

Daiwa's View

FICC Research Dept.

Points of interest at Jul MPM: Assessment of economy and prices, as well as risk balance

- FY25 economic projection and FY25 and FY26 price projections expected to be revised upwards
- Risk balance regarding economic activity and prices might be neutralized
- Economic and political developments warrant attention from summer through to autumn

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Economic and price projections, as well as risk balance, will be points of interest at Jul MPM

On 23 July, Japan and the US reached [an agreement on tariffs](#) in which (1) reciprocal tariffs were set at 15% on imports from Japan and (2) the additional sectoral tariff of 25% on automobiles was halved to 12.5%, resulting in an effective tariff rate of 15%.

We view the following two points as important regarding requirements for the BOJ's next rate hike: (1) neutralization of downside risks to the economy and prices (i.e., reduced uncertainty about tariffs) and (2) careful assessment of the impact of tariffs on the Japanese economy and prices. The latest agreement is expected to significantly reduce tariff-related uncertainties in Japan and the US, which should mitigate the negative impact on the Japanese economy and prices.

Under the circumstances, the BOJ is likely to decide to maintain the status quo on the policy interest rate at the Monetary Policy Meeting (MPM) on 30-31 July. While it is likely to maintain its stance regarding raising rates in the future, the central bank will probably emphasize that there is a high level of uncertainty given the continued need to discern the impact of tariffs. What should be noted is the *Outlook for Economic Activity and Prices* report (*Outlook Report*) to be released alongside the meeting, which will show economic and price projections and risk assessments, reflecting recent macroeconomic conditions and tariff policy developments.

In the *Outlook Report*, the projection for the FY25 economic growth rate is expected to be revised upwards slightly from +0.5% to +0.6%, but forecasts for FY26 and FY27 are likely to remain unchanged. This upward revision reflects the fact that the impact from tariffs has not materialized as much as initially expected.

Price projections are also expected to be revised upwards, particularly due to rising food prices. Projections for core CPI are expected to be +2.5% for FY25 (previously +2.2%) and +1.8% for FY26 (+1.7%), but the projection for FY27 is expected to remain unchanged.

Regarding risk balance, the previous *Outlook Report* stated that risks to economic activity and prices were "skewed to the downside." In light of the progress made with the US/Japan tariff agreement, we forecast that the assessment will be revised to state that "risks are balanced" for FY25 and FY26. (Details will be explained later in this report.)

BOJ Policy Board Members' Projections (median, y/y %)

	Real GDP		Core CPI		Core core CPI	
	Apr 2025*	Jul 2025**	Apr 2025*	Jul 2025**	Apr 2025*	Jul 2025**
FY25	+0.5 %	+0.6 %	+2.2 %	+2.5 %	+2.3 %	+2.6 %
FY26	+0.7 %	+0.7 %	+1.7 %	+1.8 %	+1.8 %	+1.9 %
FY27	+1.0 %	+1.0 %	+1.9 %	+1.9 %	+2.0 %	+2.0 %

Source: BOJ, various materials; compiled by Daiwa.

*BOJ projections. **Our estimates for policy board member projections (highlighted in light blue).

First point of interest at MPM: Economic outlook

As previously mentioned, the economic outlook for FY25 is expected to be revised upwards slightly because the impact from tariffs has not materialized in the real economy as much as initially expected.

In fact, real exports through June have remained solid across major export destinations. In terms of production, as well, no significant impact has been observed in any industry (incl. transport equipment).

On 18 July, a Reuters report (based on sources from those in the know) also stated that data (currently not showing any apparent impact from tariffs) may be reflected in the wording of the next report (*Outlook Report*) on the economic outlook and risks, as well as in the board's growth projections.

The current tariff situation, including the US/Japan agreement, appears to be falling within what was anticipated by the BOJ. This is because Governor Kazuo Ueda stated during his regular press conference in May that the BOJ was assuming that tariff negotiations would not settle at zero or only 10%, but slightly higher than that.

