Daiwa Securities

Daiwa's Economic View

Summary of Opinions from Apr BOJ meeting: Entering "wait-and-see" mode

- Stressed downside risks for economy, prices
- Focus on possible long-term inflation impacts
- Consensus calls for wait-and-see stance, but rate hiking policy remains in place
- US/China tariff agreement to have limited impact on Japan's economy

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Summary of Opinions; BOJ consensus is to adopt "wait-and-see" mode for now

On 13 May, the BOJ released the "Summary of Opinions" from its Monetary Policy Meeting (held on 30 April and 1 May). Monetary Policy Board member opinions stressed the downside risks of US tariff policy on the Japanese economy and prices, as well as the high degree of uncertainty. With regard to the conduct of monetary policy, there was a clear "wait-and-see" stance and many were cautious about raising interest rates.

Meanwhile, at this juncture, we have not heard any opinions that hiking the interest rate has become more difficult or that interest rates should be lowered. As indicated at BOJ Governor Kazuo Ueda's press conference on 1 May, there appears to be consensus within the Bank that while the basic policy is to raise interest rates, the situation will be assessed for the time being (= "wait-and-see" mode). However, compared to the April meeting (including post-meeting press conference), which left a more dovish impression, the Summary of Opinions for the April meeting also mentioned higher-than-expected risks for the economy and prices. Specifically, the report said, "If the (US) administration were to conduct policy changes, such as reducing domestic taxes, the growth rate for the US economy could be higher than expected." We can probably say that the content within the report evenly balanced the hawkish and dovish viewpoints.

Opinions on economic developments: Stressing downside risks

Opinions on the economic developments noted that, "Japan's economic growth is likely to moderate due to the effects of trade and other policies in each jurisdiction. Thereafter, however, Japan's economic growth rate is likely to rise." This seems to suggest that Japan's economy is at a standstill for now. Specific adverse effects that were cited included "negative demand shocks are expected, including the impact of increased uncertainties on business fixed investment and household consumption," "decrease in Japanese exports to the world and to the US," "deterioration in corporate profitability (earnings)," and "impact on SMEs due to selection of suppliers and compression of subcontracting structure." These comments highlight the downside risks for Japan's economy and prices.

Meanwhile, there was the opinion that, "As reciprocal tariffs will be imposed on jurisdictions around the world, it is unlikely that the tariffs will lead to a deterioration in the relative competitiveness of Japanese firms." There was also the view that, "Japan's dependence on trade is not high, and decisions should be made calmly, paying attention to domestic factors."

In this regard, for example, corporate actions in response to tariffs are expected to include (1) passing on tariff-related costs to the US side, (2) Japanese firms bearing these costs, or (3) both parties splitting the costs. In the case of passing on tariff-related costs to the US side, price increases for Japanese products are generally similar to those for products from other countries, suggesting that relative price increases may be limited and reduced demand for Japanese products may also be curbed.

The current outlook is only temporary, as it is fluid and depends on the "corporate response" and the 'actual tariff policies" as contemplated above. Going forward, the focus will likely turn more to tariff policy trends and business behavior.

◆ **Opinions on Economic Developments in Summary of Opinions at April 2025 Monetary Policy Meeting (13 May 2025)**

