

Economic Commentary

FICC Research Dept.

September Tokyo CPI: Weaker-than expected on free daycare impact

- Roughly 0.3% drag on headline CPI from free daycare for children
- Food prices in line with BOJ's expectations
- Does not warrant further rate hike acceleration, but upside price risks persist

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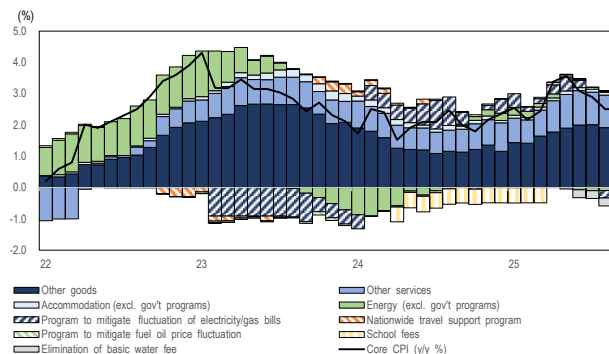
Weaker-than-expected CPI due to free daycare impact

Tokyo core CPI (headline excl. fresh food) for September 2025 was +2.5% y/y, unchanged from the August result, but lower than the market forecast of +2.8%. Core-core CPI (headline excl. fresh food and energy) was also +2.5%, contracting from +3.0% for August.

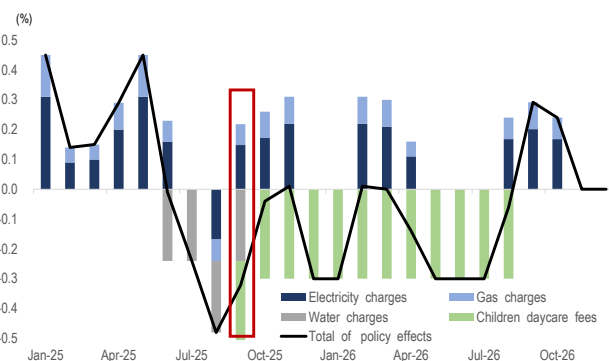
September core CPI (y/y) includes both upside and downward factors due to policy effects. First, the upward factor vs August stems from a drop off for government electricity/gas subsidies provided in September 2024. The government has resumed electricity subsidies for Jul-Sep 2025 and the downward effect will appear in CPI for the billing months of Aug-Oct. Meanwhile, the downward effect of similar subsidies last year was greater and, compared to the previous year, it became an upward factor. The electricity/gas subsidies, combined with Tokyo's decision to scrap basic water fees, pushed down the previous month's CPI by approximately 0.48%, including base effects (of previous year's policy). As of September, that effect had narrowed to approximately – 0.02%.

Meanwhile, this decline vs August can be attributed to the impact of free daycare for children. This implementation of free daycare in Tokyo for the first child starting in September 2025 contributed a drag of 0.3% on headline CPI.

The weaker-than-expected result this time was probably due to a failure to fully factor in the impact of free daycare for children. Indeed, the results were largely in line with market expectations when excluding the impact of free daycare. In other words, we think the underlying rate of inflation has remained largely unchanged. Of note, the October Tokyo CPI is expected to show stronger growth as the impact of scrapped basic water fees implemented from the Jun-Sep period drops off.

Breakdown of Contributions to Core CPI in ward-area of Tokyo

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

Impact of Inflation Measures on Tokyo CPI

Source: MIC; compiled by Daiwa.

Note: Base effects are included.

Food prices in line with BOJ's expectations, but risks are to the upside

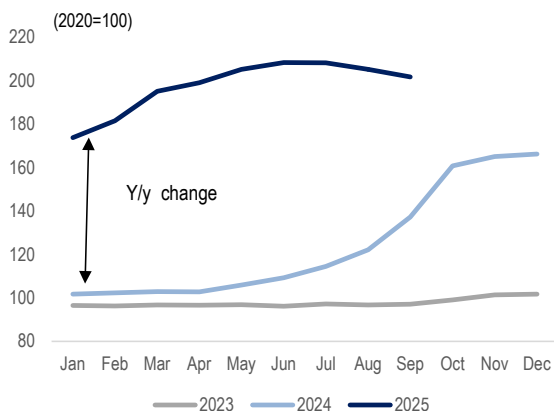
Core-core CPI growth (y/y) slowed due to the abovementioned factors, along with a drop off from the sharp rise in rice prices in September 2024. The contribution of rice prices to the headline CPI for August was +0.37%, but narrowed to +0.29% for September. The contribution of rice prices to the Tokyo metropolitan area CPI is also expected to decline significantly for October.

