

Daiwa's Economic View

September BOJ MPM: Three remaining uncertainties; could raise rates within 2025

- BOJ stands pat on monetary policy, but two members dissent
- Decision to sell ETFs, other assets; gradual pace shows consideration for market
- Three remaining uncertainties: Corporate trends, US economy, domestic political landscape
- Focus at press conference on potential for rate hike within 2025

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BOJ stays on hold; focus at press conference on remaining scope for rate hike within 2025

As per prior media reports, the Bank of Japan (BOJ) opted to stand pat at its 18-19 September Monetary Policy Meeting (MPM). However, board members Hajime Takata and Naoki Tamura dissented and proposed raising the policy rate to 0.75%. Opinions within the BOJ are also divided on the impact of tariffs and upside risks to inflation.

The BOJ also decided at today's MPM to begin selling ETFs and J-REITs. It drew on past experience in determining the amount it will sell (around Y330bn per year in book value terms for ETFs). According to the 10 September Bank of Japan Accounts report (issued every 10 days), the book value of its ETF holdings is around Y37.2tn, and at the above pace it would take more than 100 years to finish selling its entire holdings. We had expected the BOJ to begin selling ETFs once the current rate-hiking cycle was over, and its decision came as a surprise; however, its statement that it may temporarily adjust or halt its selling depending on market conditions indicates its consideration for the market.

Current Conditions and Baseline Scenario of Japan's Economy and Prices (Sep BOJ MPM)

Current conditions		Red lettering indicates corrections and additions. ⇒ indicates status of revisions from previous assessment
Japan's economy	Has recovered moderately, although some weakness has been seen in part. ⇒ Unchanged	
Overseas economies	Have grown moderately on the whole, although some weakness has been seen in part, reflecting trade and other policies in each jurisdiction. ⇒ Unchanged	
Exports and industrial production	Have continued to be more or less flat as a trend, although there has been some front-loading and a subsequent reactionary decline, due to the increase in U.S. tariffs. ⇒ Unchanged	
Business fixed investment	Has been on a moderate increasing trend. ⇒ Unchanged Corporate profits have remained at high levels on the whole, although downward effects due to tariffs have been seen in manufacturing. ⇒ Downward revision from previous "have been on an improving trend"	
Private consumption	Has been resilient against the background of an improvement in the employment and income situation, despite weakness in consumer sentiment due to the impact of price rises and other factors ⇒ Unchanged	
Public investment	Has been more or less flat. ⇒ Unchanged	
Housing investment	Has been relatively weak. ⇒ Unchanged	
Financial conditions	Have been accommodative. ⇒ Unchanged	
Prices	With moves to pass on wage increases to selling prices continuing, the y/y rate of increase in the consumer price index (CPI, all items less fresh food) has been in the range of 2.5-3.0 percent recently, due to the effects of the rise in food prices, such as rice prices, and other factors. Inflation expectations have risen moderately. ⇒ Downward revision from "range of 3.0-3.5 percent" in the previous assessment to "the range of 2.5-3.0 percent." Descriptions about inflation expectations have been left unchanged.	
Outlook		
Japan's economic growth	Is likely to moderate, as trade and other policies in each jurisdiction lead to a slowdown in overseas economies and to a decline in domestic corporate profits and other factors, although factors such as accommodative financial conditions are expected to provide support. Thereafter, Japan's economic growth rate is likely to rise, with overseas economies returning to a moderate growth path.	
Prices	With regard to the CPI (all items less fresh food), the effects of the recent rise in food prices, such as rice prices, are expected to wane. Meanwhile, underlying CPI inflation is likely to be sluggish, mainly due to the deceleration in the economy. Thereafter, however, underlying CPI inflation is expected to increase gradually, since it is projected that a sense of labor shortage will grow as the economic growth rate rises, and that medium- to long-term inflation expectations will rise. In the second half of the projection period of the July 2025 <i>Outlook for Economic Activity and Prices</i> , underlying CPI inflation is likely to be at a level that is generally consistent with the price stability target.	
Risk factors	It remains highly uncertain how trade and other policies in each jurisdiction will evolve and how overseas economic activity and prices will react to them. It is therefore necessary to pay due attention to the impact of these developments on financial and foreign exchange markets and on Japan's economic activity and prices.	

Source: BOJ; compiled by Daiwa.

The BOJ largely stuck with its previous language regarding current and forecast economic activity and inflation, maintaining its view that "in the second half of the projection period...underlying CPI inflation is likely to be at a level that is generally consistent with the price stability target." As in the July *Outlook for Economic Activity and Prices* report (*Outlook Report*), the BOJ also noted "high" uncertainty about overseas economic and inflation trends.

