

Daiwa's Economic View

Risk of higher-than-expected prices due to weak yen

- Price increases may exceed *Outlook Report* forecasts due to current depreciation pressure on yen
- Will persistent yen weakness push up FY26 CPI by +0.2%?
- Weak yen could be BOJ's trump card for hiking interest rates

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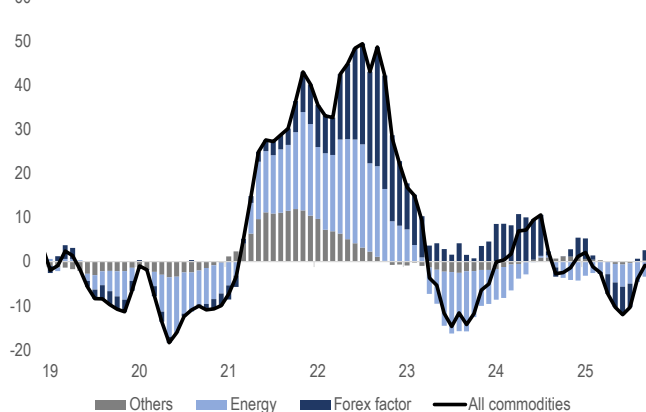
Risk of higher-than-expected prices due to weak yen

The yen has depreciated sharply by Y5.6, from USD/JPY147.47 to 153.07 over just four business days since the LDP president election. That said, the average exchange rate for FY24 is roughly USD/JPY152-153. Even if a weaker yen around USD/JPY153 were to take hold, that would not generate significant upward pressure on consumer price gains (y/y), unlike the yen depreciation pressure observed between 2022 and 2024.

Recently, the y/y change in import prices has been negative, holding near zero, and the gap between import prices and corporate prices has narrowed. According to the BOJ Working Paper "[Pass-Through of Cost-Push Pressures to Consumer Prices](#)," the import penetration ratio (indicates degree of imported goods within durable consumer goods) is estimated at approximately 33%. Our assessment is that the passing on of higher costs to prices from past yen depreciation-driven increases in import prices has significantly progressed.

Contribution to Import Price Index (Yen basis)

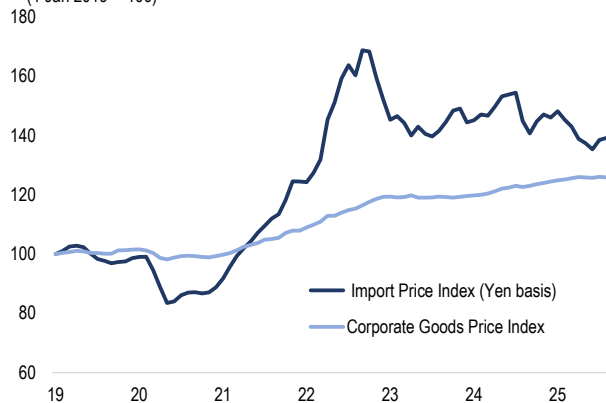
(Contribution, y/y %)



Source: BOJ; compiled by Daiwa.

Levels of Import Price Index and Corporate Goods Price Index

(1 Jan 2019 = 100)



Source: BOJ; compiled by Daiwa.

However, current yen depreciation pressures will likely result in a consumer price outlook exceeding the forecast in the BOJ's July *Outlook Report*. In that report, the BOJ projected core CPI of +2.7% for FY25, +1.8% for FY26, and +2.0% for FY27. However, it cited as a risk factor, "Future developments in foreign exchange rates and import prices, including international commodity prices, as well as the extent to which such developments will spread to domestic prices." The likelihood of those risk factors materializing is now increasing.

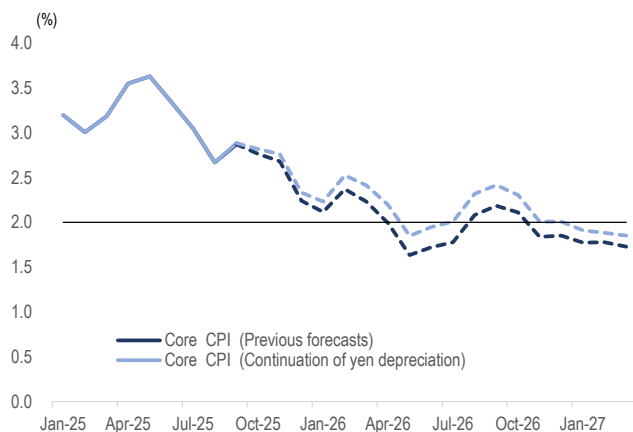
Will current persistent yen weakness push up FY26 CPI by +0.2%?