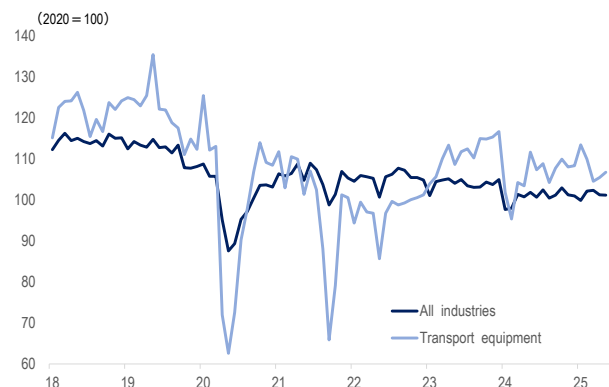
According to [a speech by BOJ Deputy Governor Shinichi Uchida on 23 July](#), forecasts in the April *Outlook Report* were prepared on the assumption that a certain degree of progress would be made during negotiations between countries. Therefore, he stated that there were no major changes to the overall structure. The economic and price projections in the upcoming *Outlook Report* will likely reflect the US/Japan tariff agreement. That said, as the situation is progressing in line with the BOJ's projections, the latest agreement is unlikely to cause major revisions.

Real Exports



Source: BOJ; compiled by Daiwa.

Industrial Production Index



Source: Ministry of Economy, Trade and Industry; compiled by Daiwa.

Second point of interest at MPM: Price outlook

Recent price trends have been stronger than expected, driven by the widespread passing through of costs to food prices. In June, the nationwide CPI for food, excluding fresh food, surged by 8.2% y/y (+7.7% in May) or +0.6% m/m.

Price increases in processed foods (especially confectioneries) and beverages have contributed to this trend. In the food sector, the rising cost of ingredients/raw materials is spreading to processed food prices. Given the fact that the price of imports has continued to decline since the beginning of 2025, we think the increase in the price of food is becoming more endogenous (i.e., home-made inflation).

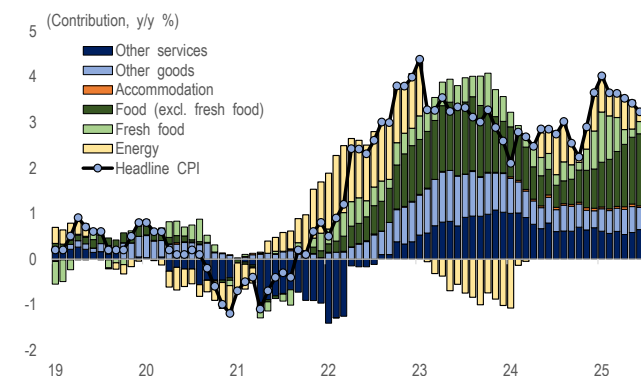
This wave of rising prices is likely to continue until at least summer. According to surveys by Teikoku Databank, the rising cost of logistics and labor have been cited as factors behind rising prices, which suggests that the pass-through of higher costs to food prices may be becoming

stickier. Deputy Governor Uchida also stated in his 23 July speech that the price-setting behavior of companies has changed significantly compared to the past, at least with regard to food prices.

Considering these conditions, the BOJ is likely to make a significant upward revision to its FY25 price projection. It is highly likely that the FY26 projection will be raised slightly, reflecting a longer period of higher costs being passed through to food prices.

However, the “Composite Index of Inflation Expectations,” a key indicator of underlying inflation, is currently rising only moderately. Therefore, we forecast that the FY27 price projection will remain unchanged.

Breakdown of Contributions to Nationwide Headline CPI



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

Composite Index of Inflation Expectations



Source: BOJ, Japan Center for Economic Research; compiled by Daiwa.

Note: Composite index of inflation expectations is an extract of the first principal component via the principal component analysis regarding household inflation expectations (median of inflation expectations over the next five years in the Opinion Survey on the General Public's Views and Behavior), corporate inflation expectations (general price outlook for the next 5 years in BOJ Tankan), and experts' inflation expectations (CPI growth rates for the next 2 to 6 years in ESP Forecast survey). In this estimate, the contribution ratio for the first principal component was 0.753.