We have a positive view of the 16 September cut in US auto tariffs (from 27.5% to 15%), which reduced uncertainty about US-Japan tariff negotiations. However, we see three remaining uncertainties: (1) trends at Japanese firms, mainly in the manufacturing industries that are readily affected by US tariff policy, (2) US economic trends, and (3) the domestic political landscape.

We think these lingering uncertainties will prevent the BOJ from sending a proactive message about rate hikes. Uncertainty about the US economy in particular is increasing, including the downside risks to US employment data cited at the September FOMC. Given the timing, we focus at today's press conference on how far off the BOJ's next rate hike is (i.e., the extent to which it leaves open the possibility of a hike within 2025).

Three remaining uncertainties: (1) Trends at Japanese firms

As noted, we see three remaining uncertainties regarding the BOJ's next rate hike: (1) trends at Japanese firms, mainly in the manufacturing industries that are readily affected by US tariff policy, (2) US economic trends, and (3) the domestic political landscape.

On trends at Japanese firms, the Summary of Opinions from the July MPM noted that "at least two to three more months are needed to assess the impact of U.S. tariff policy", suggesting that the BOJ still lacks sufficient data. However, if the September BOJ Tankan (scheduled for release on 1 Oct) and 6 October BOJ branch manager meeting report confirm upbeat corporate trends, we think this would give the BOJ more data on which to base its assessment.

The Asahi Shimbun reported that some BOJ officials are of the view that tariffs will have less impact than expected, with little adverse effect on wage hikes. [The Business Outlook Survey](#) released on 11 September indeed showed strong corporate activity. We think [the September BOJ Tankan](#) is likely to confirm similarly upbeat trends.

Three remaining uncertainties: (2) US economic trends

In contrast, uncertainty about US economic trends is increasing. The Fed cut its policy rate by 25bp at the 16-17 September FOMC meeting to address downside risks to employment, following the clear evidence from July and August payrolls data that the job market is weakening.

However, the Summary of Economic Projections (SEP) from the FOMC revised up the Fed's 2025-2027 forecasts, which are relatively firm despite downward pressure from tariff policy. This gels with Governor Ueda's comments at his press conference after the July MPM that the US economy is set to slow in 2025 but gradually recover from 2026, referencing the IMF's global economic outlook.

The key point in the BOJ's decision on whether to raise interest rates will therefore be confirming whether US growth is set to recover from 2026 (i.e., the potential for a soft landing). However, assessing this will likely take more time.

Three remaining uncertainties: (3) Domestic political landscape

The political landscape in Japan is another current uncertainty. The LDP is scheduled to hold its leadership election on 4 October, and we will be monitoring the continuity of monetary policy and financial markets' reaction. However, we think uncertainty is likely to ease from 4 October once the election outcome is known.

To sum up, we think uncertainty about corporate trends and the political landscape in Japan is likely to ease from October. However, we expect uncertainty about US economic trends to persist,

and think confirming the potential for a US soft landing in particular will be a key factor in the BOJ's future rate-hiking decisions.

Focus points at press conference: Prospects for rate hike within 2025

At Governor Ueda's press conference today, we look to gauge how the above three uncertainties affect the timeline until the BOJ's next rate hike. We expect him to stick with the BOJ's existing policy that "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."

That said, we think Governor Ueda's comments are unlikely to signal a near-term rate hike given ongoing uncertainties. We expect him to state that the cut to US auto tariffs reduced uncertainty and that recent economic and inflation trends are broadly as forecast, while noting the potential for tariffs to have an impact in future and the need to assess this impact. We also expect him to restate the view that growing uncertainty about the US economy creates considerable downside risk for the Japanese economy.

However, we think the BOJ will want to maintain a free hand given that two Policy Board members advocated a rate hike at today's MPM, solid corporate activity in Japan, and above-forecast inflation mainly for food. We look to confirm at the press conference to what extent the window is open for rate hikes within 2025. More specifically, we focus at the press conference on whether growing uncertainty about the US economy leads Governor Ueda to emphasize this as a downside risk, and whether it maintains a free hand on the basis that some of the necessary data will be forthcoming within 2025.

Today's nationwide CPI print confirmed that inflation mainly for food continues. However, upside risks to inflation have not materially increased since the July MPM, and we expect Governor Ueda to reiterate his comments from the July press conference that inflation is set to begin falling and that the BOJ will continue to monitor the data while acknowledging the risk that food prices could affect underlying trends. However, today's meeting confirmed that some Policy Board members advocate raising interest rates based on concerns about upside risks to inflation. We also expect attention to focus on Governor Ueda's perceptions as a clue to the balance of views on inflation within the BOJ.

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