Looking at recent price trends, the y/y rate of growth for processed foods appears to have peaked out, based on [the September Tokyo CPI](#). As for our price outlooks, we now assume that CPI will decline towards +2.0% y/y, as the contribution from foods declines. We also expect core CPI for the Apr-Jun 2026 quarter to temporarily fall below 2.0%. Under that scenario, we expect core CPI of +2.8% in FY25 and +1.9% in FY26. That said, these price outlooks assume that the exchange rate will remain largely unchanged (around USD/JPY146).

Assuming that the current exchange rate level persists going forward, we can anticipate CPI for FY26 of +2.1% y/y. Also, we can expect CPI for FY25 to land at +2.85%.

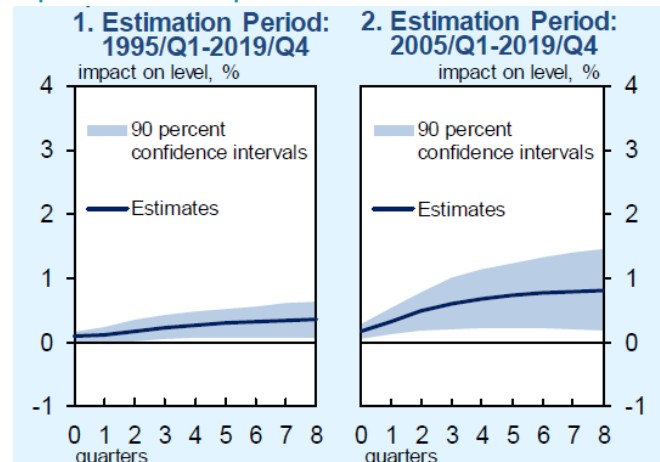
That said, the January 2022 *Outlook Report* indicated that yen depreciation of 10% pushed up CPI by about 0.8%. With companies increasingly passing on higher costs to consumer prices, caution is warranted regarding the risk that the current yen depreciation (around 4-5%) could result in higher-than-expected prices. At this juncture, estimates indicate that the y/y core CPI for the Apr-Jun quarter of 2026 will temporarily fall below 2%. However, it is increasingly likely that the timing for when core CPI will fall below the BOJ's 2% price target will be later than currently expected.

Our Forecasts for Core CPI



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

Impact of 10% Yen Depreciation on CPI



Source: Reprinted from BOJ Outlook Report (Jan 2022).

Weak yen could be BOJ's trump card for hiking interest rates

Currently, the BOJ is attempting to raise the underlying rate of inflation to 2%, while reducing the actual inflation rate towards 2%. Once both sides reach around 2%, the Bank will hike the policy interest rate to the neutral rate of interest. We see this as a very delicate and challenging path.

As indicated in the abovementioned estimates, even if the yen remains weak at around USD/JPY153, consumer prices are not expected to significantly exceed 2%. Indeed, CPI should remain around the 2% level. In other words, the recent foreign exchange movements do not raise significant concerns about the BOJ's path toward achieving 2% price stability.

However, given the secondary ripple effects stemming from the recent yen depreciation, there is an increasing risk that the underlying inflation rate will rise at a faster pace. Under such conditions, from the perspective of a risk management approach, there is no doubt monetary adjustments should be made as soon as possible. While there are [compelling reasons to hike rates](#), such as "high prices" and "issues involving the US," we believe that Takaichi's stance on BOJ rate hikes has become more moderate than before. Indeed, Takaichi indicated at her 4 October press conference that she intends to respect the Bank of Japan Act. Moreover, the weak yen provides the BOJ leadership with a convincing argument for the government to support rate hikes.

The time needed for the government and the BOJ to reach a shared understanding within October is limited. This means there is only a narrow path for realizing an October rate hike. That said, Etsuro Honda, considered a key advisor to Takaichi, stated on 6 October that, "It would be difficult to proceed with a rate hike at the October meeting." His comment spurred on further yen depreciation, which in turn actually increased the likelihood of an October rate hike. Greater attention will likely be required regarding communication between the government and the BOJ following the formation of the new cabinet.

Also, monetary policy board member Asahi Noguchi's speech on 29 September, as well as [the Summary of Opinions for the 18-19 September meeting](#) (released on 30 Sep) confirmed that momentum for a rate hike was building among board members other than just Hajime Takata and Naoki Tamura, who had proposed a hike at the September meeting. Given this situation, even if the BOJ refrains from raising interest rates at its October meeting, it is increasingly likely that members other than Takata and Tamura will propose a rate hike.

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