Daiwa's Economic View

Considering next rate hike following press conferences by Ueda, Takaichi

- BOJ Governor Ueda could be most dovish board member following dovish press conference
- Political factors could delay rate hikes; key point for government/BOJ is confidence in stable growth path even amid tariffs
- Domestic economy/prices: Conditions warranting early rate hike
- Expect next rate hike within this year; still see 1% as terminal rate for rate hikes

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Note that Ueda could be most dovish board member after dovish press conference

On 3 October, BOJ Governor Kazuo Ueda delivered a speech before business leaders in Osaka. During his press conference following this speech, Ueda was asked about the impacts of tariffs on the Japanese and US economies. He responded, "Considerable uncertainties remain." Ueda also talked about the Bank's September Tankan survey, which indicated strength for corporate fundamentals. Here he said, "The likelihood of the Bank's outlook materializing is increasing." He went on to say, "If you ask me if the Tankan survey contains strong information, that's not necessarily the case." He expressed the view that Tankan survey results alone do not constitute a sufficient condition for raising rates.

Ueda also stated that regarding uncertainty, he will make judgments based on a comprehensive assessment of "hard data, interview data, and various perspectives on the macroeconomy." He will also make policy decisions at the stage in which, "The necessary level of discernment for policy judgment can be achieved." In this manner he has shown an attitude of making policy decisions without making predictions. In other words, the content of this press conference did not provide any hints for the timing of the next rate hike.

As for 2026 wage trends, Ueda stated that there is a lack of information on ''what path the US economy will take in the future, and what impact it will have on the Japanese economy.'' Ueda appears to be taking a cautious stance toward raising interest rates amid high uncertainty.

That said, considering the 29 September speech by Monetary Policy Board member Asahi Noguchi, as well as the Bank's "Summary of Opinions" released on 30 September, it is worth noting that Ueda may now be the most dovish member on the policy board. Moreover, as evidenced by the cautious stance on the US economy expressed at his regular post-meeting press conference in September, Ueda likely wants to assess as thoroughly as possible the state of US employment and price data, economic trends including the Christmas shopping season, and the Fed's policy stance (= have not yet decided on the timing for raising rates) at this juncture. The dovish remarks came from dovish Ueda and this press conference can be said to have delivered the expected content.

BOJ governor, deputy governors as key parties for determining next rate hike

However, based on the "Summary of Opinions," even though there are other members besides Hajime Takata and Naoki Tamura who are aiming for an early interest rate hike, we believe that their opinions do not represent a strong enough stance to propose a rate increase against the position of governor/deputy governors. In other words, the key parties for the next rate hike are still Ueda and the two deputy governors (particularly Shinichi Uchida). Whether Ueda, who is currently the most dovish member, will shift his stance toward raising rates will be important when considering the timing of the next rate hike.

Political factors could delay rate hikes

In this regard, political developments are likely to be the biggest obstacle to any shift toward raising rates. In the 4 October LDP presidential election, Sanae Takaichi was elected as the party's first-ever female president.

During her press conference following the LDP presidential election Takaichi said, "Economic policy requires the government and the Bank of Japan to work in concert." She added, "Both fiscal and monetary policy are the responsibility of the government, while the BOJ is tasked with examining and implementing the most appropriate measures." Takaichi expressed her understanding that, "It's premature to feel reassured that we've "escaped deflation" based solely on the passing on of costs to prices." She added, "Demand-pull inflation driven by strong demand is desirable. We must maintain close communication with the BOJ until that is achieved." These statements suggest a cautious stance toward an early rate hike by the BOJ.

Under the new leadership of Takaichi, the "continuity of monetary policy," which is a shared understanding held by the government and the BOJ, could now revert to a nearly "blank slate." With Takaichi aiming for "demand-driven, demand-pull inflation," it has become extremely difficult for the BOJ to complete its communications with the government by the time of the October Monetary Policy Meeting. In other words, given that the current dovish Ueda stated he would "ensure sufficient communication with whoever becomes prime minister" (3 Oct press conference), the likelihood of a rate hike before the October meeting has significantly diminished.

