

Daiwa's View

FICC Research Dept.

Will overlapping Fed and BOJ meetings and domestic political situation constrain rate hike by BOJ?

- An additional "risk management" rate cut by the Fed and the new administration's expansionary fiscal policy will serve as factors in mitigating downside risks for US and Japanese economies
- This will be a tailwind for the BOJ, which has been on a short pause from rate hikes due to concerns about downside economic risks
- Neither overlapping central bank meetings nor domestic political situation is expected to be a decisive constraint on raising rates in Oct

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Some think that the BOJ will avoid implementing policy action at the same time as a Fed rate cut. There are others who think that the BOJ will refrain from hiking rates until the new administration's policy direction is solidified. While, at first glance, it may seem plausible that the Fed's actions and domestic politics could constrain the BOJ, the central bank's decision will likely be made practically on a case-by-case basis. The following is my view regarding this issue.

Will BOJ avoid implementing policy action at the same time as the Fed?

An additional 25bp rate cut by the Fed is widely anticipated at the October FOMC meeting. (The OIS market puts the probability at 91%.) With the FOMC meeting scheduled for 28-29 October and the BOJ's Monetary Policy Meeting (MPM) scheduled for 29-30 October, some market participants think that the BOJ will forgo a rate hike at its October meeting in order to avoid implementing policy action at the same time as the Fed.

To state my conclusion at the outset, in this case, I do not think that the fact that the two central banks' meetings overlap will become a decisive obstacle to the BOJ implementing an additional rate hike.

Of course, if the US economy were on the brink of recession with a strong outlook for a series of rate cuts into a zone below the neutral interest rate, there would be ample reason to be cautious about conflicting with the Fed's policy actions. However, if the Fed were to proceed with an expected additional rate cut at its next FOMC meeting, it would be seen as a front-loaded "rate cut for risk management." That would increase the probability of a soft landing for the US economy, thereby easing the BOJ's concerns about downside risks.

Coincidentally, the OECD announced on 23 September that it made an upward revision to its economic outlook. The global growth forecast for 2025 was raised to 3.2% (+0.3ppt from the previous forecast), and the growth forecast for the US and Japan were raised to 1.8% (+0.2ppt), and 1.1% (+0.4ppt), respectively. Given these upward revisions, we think that the downside risks to the US and Japanese economies, which have been a source of concern for the BOJ, are likely to be further alleviated by the Fed's October rate cut (consecutive rate cuts).

The Fed's October rate cut means a reduction in such concerns by the BOJ, which has been on a temporary "short pause" from rate hikes since July due to caution about "downside risks." Therefore, in this case, I do not think that the additional rate cut by the Fed for risk management will become a decisive factor constraining an October rate hike by the BOJ.

Will domestic politics constrain a rate hike?

There are others who think that the LDP presidential election—for which the casting and counting of votes is scheduled for 4 October—will constrain a rate hike by the BOJ in October. While we are unable to deny the possibility that the LDP presidential election could become a constraining factor, I do not think that domestic politics will become a decisive obstacle in this case either.

This is because, with parties advocating for fiscal expansion, such as Sanseito and the Democratic Party for the People, having gained momentum in [the July Upper House election](#) that led to Prime Minister Shigeru Ishiba's resignation, the new administration's policy direction will likely feature more expansionary fiscal policies than before. In fact, all five candidates have stated that they would promptly formulate an economic stimulus package, including measures to address inflation, after taking office.

Of course, the scale of fiscal expansion will differ depending on which candidate is chosen. However, as long as the direction is more expansionary than the current stance, it will serve as a factor in mitigating the BOJ's concerns—downside risks to the Japanese economy and prices. A 9 September media report based on sources from those in the know also noted the possibility of upside potential for the economy and prices resulting from fiscal expansion.

◆ Bloomberg article based on sources from those in the know (9 Sep)

- The contest in the LDP presidential election following Prime Minister Ishiba's resignation is expected to center on former Minister for Economic Security Sanae Takaichi, who was one of the top contenders in last year's election, and Minister of Agriculture, Forestry and Fisheries Shinjiro Koizumi. **Those in the know pointed out the possibility of upside potential for the economy and prices resulting from fiscal expansion.**

(Note: The above is our translation.)

If this were the case, it would represent progress toward clearing one of the conditions for resuming rate hikes for the BOJ, which is temporarily pausing rate hikes due to concerns about near-term “downside risks.”

Ultimately, when considering this situation, it is important to understand what the BOJ currently perceives as primary risks, and how new events (here, the Fed's rate cuts and the LDP presidential election) will affect those risks. In this respect, the two factors discussed above are likely to reduce the “downside risks” the BOJ is currently focusing on. Therefore, they are unlikely to become a constraint on raising rates in this case. Upcoming events, such as speeches by Governor Kazuo Ueda on 3 October and by Deputy Governor Shinichi Uchida on 17 October, will likely make it clearer whether or not my view on this matter is correct.

Concerns about falling “behind the curve”

This is not my main scenario, but, if a new prime minister who favored large-scale fiscal expansion were to come to power, concerns about “upside risk” could intensify. This could force the BOJ to not only resume rate hikes, but to accelerate them. If that were to happen, and if the BOJ were to postpone a rate hike in an inexplicable manner, and rumors spread in the market that the new administration constrained a timely and appropriate rate hike by the BOJ, there would be a risk of a resurgence of concerns about being “behind the curve,” which have recently subsided. Furthermore, if the BOJ considers concerns by some market participants about being “behind-the-curve” to be a risk that cannot be ignored, we think that the chances are lower of us seeing the scenario play out that the market is currently wary of, in which the election of a certain new leader constrained a rate hike in October.

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