Japan | Fixed Income

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# Daiwa's View

## Key points for press conference after June BOJ meeting: Inflation expectation trends will determine the future pace of rate hikes

- In response to upside price risks, the basis of policy decisions has shifted from "certainty" to "risk balance
- Broadening of cost pass-through is confirmed in corporate goods prices, with price pressures spreading to the midstream stage
- If 5-year ahead inflation expectations rise in Tankan, it could bring forward the timing and shorten the intervals of rate hikes


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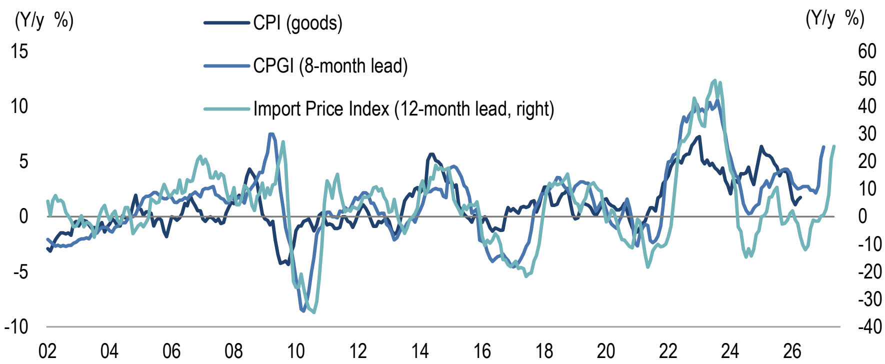
### BOJ's June MPM and materialization of upside price risks

At next week's June Monetary Policy Meeting (MPM), a hike in the policy interest rate to 1.0% is considered a done deal. Financial conditions remain accommodative, and real interest rates are still at low levels. On the price front, upside risks originating from the rise in oil-related prices are intensifying.

The May Corporate Goods Price Index, released on the 10th of this week, showed that the rise in crude oil and naphtha prices that occurred in April has begun to spill over into chemical and plastic products. While April's price increases were mainly observed in the upstream stage, the notable point in May was the spread of this impact to the midstream stage. The rise in naphtha and basic chemical prices is being passed on to resin prices with a time lag, indicating that the wave of cost increases is feeding through to downstream.

**Import Price Index, Corporate Goods Price Index (CPGI), and CPI (goods)**




*Source: Ministry of Internal Affairs and Communications, BOJ; compiled by Daiwa.*

These movements suggest that price pass-through among companies is proceeding more rapidly than before. In recent years, corporate price-setting behavior has changed in response to rising raw material and labor costs, creating an environment where cost increases are more easily reflected in sales prices. Given the price hikes at the import stage, it is unlikely that the upward pressure on corporate goods prices will subside in the short term. It is possible that this pressure will spread to an even wider range of items through synthetic resins and plastic products.

The BOJ had previously analyzed the pass-through from "upstream" (crude oil prices) to "downstream" (consumer prices) as taking about a year. However, one senior official noted with growing caution that, "looking at the current situation, there is a possibility that the speed of price pass-through may accelerate" (Jiji Press).

### Underlying inflation and change in reaction function

As MNI pointed out yesterday, the perception of the strength of underlying inflation is growing within the BOJ. In the data series that excludes the effects of the government's price-suppressing measures, the underlying inflation rate is believed to be maintaining strong growth. This situation is positioned as a factor supporting the need for a rate hike.

However, the BOJ's traditional reaction function was dependent on an increasing "certainty" in the baseline scenario that "underlying inflation would converge to the target in the second half of the projection period (from the second half of FY26 to FY27)." But at present, uncertainty is high due to the situation in the Middle East, forex rates, and resource price trends, with both upside and downside risks coexisting for prices and growth. For this reason, it has become difficult to make policy decisions based solely on the increasing "certainty" of the baseline scenario.

In this regard, the BOJ has come to place more emphasis on "risk balance (risk management)" when making decisions. As a result, heightened uncertainty in itself is no longer a reason to defer rate hikes. In phases where upside risks to prices are in focus, there is greater room to preemptively pursue normalization, or an adjustment in the degree of monetary accommodation. Unless extreme downside events such as war or an energy shock occur, the basic policy direction would lean toward tightening.

### Pace of rate hikes and the distance from the market

Even if the policy rate reaches 1.0% with this rate hike, it will still be below the neutral interest rate range (from 1.1% to 2.5%). Therefore, this policy change is still positioned as part of the normalization process. As the continuation of additional rate hikes is assumed, the market has substantially priced in a rise in the policy rate to the low 1% range by December. Accordingly, this rate hike itself is unlikely to be a major policy surprise.

On the other hand, the hurdle is high for the BOJ to deliver a message that is more hawkish than market expectations. For a meaningful surprise, the BOJ would need to suggest an acceleration in the pace of rate hikes or tightening to a level exceeding the neutral rate, but such a scenario is unlikely.

Furthermore, the FOMC meeting under new Warsh leadership is scheduled right after the BOJ MPM, making it very risky for the BOJ to significantly change its stance independently. Considering consistency with the external financial environment, the baseline scenario is likely to be that, even after raising the policy rate to 1.0%, the BOJ maintains its previous assessment of "extremely low real interest rates," keeps its policy guidance itself of "in response to developments in economic activity and prices as well as financial condition," and preserves discretion.