◆Excerpts from Press Conference by New LDP President Takaichi (4 Oct 2025 after LDP presidential election)

- Regarding new party policy, as I stated at the time of the run-off vote, I want the LDP to be one where we all work together, embodying the principles of "everyone contributing" and "mobilizing the full strength of all generations." Above all, we have no time to lose. We must convene an extraordinary session of the Diet as soon as possible and address the challenges facing many of our citizens with the utmost urgency. I intend to focus particularly on measures to combat rising prices.
- In accordance with the Bank of Japan Act, I believe economic policy should be pursued through close cooperation between the government and the Bank of Japan. We are working closely together, even inviting the Deputy Minister of Finance to attend BOJ meetings. Both fiscal and monetary policy are the responsibility of the government and I understand that the Bank of Japan is the institution tasked with examining and implementing the optimal measures.
- Currently, Japan remains in a situation characterized by a high degree of uncertainty. "It's premature to feel reassured that we've "escaped deflation" based solely on the passing on of costs to prices." Demand-driven, demand-pull inflation is desirable and we must maintain solid communication with the Bank of Japan until it is achieved. We will carefully consider whether the current state is optimal when reviewing the Accord.

Key point for government, BOJ is confidence in stable growth path even amid tariffs

Meanwhile, Takaichi's preference for "demand-driven demand-pull inflation" aligns closely with the cautious view of Ueda. Indeed, Ueda himself indicated that the current rise in prices, mainly involving food items, is "temporary," noting that the "trends among companies to pass on price increases to wages may weaken (due to the impact of tariffs)."

Moreover, it would be difficult for Takaichi to completely rule out the possibility of the BOJ hiking rates. During her post-election press conference, Takaichi said, "I particularly want to focus on measures to combat rising prices." As she said at her press conference after the presidential election, "I would like to focus especially on price measures," which she sees as the government's first priority. If the BOJ suspends rate hikes for an extended period, that could lead to further pressure to pass on higher costs to prices through channels such as the exchange rates, potentially prolonging high inflation.

Also, diplomatic considerations could make it difficult to rule out rate hikes. Indeed, in an interview with Bloomberg in August, US Treasury Secretary Scott Bessent said, "The BOJ is behind the curve. So, they're going to be hiking rates." He added that Japan needs to curb its inflation. Also, the "US-Japan Finance Ministers' Joint Statement" released in September, reaffirmed that, "Exchange rates should be market determined and that excess volatility and disorderly movements in exchange rates can have adverse implications for economic and financial stability."

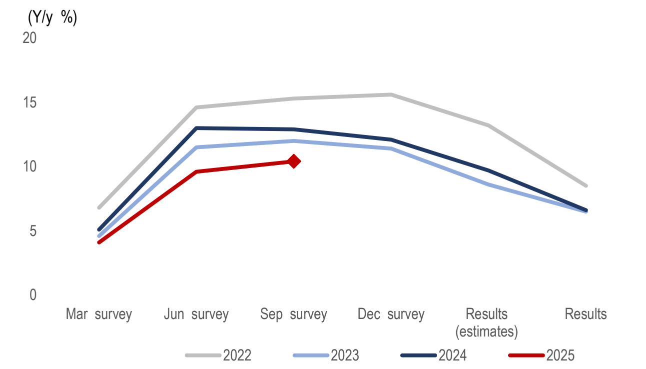
As noted in the Foreign Exchange Report released by the US Treasury Department in June, the "excess volatility" and "disorderly movements" highlighted in the joint statement would naturally include exchange rate fluctuations stemming from the BOJ's delayed rate hikes. Specifically, the report said, "BOJ policy tightening should continue to proceed in response to domestic economic fundamentals including growth and inflation."

Under these circumstances, the most important perspective in terms of communication between the government and the BOJ when deciding on the next interest rate hike is "confidence in a stable growth path even amid tariffs." If the BOJ's leadership, particularly Ueda, and the government reach agreement on that point, the conditions for proceeding with a rate hike will likely fall into place.

Domestic economy/prices: Conditions warranting early rate hike

Looking solely at Japan's economy, the conditions for the next rate hike are taking shape. The BOJ's Tankan survey for September confirmed solid business conditions among companies, with capex plans also showing strength exceeding expectations. Even though real exports are currently impacted by a pullback following a rush in demand before tariffs took effect, the level itself is high and remains strong overall. This strength for both domestic and external demand is increasing the likelihood that the economy possesses a certain degree of resistance to tariff shocks.

Fixed Investment Plans in BOJ Tankan (all-size manufacturers)



Source: BOJ; compiled by Daiwa.