Third point of interest at MPM: Risk balance assessment

We point out the following three items as the main uncertainties regarding the outlook for the Japanese economy and prices: (1) the outcome of tariff negotiations, (2) the impact of tariffs, and (3) the government's economic and fiscal policies. The BOJ is likely to regard its assessment of these uncertainties as important when determining the risk balance.

(1) Outcome of tariff negotiations

While the US/Japan tariff agreement has significantly reduced downside risks due to tariff policies, the US is still negotiating with Europe, China, and other regions. In his 23 July press conference, Deputy Governor Uchida stated that, while the US/Japan tariff agreement reduced uncertainties, the BOJ needed to continuously monitor downside risks, as well. Therefore, the outcome of tariff negotiations still entails risks in both directions.

(2) Impact of tariffs

Due to the US/Japan tariff agreement, it appears that [the impact from tariffs on Japan's real GDP will be limited, resulting in an estimated cumulative drag of only about 0.6ppt](#). However, this analysis is still mechanical at this stage.

Under the circumstances, real economic trends must be closely monitored. However, no clear impact from tariffs has been observed thus far, and recent macro data may influence the risk balance assessment. In other words, we think downside risks have declined compared to the real economic trends confirmed since the April meeting.

Japan's price elasticity vs. the quantity of its exports may have declined in recent years. Price elasticity is an indicator showing how much the quantity of exported goods changes when the price of exports fluctuates. A price elasticity of 1 means that if the price increases by 15%, demand will also decrease by 15%.

Meanwhile, income elasticity vs. the quantity of exports may have risen. Income elasticity is an indicator of how export volume changes in line with the economic conditions (income levels) of the nation receiving the exports.

[Based on the results of these analyses](#), even if Japan were to pass through the cost of higher tariffs to prices, the impact on export volume would be limited. However, a slowdown in the US economy would likely have a major impact on exports.

Therefore, US economic trends are increasingly important when evaluating the impact from tariffs on Japan. A slowdown in the US economy could become a turning point with regard to the impact from tariffs. Paradoxically, if the US economy were to remain solid, the impact from tariffs could decline.

(3) Government's economic and fiscal policies

The figures presented in the BOJ's *Outlook Report* generally only reflect information that has been finalized based on government policies. We assume that uncertain policies are treated as variables of uncertainty. Therefore, the recent political situation, including the ruling coalition's loss in the Upper House election, could become a factor for uncertainty with regard to the Japanese economy and prices in the future.

In his 23 July press conference, Deputy Governor Uchida stated that fiscal expansion could support the economy and consumption, and that the increase in the upside potential depended on the scale of fiscal spending.

Due to political instability, the ruling parties are forced to cooperate with opposition parties that take the stance of implementing greater fiscal expansion. This is increasing the likelihood that agreements will be reached on fiscal expansionary policies (i.e., upside risks).

Based on these three uncertainties, we think downside risks are decreasing and upside risks are increasing. Furthermore, there is an increasing risk of prolonged inflation with food prices. We, therefore, forecast that the risk balance for both economic activity and prices will be revised to "balanced" for FY25 and FY26.

Economic and political developments warrant attention from summer through to autumn

It will also be important to monitor how much of the tariff burden is passed on to consumers in the US during the summer. US economic trends are important when assessing the impact of tariffs on Japan. Therefore, we need to carefully monitor the direction the economy takes.

Furthermore, if other nations' tariff negotiations are concluded by autumn, we will be able to discern how corporate trends in Japan will be influenced by tariffs via the BOJ Tankan surveys announced during the Oct-Dec period (to be released on 1 Oct and 15 Dec) and the branch managers' meeting report in mid-October.

On 23 July, *Yomiuri Shimbun* and *Mainichi Shimbun* reported about [Prime Minister Shigeru Ishiba's possible resignation](#). The gathering of party members of both houses of the Diet to be held by the LDP leadership on 28 July will be a point of interest in the near term. By autumn, we should have a clearer understanding of developments regarding (1) whether Ishiba will step down, (2) the selection of a new prime minister if Ishiba resigns, and (3) the direction taken in coalition talks with opposition parties. There are a number of issues to monitor carefully on both the economic and political fronts through to autumn.

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