- Japan's economy has recovered moderately, although some weakness has been seen in part. Japan's economic growth is likely to moderate due to the effects of trade and other policies in each jurisdiction. Thereafter, however, Japan's economic growth rate is likely to rise, with overseas economies returning to a moderate growth path.
- Negative demand shocks are expected, including the impact of increased uncertainties on business fixed investment and household consumption, a decrease in the volume of exports to the United States and a deterioration in Japan's export profitability, the impact of a deterioration in global economic activity and of the yen's appreciation on exports from Japan, and negative wealth effects due to a decline in stock prices. While positive supply shocks due to factors such as a decline in commodity prices are also expected, these shocks are likely to be smaller than the demand shocks. Overall, U.S. tariff policy will exert downward pressure on both economic activity and prices in Japan.
- How U.S. tariff policy will turn out and how firms respond to the policy are both fluid. Therefore, the Bank's outlook for economic activity and prices can only be provisional at this point; it could be revised considerably depending on developments.
- Since it took office, the new U.S. administration has given priority to policies, such as tariffs, that have a negative impact on economic growth. However, if the administration were to conduct policy changes, such as reducing domestic taxes, the growth rate of the U.S. economy could be higher than expected.
- As reciprocal tariffs will be imposed on jurisdictions around the world, it is unlikely that the tariffs will lead to a deterioration in the relative competitiveness of Japanese firms. Therefore, it is possible that the decline in profits of Japanese firms will be limited.
- Japan's economy is not heavily reliant on trade. Therefore, the Bank should assess economic and financial developments in a considered manner, paying attention not only to developments in U.S. tariff policy, but also to domestic factors.

Opinions on prices: Focus on possible long-term inflation impacts

With regard to prices, there was the view that, “Prices are currently expected to be at a level that is generally consistent with the price stability target through the second half of the projection period, albeit with fluctuations, as they continue to be supported by wage growth and tight labor market conditions.” However, in regards to the tariff policy, one opinion stated, “These factors could have a negative impact on wages. Therefore, US tariff policy is highly likely to exert downward pressure on Japan’s underlying inflation.”

The BOJ has traditionally focused on the long-term underlying inflation rate and not the current inflation rate. Meanwhile, there was also the opinion that, “At this point, from a somewhat long-term perspective, US tariff policy and its uncertainties will not impact Japan’s underlying inflation rate and potential growth rate.” Here, it is also recognized that price shocks due to tariffs and other factors can theoretically impact price levels over the short run, but only change the “level” of prices in the long run and so have no lasting effect on the “rate of increase” for prices.

The focus of attention regarding prices is on whether there will be any impacts for long-term inflation trends. Specifically, whether the impact of tariff policies, via deteriorating corporate earnings, will (1) negatively impact the passing on of higher cost to prices by companies, (2) negatively impact the virtuous cycle of “higher wages→higher prices,” and (3) cause corporate behavior to move toward a return to deflation. As long as tariff policy does not have that much of an impact, the BOJ’s basic outlook for long-term price increases toward 2% is expected to remain in place.

◆ **Opinions on Prices in Summary of Opinions at April 2025 Monetary Policy Meeting (13 May 2025)**

- Even with the impact of tariff policies and other factors that is assumed in the April Outlook Report, prices are currently expected to be at a level that is generally consistent with the price stability target through the second half of the projection period, albeit with fluctuations, as they continue to be supported by wage growth and tight labor market conditions.
- U.S. tariff policy is likely to push down Japan's economy through both trade and sentiment. On the price front, while tariffs could either push up or push down prices in Japan through supply-chain disruptions and deceleration in Japan's economy, both of these factors could have a negative impact on wages; therefore, U.S. tariff policy is highly likely to exert downward pressure on Japan's underlying inflation.
- As tariff shocks can be considered short-term price shocks, it is possible to conclude theoretically that tariff shocks do not have practical effects in the long term. Therefore, at this point, from a somewhat long-term perspective, U.S. tariff policy and its uncertainties will not affect Japan's underlying inflation and potential growth rate.

Opinions on conduct of monetary policy: Wait-and-see mode while keeping free hand

In response to these economic and price conditions, and in regards to the Bank's conduct of monetary policy, there was the opinion that, "Real interest rates have been significantly negative. Given this, the Bank's stance to continue to raise the policy interest rate is unchanged." However, there was also the opinion that under conditions of extremely high uncertainties, "It is necessary to examine the likelihood of realizing the outlook and the risks to the outlook." In that situation, the BOJ is cautious about raising interest rates too early, saying, "The Bank needs to wait and see until developments in US tariff policy have become somewhat settled."

