Daiwa Securities

Daiwa's Economic View

Considering possibility of early rate hike

- Conditions for April rate hike: (1) higher-than-expected inflation, (2) progress communicating with government
- Need to remain cautious regarding possible emergence of higher-than-expected inflation
- Higher April rate hike hurdles if Lower House dissolved for snap election at start of regular Diet session

FICC Research Dept.

Kento Minami
81-3-5555-8789
kento.minami@daiwa.co.jp

Kenji Yamamoto
81-3-5555-8784
kenji.yamamoto@daiwa.co.jp

Daiwa Securities Co. Ltd.

Increasing likelihood of early rate hike

The "Summary of Opinions" for the December 2025 BOJ Monetary Policy Meeting (MPM) indicated that the outlook for economic activity and prices among board members is shifting toward the upside, triggered by exchange rate (yen depreciation) and fiscal policy developments. Indeed, this was indicated in the "Summary of Opinions" statement, "The yen's depreciation and the rise in long-term interest rates reflect to some extent the policy interest rate being too low relative to the inflation rate." Awareness is beginning to emerge within the BOJ regarding the harmful effects of excessively low real interest rates. Given that recognition, we can assess that the pace of interest rate hikes is more likely to accelerate.

Regarding the timing of the next rate hike, assuming the earliest possible scenario, we think the MPM scheduled for 27-28 April 2026 could be a particularly relevant meeting. This is because the first round of responses to the 2026 annual spring labor-management wage negotiations will be announced on 23 March 2026. (March meeting to be held on 18-19 Mar 2026).

That said, we view assessing the impact of the December 2025 rate hike (policy interest rate +0.5% → +0.75%) to be one of the key conditions for the next rate hike. Following that assessment period, we anticipate an interest rate hike during the Jul-Sep quarter of 2026. (For details, see our 22 Dec 2025 *Daiwa's View: Government/BOJ's policy mix contradictions = "maintaining degree of monetary easing."*

Still, if the BOJ decides to raise interest rates at its April 2026 meeting, the following points would be crucial from the perspective of the economy and prices: (1) confirmation of high wage increases achieved during the 2026 annual spring labor-management wage negotiations, (2) "stickiness" seen amid the rising prices in the Jan-Mar quarter of 2026, and (3) emerging concerns that the passing on of high costs to prices will spread going forward, driven by such factors as yen depreciation (= increasing risk of higher-than-expected inflation). Furthermore, sufficient progress in terms of communication with the government will also likely be an important condition when raising the policy interest rate to 1%.

The BOJ released its branch managers' meeting report on 8 January, which included the statement that, "With corporate profits remaining high overall and a strong sense of labor shortages persisting, many companies believe it is necessary to implement wage increases in FY26 on par with those for FY25, from the perspective of better employee retention and improved morale." As such, it seems that confidence within the BOJ regarding the outcome of the 2026 annual spring labor-management wage negotiations has already strengthened.

Will inflation really decline?

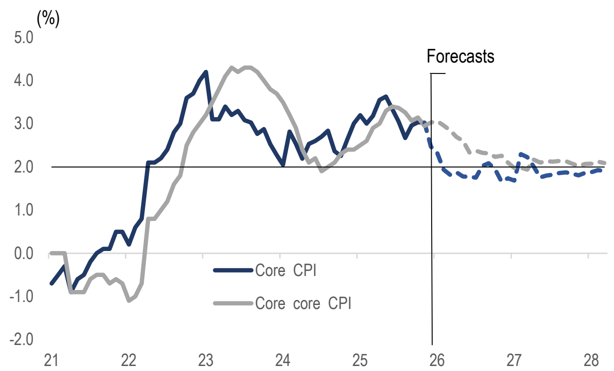
The most important condition for an April rate hike is the emergence of higher-than-expected inflation risk. As for the future outlook for prices, we expect core CPI to decline significantly with a drop below 2% starting in February 2026, driven by slowing food price inflation, starting with the US, and the effectiveness of government measures to address high prices. The BOJ's price outlook also indicates a similar view.

◆ **Economic Activity and Prices in Japan: Current Situation and Outlook (Dec MPM: 19 Dec 2025)**

- The year-on-year rate of increase in the CPI (all items less fresh food) is likely to decelerate to a level below 2 percent through the first half of fiscal 2026, with the waning of the effects of the rise in food prices, such as rice prices, and partly due to the effects of government measures to address rising prices. Thereafter, since it is projected that a sense of labor shortage will grow as the economic growth rate rises and that medium- to long-term inflation expectations will rise, it is expected that underlying CPI inflation and the rate of increase in the CPI (all items less fresh food) will increase gradually and, in the second half of the projection period of the October 2025 *Outlook for Economic Activity and Prices*, will be at a level that is generally consistent with the price stability target.

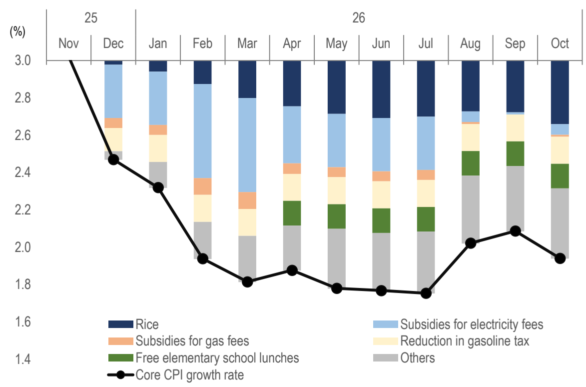
There are two main reasons why core CPI will decline going forward, specifically (1) y/y increase in rice prices is slowing and (2) effectiveness of government measures to address high prices. Specifically, even if rice prices remain flat going forward, the rice contribution alone will push down the core CPI by as much as roughly 0.3ppt compared to the level in November 2025. Furthermore, the government's measures to address high prices are expected to contribute to a maximum downward pressure of around 0.8ppt. Considering just these two factors, it is highly likely that core CPI will decline to around 2% by the Jan-Mar 2026 quarter. Also, we expect the contribution from food products excluding rice to also fall, with inflation seen dropping below 2%.

