

Daiwa's View

Signaling possible rate hike within this year

- Proposal from two BOJ policy board members for rate hike came as a surprise, significantly boosting market expectations for such a hike
- Twist-flattening of yield curve points to recovered confidence in BOJ's policy responsiveness plus waning concerns about falling behind curve
- Focus now on US economic trends, shift in BOJ policy board balance with two members supporting rate hike

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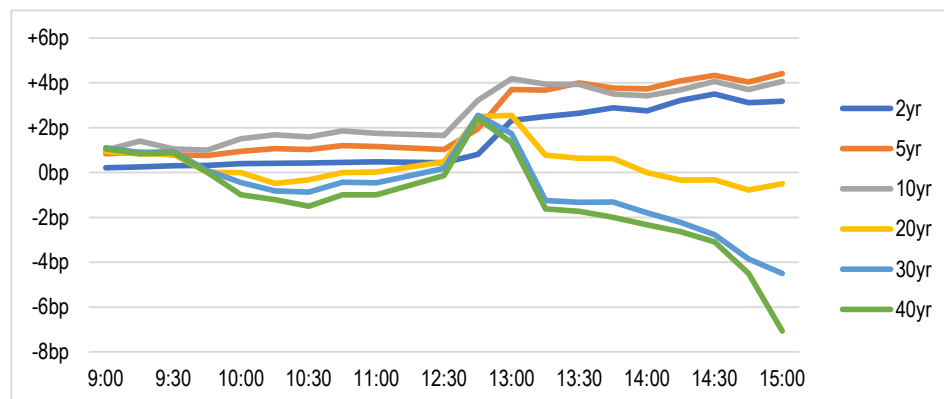
Daiwa Securities Co. Ltd.

At the BOJ's Monetary Policy Meeting on 19 September, two members cast dissenting votes for the first time since Kazuo Ueda became BOJ Governor. Board members Naoki Tamura and Hajime Takata each proposed raising the policy interest rate to 0.75%, maintaining the stance they had consistently held since the July meeting's [Summary of Opinions](#). Tamura's reasoning was, "The risk of rising prices is increasing and we need to move closer to the neutral rate of interest." Takata's rationale was, "The norm of stable prices has shifted and the price target has been achieved for the most part."

Actions speak louder than words. These "actions" (dissenting votes from two board members and decision regarding disposal of BOJ-held ETFs and other assets) had a strong impact on the market. Indeed, the probability of a rate hike at the next meeting in October increased to 52% from 34% on 18 September, one day earlier. Particularly noteworthy is the fact that Tamura also cast a dissenting vote at the December 2024 meeting, immediately preceding the January 2025 meeting where the last rate hike was implemented. This precedent led to market speculation that a rate hike would be implemented at the next meeting following the dissenting votes by two committee members, further amplifying the sense that a rate hike is now imminent.

Easing concerns about behind-the-curve risks seen in yield curve twist-flattening

Following the announcement of that decision, a distinctive twist-flattening pattern was observed in the JGB market. This represents a contrasting movement, with the 2-year JGB yield rising by 3.5bp while the 30-year JGB yield fell 4bp. This clearly demonstrates that the BOJ's [behind-the-curve concerns](#), which had been shared by some in the market, have eased following this hawkish surprise.

D/d Change in JGB Yields

Source: Compiled by Daiwa.

Takaichi's candidacy announcement and market's calm reaction

On that same day (19 Sep), just after the BOJ announced the results of its policy board meeting, former Japanese Economic Security Minister Sanae Takaichi officially announced that she will run in the ruling Liberal Democratic Party's leadership race (party election to be held on 4 Oct). Takaichi is seen as a proponent of monetary easing and expansionary fiscal policy. As market participants view her as one of the leading candidates, the content of her press conference was closely watched. However, super-long JGB yields continued to decline as the market stressed easing concerns about falling behind the curve via the further pricing in of a likely BOJ rate hike.

As for Takaichi's press conference, while she is a leading candidate, her chances of winning are currently not seen as particularly high. Also, content from her press conference included no significant changes from the previous day's reports, as well as no indication of further aggressive fiscal expansion beyond market expectations. As such, she did not provide any material that would encourage further factoring in of higher yields due to fiscal expansion following a potential Takaichi victory. Furthermore, the fact that Takaichi's press conference did not provide an opportunity to address monetary policy (a key point of interest beyond fiscal matters) also contributed to the absence of [twist-steepening yield curve pressure](#).