At the April meeting, the BOJ already added the phrase that it "will consider the timing and pace of adjustment, while closely monitoring the impact of the future course of the situation in the Middle East on Japan's economic activity and prices and examining the likelihood of realizing the baseline scenario of the outlook for economic activity and prices and the risks to the outlook," so there is no need to revise the guidance.

◆ April BOJ *Outlook for Economic Activity and Prices* report (*Outlook Report:* 28 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**.
- In this regard, it will consider **the timing and pace of adjustment**, while closely monitoring the impact of the future course of the situation in the Middle East on Japan's economic activity and prices and examining the likelihood of realizing the baseline scenario of the outlook for economic activity and prices and the risks to the outlook.
- With the price stability target of 2 percent, the Bank will conduct monetary policy as appropriate from the perspective of sustainable and stable achievement of the target.

## Key points for the press conference: How much detail will he provide regarding the BOJ's view on upside price risks?

As Governor Kazuo Ueda will be absent, Deputy Governor Shinichi Uchida will handle the post-meeting press conference. The biggest focus of this conference will be the extent to which he comments on upside price risks. In other words, this will show the BOJ's current price perception ahead of the price review in the July *Outlook Report*.

At present, the weak yen and rising crude oil prices are pushing up import costs and strengthening inflationary pressures through corporate price-setting behavior. Solid consumption allows companies to continue passing on higher costs to their sales prices. The progress in price pass-through confirmed in the corporate goods price data is a factor suggesting that the spillover to consumer prices may be brought forward.

Given this situation, the focus of the press conference will be on how much detail is provided regarding the response if underlying inflation strengthens more than expected. In other words, attention will be on whether he will explain the judgment for additional rate hikes as being based on a risk balance, decoupling it from the conventional scenario-dependent approach.

◆ BOJ Governor Ueda (3 Jun 2026)

- With regard to the situation in the Middle East, in addition to these upside risks to prices, there is also a possibility that underlying inflation will be pushed down due to factors such as a deterioration in the output gap stemming from an economic slowdown. However, based on the data and anecdotal information available thus far, the upside risks to prices appear to be greater overall and are likely to emerge sooner.
- The Bank considers it necessary to pay particular attention to whether the rise in actual prices will push up people's inflation expectations and whether this will cause underlying CPI inflation to deviate upward to a level above the price stability target of 2 percent.

## Implication: Seeds of an accelerated pace of rate hikes remain

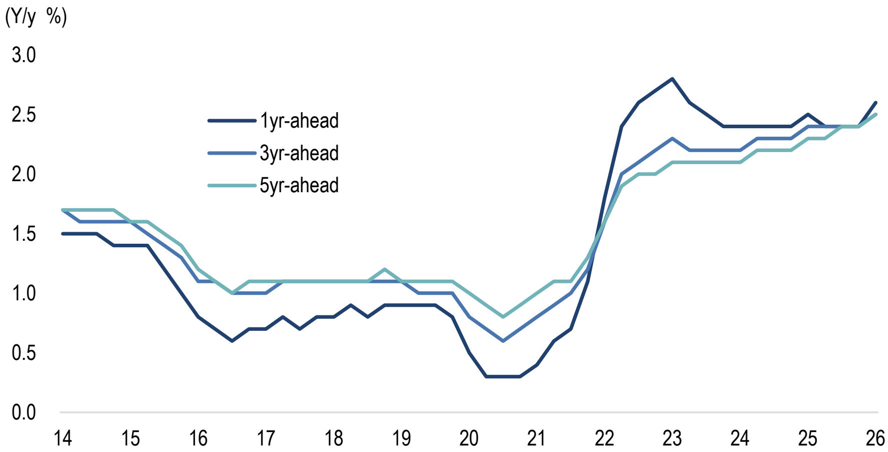
Overall, it is highly likely that the meeting will result in a decision to raise rates by 25bp and maintain the current guidance. However, the perception of price risks is changing within the BOJ.

The early pass-through of costs confirmed in corporate goods prices, the strength of underlying inflation, and the shift to a reaction function that can continue tightening even under high uncertainty all indicate the possibility of upward pressure on the future pace of rate hikes. The size and timing of policy hikes are becoming more dependent on how quickly the BOJ responds to changes in the distribution of price risks, rather than on the certainty of the outlook.

The BOJ is also paying close attention to trends in inflation expectations. In Japan, long-term inflation expectations have not yet reached a state of being anchored near 2%, and if upward price pressure continues, there is room for them to fluctuate above this level. In such a case, rate hikes may become necessary at an earlier timing and at shorter intervals than currently assumed.

In this regard, BOJ officials are attentive to the possibility that 5-year ahead corporate inflation expectations could rise further in the June Tankan survey, scheduled for release on 1 July (MNI). If such a movement is confirmed, it would be an early sign that inflationary pressures are stronger than previously assumed and could trigger a revision of the price perception in the July *Outlook Report* and consideration of bringing forward subsequent additional rate hikes.

**BOJ Tankan: Inflation Outlook of Enterprises (all-size enterprises, all industries)**




*Source: BOJ; compiled by Daiwa.*

For the BOJ, the stable achievement of the 2% price target remains the top priority. If the BOJ allows inflation expectations to remain persistently above this level, it may be forced to implement a more significant tightening in the future. For this reason, if underlying inflation accelerates more than expected, policymakers may be forced to adjust at a faster pace.

At present, it is difficult to assume a sudden hawkish shift. However, if upside price risks continue and a rise in inflation expectations is confirmed, the pressure to review the pace of gradual normalization will surely mount. The June meeting and press conference will be a good opportunity to assess to what extent this change is materializing in its early stages.

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