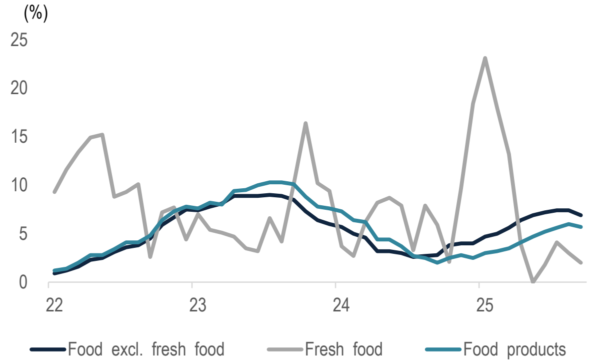
Real Import and Exports

Source: BOJ; compiled by Daiwa.

Meanwhile, on the price front, there are signs that the on-year rate of increase for food products has peaked. As for the Tokyo CPI for September, "food excluding fresh food" inflation slowed to +6.9% y/y in September from +7.4% in August due to a smaller contribution from rice prices. Processed food inflation also slowed to +5.7% from +6.0% in August. According to a survey by Teikoku Databank on price revision trends among 195 major food companies, price increases through October will exceed the previous year's levels, while food price hikes will pause temporarily in November. Taking all these factors into account, current price trends appear to be developing within the range anticipated by the BOJ, which views the rise in food prices as having "strong temporary aspects."

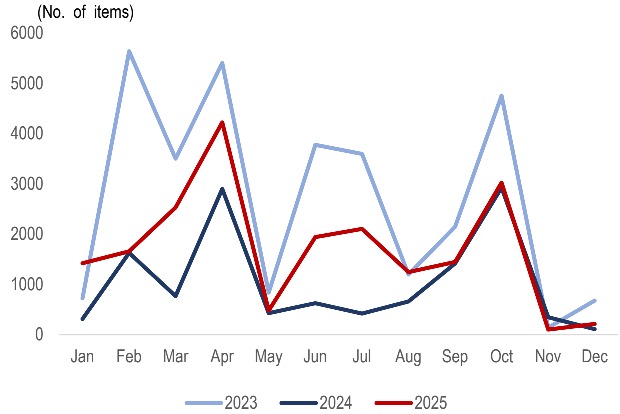
However, we believe that the balance of food price risks remains skewed toward upside risks, as factors such as increased intentions to pass on higher costs to prices. Given the current trends for Japan's economy and prices, it is conceivable that the BOJ should raise rates sooner rather than later.

Y/y Change in Food-related Prices



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

Number of Food Items with Price Increases



Source: Teikoku Databank; compiled by Daiwa.

Next hike still expected in 2025, with possible upward pressure on prices via fiscal/forex channels

When will confidence in the next rate hike start to strengthen? First, the next Tankan survey (Dec survey: due out on 15 Dec) is expected to provide a more accurate picture of corporate trends, taking into account the tariff impacts. Also, wage increase momentum can be gauged based on the Japanese Trade Union Confederation's (Rengo) policy for the 2026 spring wage negotiations (expected to be announced in early Dec). The December FOMC meeting will release the new members' Summary of Economic Projections (SEP) and other materials. Progress is expected in terms of assessing the US economy, which is a point of concern held by Ueda.

In addition to these circumstances, considering that upside price risks remain elevated even at this juncture, we maintain our assumption that the next rate hike will take place within this year. That said, in addition to food price trends, if risks of upward price pressures (particularly exchange rate-driven ones) do not intensify, the timing for a rate hike could potentially be pushed back to early next year. There remains a possibility that rate hikes could be pushed back to the beginning of the year, in order to more accurately confirm trends for higher wages emerging from the 2026 annual spring labor-management wage negotiations.

We continue to expect a 1.0% terminal rate for this rate-hiking cycle. From the perspective of communication with the government, the existence of two reasons for hiking rates (high prices and diplomacy) means that while the pace of rate hikes may slow due to caution, completely ruling out rate hikes is probably unlikely. Rather, if expansionary fiscal policies are implemented under the new LDP president Takaichi, the risk of upward pressure on prices could increase through both fiscal and forex channels. From the perspective of prices, the emergence of upward pressure has increased the likelihood of the policy interest rate climbing above 1%.

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