The BOJ expects that underlying inflation will "stagnate for some time, before heightening again" (from Ueda's post-meeting press conference in May) as a result of the tariff policy. Any policy decision will be based on its feasibility and risks. As mentioned earlier, the downward pressure on prices is due to the impacts of tariff policy on the wage side. The focus of attention going forward will be particularly on the extent of weaker-than-expected corporate earnings, winter bonus trends, and the realization of wage increases from the 2026 annual spring labor-management wage negotiations (= continuation of virtuous cycle of "higher wages→higher prices").

The Summary of Opinions from this meeting also noted, "US tariff policy could lead Japanese firms to conduct excessive cost-cutting, shift their stance in the direction of contracting their businesses—such as by restraining wage hikes and investment—and bring about a hollowing out of industries." As such, the Bank is on guard for any risk of a return to a deflationary economy. With high uncertainty and concerns about a return to deflation, the BOJ is currently in no rush to raise interest rates.

However, the BOJ's current outlook is just temporary. Indeed, it will, "Need to conduct monetary policy in a nimble and more flexible manner with more freedom" in light of the opinion that, "The outlook could be revised, either in a positive or a negative direction, depending on the course of US tariff policy." With no clear prospects for the future of tariff policy, we can assume that the Bank will need to maintain a free hand in policy decision making for now.

Some of the opinions argued for a wait-and-see approach. Still, we could not confirm any opinions that the Bank feels a rate hike would be difficult or that it needs to switch to cutting rates. The consensus within the BOJ, including even the dovish members, appears to be a continuation of the policy of raising interest rates for now, but with an emphasis on assessing uncertainties.

In particular, there was the opinion that, "There is little risk of the economy going back to a state in which wages and prices do not increase easily." We, likewise, agree with that opinion. Considering that Japan's structural challenges include an increasingly severe shortage of labor and considering that the environment is such that wages and prices are more likely to rise than in the past, a return to the former cost-cutting deflationary economy seems unlikely.

There was also the opinion that, "The current monetary policy stance is highly accommodative." The use of the expression "highly accommodative" is a strong indication that the BOJ still maintains a very accommodative monetary environment in terms of determining the final destination (terminal rate) of future rate hikes. Depending on the future outcome of tariff policy, discussions on the normalization of monetary policy will take place. So, any changes in the BOJ's stance should continue to be closely monitored.

Also, in regards to the rise for super-long-term JGB yields, there was the view that, "The JGB market was divided by maturity. In view of the interim assessment of the plan for the reduction of the purchase amount of JGBs, it is important for the Bank to carefully examine supply and demand conditions and liquidity of JGBs by maturity and the variety of views of market participants from different business types." Even within the BOJ, it appears that a close eye is on the rising super-long-term JGB yields and the deteriorating supply/demand balance behind that rise, just ahead of the "interim assessment of plan to reduce its JGB purchases" scheduled for the June meeting.

However, the Summary of Opinions also indicated that, "If a central bank is continually over-flexible in response to these views, this flexibility itself could make the bank's responses less predictable, thereby increasing uncertainties in the markets." No consensus has yet been formed within the BOJ on the policy for its interim assessment. So, we want to focus on the "Bond Market Group" meetings to be held on 20-21 May.

Opinions on Monetary Policy in Summary of Opinions at April 2025 Monetary Policy Meeting (13 May 2025)