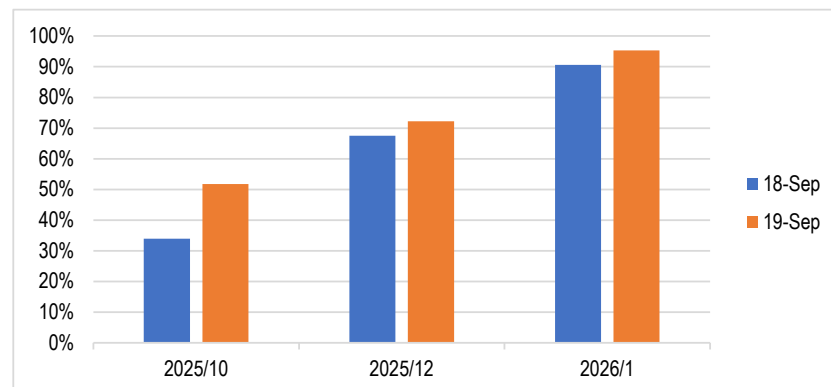
Subtle risk perception shift seen in BOJ Gov Ueda's press conference

BOJ Governor Kazuo Ueda's post-meeting press conference was largely consistent with the content of [the Bank's Outlook Report](#) released at the previous meeting in July. The US economy has been weakening due to the additional tariffs the US has imposed on various other countries. As a result, the BOJ is wary of the downside risks to prices and the economy stemming from a potential decline in Japanese exports. Ueda has consistently identified the impact of these tariffs as a key factor in determining interest rate hikes.

However, one noteworthy point is the subtle shift in Ueda's perception of risk. A reporter asked, "In the previous *Outlook Report*, the Bank determined that downside risks outweighed upside risks in the economic outlook. Has this assessment changed?" Ueda responded by saying, "We still recognize that there is downside risk to 'some extent.' Downside risks to the US economy have not materialized so far, but the possibility remains that they could emerge going forward." This wording gives the impression that risk awareness has softened somewhat compared to before.

This may simply be Ueda's personal view and so does not necessarily directly influence the Bank's overall decisions. Still, considering that two board members also proposed a rate hike, it is reasonable to conclude that such a hike is closer than before.

Rate-hike Probability (OIS) as of Each MPM



Source: Bloomberg; compiled by Daiwa.

Future outlook and key points to monitor

The market reaction (rising short/medium-term yields and falling super-long yields) is understandable given the heightened sense of an imminent rate hike following the BOJ's meeting.

The twist-flattening of the yield curve due to easing [concerns about falling “behind-the-curve”](#) can be viewed as a consistent movement, theoretically speaking.

That said, while Takaichi's press conference to announce her candidacy contained only expected content, it also left the impression of a highly eloquent event that leveraged her extensive political experience. The market had already priced in the possibility that Agriculture Minister Shinjiro Koizumi would be the frontrunner, so it did not react to her press conference advocating fiscal expansionary policies, which was within expectations. However, watching this press conference, we could sense the possibility that Takaichi might gain the upper hand during the debates, forcing us to once again consider the risk of Koizumi losing momentum, as he did during the previous election.

While Koizumi is seen as the frontrunner, it is noteworthy that former LDP Digital Transformation Minister Taro Kono, who had previously urged the BOJ to raise interest rates, has declared his support for Koizumi. Should Koizumi come to power, Kono's influence could grow significantly. In that case, we should also consider the possibility that politics might become a driving force rather than a constraint on interest rate hikes.

The BOJ's latest decision eased [concerns about falling behind the curve](#) and produced twist-flattening of the JGB yield curve. Still, it remains unclear whether these conditions will stabilize. Attention will now focus on the outcome of the election debates. If Takaichi's chances of winning increase, her current views on monetary policy, which were not disclosed this time, will become a key point of focus.

(Kawahara)

Ueda's press conference: Focus on assessing US economy (Minami)

At his post-meeting press conference in September, Ueda explained the impact of the US tariff policies as, “The time required remains highly uncertain.” This suggests that while downside risks have not materialized, they exist to “some extent.” The tone of the “some extent” remark also suggests a view that downside risks have somewhat eased, given the relatively robust state of the Japanese economy. He then stated, “I'd like to see a bit more data and information,” reaffirming his flexible stance (= free rein) regarding rate hike decisions.

What are the BOJ check points?

However, the more important point is when exactly will Ueda have this “bit more data.” First, Ueda stated that regarding the current state of the US economy, tariffs are impacting some corporate actions and, “There are signs that US employment is slowing down.” That said, the “strong capital investment, supported by AI and deregulation” factors are at work and the economy remains resilient. Still, Ueda said, “We do not have a clear idea of the possible conditions once tariffs are passed on to consumer prices.”

Regarding the impact on the Japanese economy, Ueda stated that, “It is not yet starting to have a significant impact at this point.” He added that, under the typical case, “Tariffs are passed to US consumer prices, causing US consumption to decline and Japanese exports to fall.”

At this juncture, while a gradual rise in goods prices due to tariffs has been observed in regards to US consumer prices, no sharp movements have been confirmed. It will likely take several more months of observation to determine with certainty the extent to which tariffs will be passed on to US prices, or whether such passing on of costs will remain limited.

Rate hiking momentum could increase depending on balance within policy board

Meanwhile, two policy board members (Takata and Tamura) calling for a rate hike at the September meeting is a significant development. Regarding prices, Ueda explained, “The inflation rate for food prices is expected to decline and underlying prices are likewise a ‘temporary factor’.”

As such, the BOJ has maintained its usual stance. However, this is merely the central view within the BOJ and we still need to confirm the balance of views among policy board members.