Following this y/y slowdown for the price of rice, y/y price growth for food excluding fresh food declined to +6.9% (+7.4% for Aug). Likewise, the m/m result slowed to +0.1% (+0.3% for Aug). Also, growth for food products (processed food) was +5.7%, narrowing from +6.0% for August.

Conditions for specific food items were somewhat mixed. Sushi (dining out), yogurt, fried chicken, and rice crackers contributed to price increases, while grilled eel, carbonated beverages, and prepared curry contributed to price declines. The y/y growth rate of food products, which had been on an upward trend, appears to be peaking. This trend is probably consistent with the BOJ's outlook that y/y food price inflation will gradually decline.

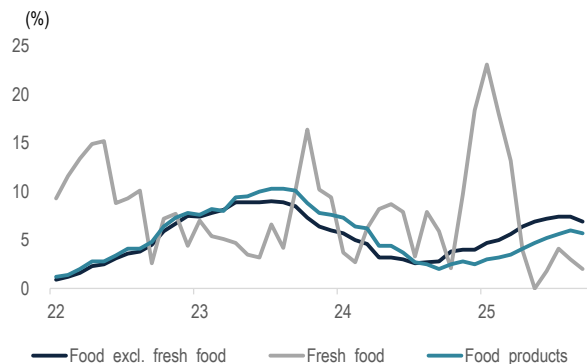
However, A Teikoku Databank survey of price revision trends among 195 major food companies shows that the number of items with price increases slightly exceeded last year's levels through October. This confirms a strong willingness to pass on costs (amid rising logistics and labor expenses) to prices. If there is a continuation of passing on such costs to processed food prices, that would pose a risk of the CPI landing point (long-term outlook) being pushed higher, which would require ongoing vigilance.

Price Level for Rice



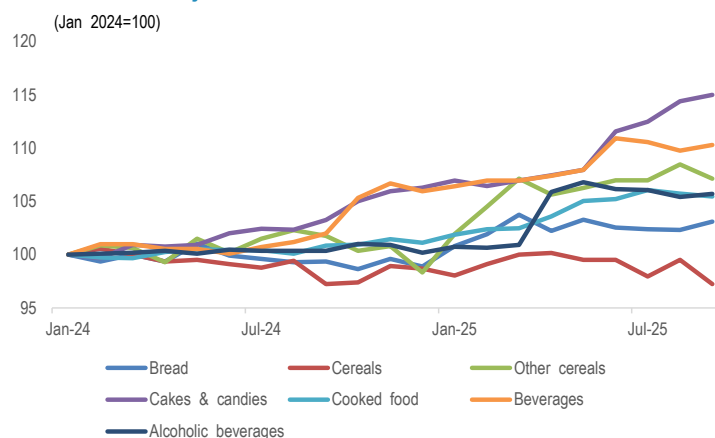
Source: MIC; compiled by Daiwa.

Y/y Change in Food-related Prices



Source: MIC; compiled by Daiwa.

Price Levels for Major Food Products



Source: MIC; compiled by Daiwa.

Price growth for other items limited, but strong desire to pass on costs to prices remains

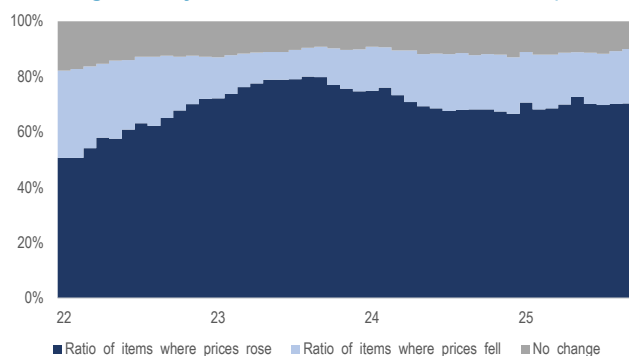
The headline reading for “all items, less food (less alcoholic beverages) & energy” was +1.0% y/y, narrowing from +1.5% for August. This was largely due to the elimination of daycare fees and the contribution from lower rice prices. However, even when excluding these factors, the rate of increase is low and price growth for items other than food items is viewed as limited.

