Bloomberg; compiled by Daiwa.

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[1] For details, see 28 Apr 2026 *Economic Commentary (Apr BOJ MPM): Hawkish hold preserves path to June rate hike* (Kento Minami).

[2] In the April *Outlook Report*, although the forecast horizon was extended to 2028, the timeframe for achieving the price target—between the second half of fiscal 2026 and fiscal 2027—was maintained.

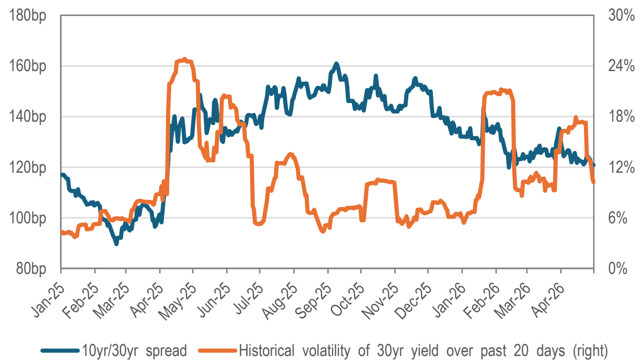
[3] From the phrase in the January *Outlook Report*, "the Bank, in accordance with improvement in economic activity and prices, will continue to raise the policy interest rate," the April *Outlook Report* has removed the condition "in accordance with improvement in economic activity and prices."

Risk of falling substantially behind the curve or slightly behind the curve

The reason behind the slowdown in expectations for rate hikes is likely that the market ultimately lacks conviction about a rate hike in June or beyond. The more hawkish the BOJ becomes, the more the market raises suspicions such as, "Then why didn't the Bank hike this time?" and "Are political factors constraining a rate hike?"

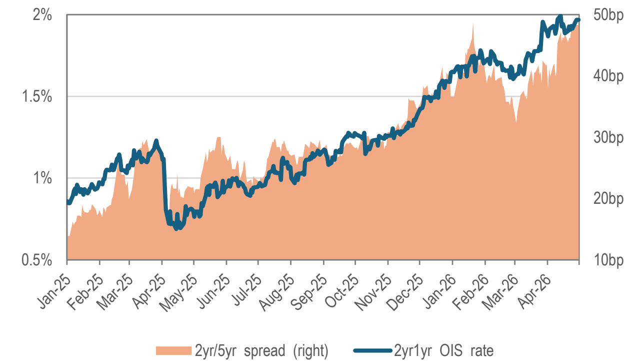
Looking at the superlong JGB market, the 10-year/30-year spread has been generally moving in a flattening direction, and the historical volatility of the 30-year yield over the past 20 business days has been trending downward. At the very least, we are not seeing a "steepening tantrum" like the one seen last spring. On the other hand, turning to the short- to medium-term zone, the 2-year forward 1-year OIS rate—a point of reference for the terminal rate—has reached nearly 2%. Furthermore, the 2-year/5-year JGB yield spread has steepened since the deterioration of the situation in the Middle East, reaching nearly its high in January.

Chart 3: 10yr/30yr Spread, Volatility of 30yr Yield



Source: Bloomberg; compiled by Daiwa.

Chart 4: Priced-in Terminal Rate, 2yr/5yr Spread



Source: Bloomberg; compiled by Daiwa.

The market has not fallen into a "substantially behind the curve" scenario, where the long end of the yield curve steepens significantly. However, with many market participants assuming a terminal rate of 1.5% to 2.0%, the fact that the market is pricing it near 2% indicates that it is conscious of a situation in which the BOJ may be forced to raise rates into restrictive territory above 2% in one to two years. In other words, it can be said that the market's concern for falling "slightly behind the curve" is growing.

Forex market holds the key to rate hike expectations

The forex market is likely to be a key factor influencing rate hike expectations. Even after the events in the Middle East, the USD/JPY rate has remained in the upper Y150 level without significant depreciation of the yen. The forex market is focused on whether Japanese authorities will intervene, but it is difficult to change the trend through intervention amid changes in fundamentals, such as geopolitical factors and worsening terms of trade due to high energy prices. Moreover, any dollar-selling by Japanese authorities, even if financed with cash rather than the sale of US Treasuries, reduces dollar-denominated foreign reserves. This essentially translates to a decrease in demand for US safe assets (a decline in the convenience yield), which becomes a factor for higher US yields. While US authorities did signal US-Japan coordination with a joint rate check in January, they likely believe that the proper course of action is a rate hike by the BOJ, which would lead to a narrowing of the real interest rate differential.

Even if the Takaichi administration is positive about yen depreciation, as reflected in her remark (that Foreign Exchange Fund Special Account's investments are "in great shape" as a result of the weak yen) during the Lower House election campaign, the relative decline in national wealth caused by a weaker yen is unpopular with the public, and yen depreciation is a factor that could prompt the authorities toward accepting rate hikes. During New York trading hours on the 29th, the USD/JPY rate exceeded Y160. If the yen were to weaken further and approach the upper Y161 range, its recent high in summer 2024, rate hike expectations are likely to increase.

Toward the June meeting

The situation in the Middle East, which was a major reason for holding off on a rate hike this time, will be a significant factor in forecasting whether a hike will occur in June. The ceasefire between the US and Iran has not progressed to further agreement, and President Trump has expressed his intention to prolong the blockade of the Strait of Hormuz. In addition, with the decline in rate cut expectations after the FOMC meeting, the 10-year US yield has risen above 4.40%. Taken together, it seems likely that the 10-year JGB yield could also rise above the 2.50% threshold. After Japan's Golden Week holiday, BOJ Deputy Governor Ryozo Himino is scheduled to give a speech at the Japan Society of Monetary Economics on 16 May. In his speech before the January 2025 MPM where the BOJ decided to raise rates, Deputy Governor Himino had stated, "the board will have discussion to decide whether to raise the policy rate or not," which the market took as the decisive signal for a rate hike. Although mid-May is still about a month before the June meeting, the market will be looking to gauge the probability of a hike, including the aspect of political consent.

Central banks' decision-making under pressure

Former Fed Chair Paul Volcker, who became Fed Chair in 1979—the year of the Iranian Revolution—and subsequently dealt with inflation, recounts in his autobiography that he only once had to face a direct assault on the independence of the central bank. That was in 1984, as the presidential election was approaching. During a closed-door meeting also attended by President Ronald Reagan, White House Chief of Staff James Baker told Volcker that the President was ordering him not to raise interest rates.

Following a meeting on 16 February between Prime Minister Sanae Takaichi and BOJ Governor Kazuo Ueda, it was reported that PM Takaichi expressed reluctance toward a rate hike. It was a closed-door meeting, and the exact content is unknown. Amid the historic uncertainty of the Middle East situation, the central bank's independence as the ultimate guardian of price stability is under pressure.

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