According to the Summary of Opinions following the July meeting, there were already scattered reports pointing to upward pressure on prices. We must pay close attention to the balance of price perceptions within the policy board based on the next Summary of Opinions due out on 30 September. If the views of members like Takata and Tamura were to gain traction, the momentum for hiking interest rates would likely increase.

Future materials include the BOJ's Tankan Survey (1 Oct) and the BOJ branch managers' meeting report (6 Oct), which should provide insights into corporate trends. Also, the basic framework for the 2026 annual spring labor-management wage negotiations (mid-October) will also reveal the momentum for union-based wage increases. Also, in addition to remarks by BOJ Deputy Governor Shinichi Uchida (2 Oct) and Ueda (3 Oct), speeches will be made by policy board members Tamura (16 Oct) and Takata (20 Oct), who both supported a rate hike at this meeting. Depending on corporate trends, the BOJ's external communications could potentially shift toward a more positive stance on interest rate hikes.

Oct rate hike obstacles

The biggest obstacles to an October rate hike could be the state of the US economy and the FOMC's policy decisions. As mentioned earlier, one of the key checkpoints that the BOJ prioritizes is "likelihood of a soft landing for the US economy." Confirming that point will still take some time. This could be the first hurdle.

Also, amid clear signs of weakening employment in the July and August US employment statistics, the September FOMC participants' policy rate projections (dot plot) showed a majority vote of 10 to 9 indicating that three consecutive rate cuts, including September, would be appropriate. If the FOMC decides to cut rates at its October meeting, the date of the statement's release will coincide with the BOJ's announcement of its own monetary policy decision. The very fact that these announcements coincide is one factor making an October rate hike difficult.

That said, during his post-meeting press conference, Ueda said, "The Fed's interest rate cuts should support the US economy." In other words, a risk-management-driven rate cut amid persistently weak US employment should inherently act to increase the likelihood of a "soft landing for the US economy." When making forward-looking policy decisions, we expect that the Fed's series of rate cuts could actually serve as a factor supporting BOJ rate hikes.

In addition, given that both Takata and Tamura have indicated their support for raising interest rates, the likelihood of a rate hike occurring within the year is seen as increasing. We continue to expect the next rate hike to occur during the Oct-Dec period.

More than 100 years to dispose of ETFs, very high hurdle for resuming such purchases

[At the September meeting](#), the BOJ also decided to start selling off its holdings of ETFs and J-REITs. Based on past experience, these sales will be conducted using a scale commensurate with the sales amount (¥330bn annually for ETFs, at book value).

However, during his post-meeting press conference, Ueda said that it would "take more than 100 years" to complete the disposal of ETFs held by the Bank. This is an exit strategy for an endless journey. Ueda also indicated that, "In the event of significant changes, reviews will be made from the basic policy and, as necessary, determine appropriate responses at meetings." Here, he signaled a stance of providing the utmost consideration for the market.

Ueda also said, "While we cannot see this through to 100 years from now, by documenting the decision-making process and fundamental principles, we can pass on this insight to the next generation of board members." The difficulties of striking a balance with the market when

purchasing risk assets through unconventional monetary policy (exit strategy difficulties) will likely be passed down to the next generation.

The BOJ's "Review of Monetary Policy from a Broad Perspective" published in December 2024 pointed out that, "Unconventional monetary policy measures cannot fully substitute for short-term interest rate control, and it is desirable to conduct monetary policy so that the zero lower bound would not be reached." The hurdle for resuming such unconventional measures has been raised. In particular, the announcement of a policy to gradually sell off ETFs over an extremely long period has set an extremely high bar for the future resumption of ETF purchases.

(Minami)

Decisions on Disposal of ETFs and J-REITs (Sep 2025 MPM)

Fundamental principles for the disposal

The Bank should dispose its holdings of ETFs and J-REITs for adequate prices, taking into account the condition of the financial markets.

The Bank should avoid incurring losses as much as possible.

The Bank should avoid inducing destabilizing effects on the financial markets as much as possible.

Experience of the sales of the "stocks purchased from financial institutions"

The Bank completed in July 2025 the sales of the stocks purchased for financial stability purposes, while avoiding major market impact.

1. The Bank will sell its holdings of ETFs and J-REITs to the market at a scale generally equivalent to that of the sales of the "stocks purchased from financial institutions."

	Stocks (completed)	ETFs	J-REITs
Pace of sales (amount per year)*	Book value (Market value) About 150 billion yen (About 620 billion yen)	About 330 billion yen (About 620 billion yen)	About 5 billion yen (About 5.5 billion yen)
Proportion to the trading value	About 0.05%	About 0.05%	About 0.05%

* The Bank will sell each ETF and J-REIT at the amount approximately proportionate to the share of each asset in its holdings, with consideration to spreading out the timing of the sales.

2. A framework supporting the stability in the financial markets will be provided.

- Under the pace of sales described above, the trustee may temporarily adjust the sales amount or suspend the sales, in response to changes in the condition of the financial markets.
- The pace of sales may be modified at future MPMs, based on the fundamental principles and the experience from the sales to be conducted.

3. The disposal will begin once necessary operational preparations are completed.

Source: Reprinted from BOJ materials.

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