In particular, y/y growth for other industrial products such as golf clubs and microwave ovens slowed to +1.7% (down from +2.4% for Aug). Also, durable goods prices declined 0.4% y/y (+0.6% for Aug), resulting in a y/y decrease. These trends are consistent with declining external costs, including import prices. That said, prices for general services were +2.3% y/y (+2.3% for Aug), unchanged from the previous month, but they continue to show relatively strong growth. We also confirmed persistent inflation driven by rising labor costs.

Also, in order to gauge the progress for passing on higher costs to prices, we looked at the proportion of items with rising and falling prices. The proportion for items with rising prices in the September core CPI increased to 70.3% (up from 70.1% Aug). The proportion of items with price increases was 81.3% for food excluding fresh food (81.8% for Aug), 64.1% for goods excluding food (64.5% for Aug), and 64.9% for services excluding dining out (62.3% for Aug). Price increases are continuing to spread at a high level.

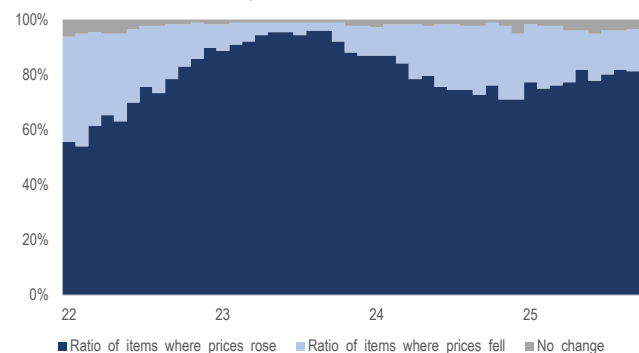
Considering that food prices are peaking (y/y), the September Tokyo CPI results likely suggest that the BOJ's outlooks are on track and, as such, further hastening of rate hikes is not warranted. That said, the risk of upward price pressures, particularly for food items, has not changed.

Percentage of Tokyo Items for Which Prices Rose/Fell (core CPI)



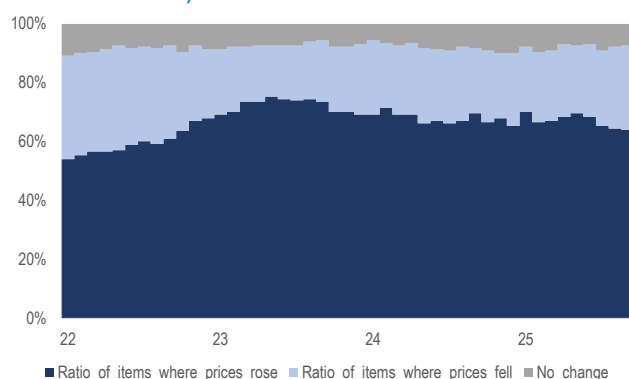
Source: MIC; compiled by Daiwa.

Percentage of Tokyo Items for Which Prices Rose/Fell (food excl. fresh food)



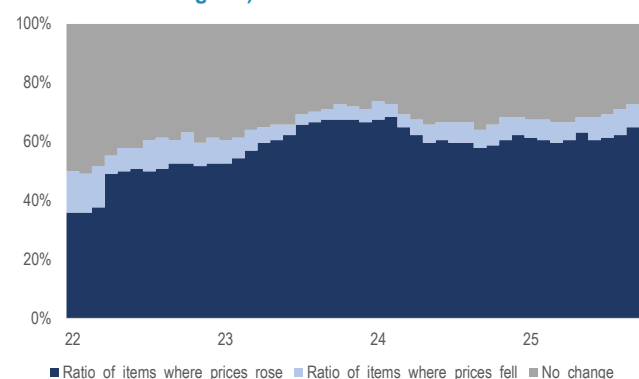
Source: MIC; compiled by Daiwa.

Percentage of Tokyo Items for Which Prices Rose/Fell (goods excl. food)



Source: MIC; compiled by Daiwa.

Percentage of Tokyo Items for Which Prices Rose/Fell (services excl. eating out)



Source: MIC; compiled by Daiwa.

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