	Opinions on Monetary Policy
1	If its 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. In this regard, considering the extremely high uncertainties, it is important for the Bank to judge whether the outlook will be realized, without any preconceptions.
2	The outlook presented by the Bank shows that the price stability target of 2 percent is likely to be realized, and real interest rates have been significantly negative. Given this, the Bank's stance to continue to raise the policy interest rate is unchanged. In this regard, amid the extremely high uncertainties -- including the future course of tariff negotiations that is assumed in the outlook -- the outlook itself could change, both upward and downward. Therefore, it is necessary to examine the likelihood of realizing the outlook and the risks to the outlook.
3	There are high uncertainties regarding the outlook for economic activity and prices, and the likelihood of realizing the outlook is not as high as before. **It will be necessary for the Bank to examine the possibility of both upward and downward deviations from its outlook and conduct monetary policy as appropriate, based on this examination.**
4	The Bank needs to wait and see until developments in U.S. tariff policy have become somewhat settled.
5	U.S. tariff policy could lead Japanese firms to conduct excessive cost-cutting, shift their stance in the direction of contracting their businesses -- such as by restraining wage hikes and investment -- and bring about a hollowing out of industries. Close attention is thus warranted on whether there will be a change in the more active sentiment of firms or in trends in bankruptcies. The Bank needs to carefully examine the impact of U.S. tariff policy on Japan's economy, and it is therefore appropriate for the Bank to maintain the current monetary policy.
6	While the Bank of Japan will enter a phase of pausing its policy interest rate hikes with a deceleration in the U.S. economy, it should not be too pessimistic, and it will be required to conduct monetary policy in a nimble and more flexible manner, such as by conducting further policy interest rate hikes in response to policy changes in the United States.
7	The most important factor with regard to achieving the price stability target is developments in firms' wage- and price-setting behavior and in firms' and households' inflation expectations. In that sense, there is little risk of the economy going back to a state in which wages and prices do not increase easily. Therefore, it is unlikely that underlying CPI inflation, which has been increasing toward the price stability target of 2 percent, will turn to a decline.
8	It has been more than a year since the Bank moved away from the lower bound on interest rates. In this situation, economic activity and prices have been firm, and the current monetary policy stance is highly accommodative.
9	Regardless of the outlook for economic activity and prices that is developed at this point, it could be revised, either in a positive or a negative direction, depending on the course of U.S. tariff policy. This means that the Bank's policy path may change at any time. Therefore, at this particular juncture, the Bank should communicate this point candidly to the market.
10	Market participants have developed their views on the timing of policy interest rate hikes and continued to revise their views by applying the Bank's basic thinking on monetary policy conduct to information obtained from home and abroad, without seeking direct indications from the Bank. It is therefore desirable for the Bank to continue to communicate in a way that this situation can be maintained.
11	During the market turmoil in April, the Japanese government bond (JGB) markets were divided by maturity, as seen, for example, in the significant rise in yields on super-long-term JGBs. In view of the interim assessment of the plan for the reduction of the purchase amount of JGBs, it is important for the Bank to carefully examine supply and demand conditions and liquidity of JGBs by maturity and the variety of views of market participants from different business types.
12	Investors need to be cautious about investing in super-long-term JGBs when market expectations regarding the interest rates on these bonds are particularly high and the markets are nervous. While it is natural for central banks to take appropriate account of market views, if a central bank is continually over-flexible in response to these views, this flexibility itself could make the bank's responses less predictable, thereby increasing uncertainties in the markets. The Bank should avoid, as much as possible, actions that lead to such uncertainties.

Source: BOJ; compiled by Daiwa.

Implications of US-China tariff agreement for Japan's economy

Meanwhile, some progress resolving these uncertainties is now being made. On 12 May (JST), the US and China finalized a tariff agreement that will lower reciprocal tariffs by 115% for 90 days. This led to yen depreciation and higher JGB yields.

However, even if tariffs under a US-China tariff agreement were to remain unchanged, that effect alone would probably not significantly ease downward pressure on the Japanese economy. We assume that the moderating effect of the US/China agreement on the Japanese economy in terms of downward pressure on real GDP would amount to only +0.1 to +0.2% in FY25.

The US/China tariff agreement may also impact the priorities of the Japan/US negotiations, which were initially considered a “top priority.” For the US, Japan is the cornerstone of its security in Asia and, from the perspective of ensuring deterrence against China, Japan may have been considered a “top priority” in the tariff negotiations. As such, now that a US/China tariff agreement has been reached, Japan's priority within tariff negotiations could decline.

Under these circumstances, even with a US-China tariff agreement in place, uncertainty surrounding the Japanese economy remains high. Now is still the phase for assessing tariff policy outcomes and their impacts.

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