Our Forecasts for Core CPI and Core Core CPI



Source: Ministry of Internal Affairs and Communications (MIC); compiled by Daiwa.
Note: Based on the assumption that WTI crude oil price will stay around $60/bbl, and average USD/JPY rate will be Y150 for FY25, Y148 for FY26, and Y146 for FY27.

Differences in Our Core CPI Forecasts and Contributions from Nov 2025

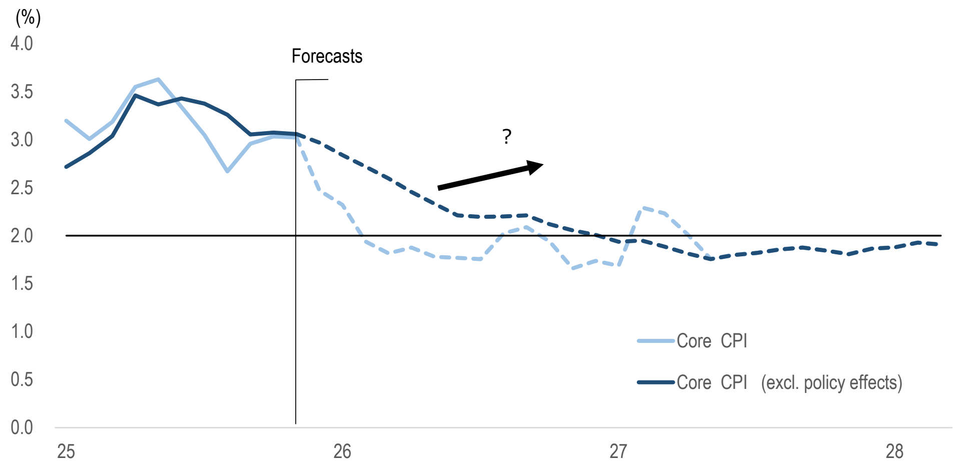


Source: MIC; compiled by Daiwa.
Note: The change in contribution from rice is estimated assuming the Nov 2025 price level remains unchanged.

Meanwhile, we should note that the core CPI decline is largely due to temporary downward pressure stemming from the government's measures to address high prices, as mentioned above. Central banks, including the BOJ, will assess long-term price outlooks by excluding temporary factors and then make monetary policy decisions accordingly. In this regard, excluding the impact of temporary measures to address high prices, we expect core CPI to decline to around 2% by around the end of 2026.

In other words, excluding temporary factors, we expect inflation to remain above 2% for the time being with the need to remain cautious regarding higher-than-expected inflation risks likely to persist. In particular, the BOJ's Regional Economic Report (*Sakura Report*) released on 8 January included the comment, "In response to cost increases due to the recent yen depreciation, we need to consider passing on higher cost to prices." It is impossible to rule out the possibility of further price increases due to higher costs. In particular, whether the passing on of higher costs to prices becomes widespread during the April 2026 price-revision period will be a key point to monitor.

Our Forecasts for Core CPI (excl. policy effects)



Source: Ministry of Internal Affairs and Communications; compiled by Daiwa.
Note: Core CPI (excl. policy effects) is calculated by excluding the impact of subsidies for electricity and gas, lower gasoline prices, free high school tuition, and free elementary school lunches.

Considering rate hike timing based on political schedule

One factor influencing the timing of the next rate hike is communication between the government and the BOJ. Here, dissolving the Lower House for a snap general election would be a very significant event. The *Yomiuri Shimbun* reported on 9 January that Prime Minister Sanae Takaichi is considering dissolving the Lower House at the start of the regular Diet session set for 23 January. Proposed schedules, assuming the Lower House is dissolved for a snap general election at the start of the regular Diet session, include "27 January announcement date, 8 February vote casting/counting date" and "3 February announcement date, 15 February vote casting/counting date."

Meanwhile, if the Lower House is dissolved at the start of the regular Diet session, the passage of the FY26 initial budget could be delayed until April or later (would expect formulation of a provisional budget at that time). As such, we expect deliberating and passing the Takaichi administration's first initial budget to take place in April. Furthermore, if the Takaichi administration secures public support via the Lower House election, the likelihood of the government shifting away from reflationary policy operations would also decrease. Under such circumstances, the hurdle for the BOJ to communicate with the government regarding an early interest rate hike would likely become considerably higher.

However, depending on the policies of the ruling Liberal Democratic Party (LDP), pledges during the Lower House election, and the election results, the yen could weaken further amid concerns that the LDP's expansionary fiscal policy stance might strengthen. Amid heightened risks of higher-than-expected inflation pressures triggered by factors such as yen depreciation, should favorable conditions emerge for the BOJ in terms of hiking rates, we could not rule out the possibility of an early rate hike.

Considering the political calendar, we currently anticipate that the most likely time for a rate hike is the Jul-Sep quarter of 2026. Meanwhile, amid growing concerns even within BOJ internal affairs about potential higher-than-expected inflation, caution is particularly needed for price and exchange rate movements during the Jan-Mar 2026 quarter. It is important to note that the timing for rate hikes could be brought forward, depending on such developments.

At its June meeting, we expect the BOJ to make an interim assessment of its JGB purchases. From the perspective of avoiding market turmoil, we believe that the Bank would prefer to avoid implementing this assessment and making a rate hike at the same time.

Key Schedule for 2026

※Blue text: Events with unconfirmed date
※Red text: Expected timeline for a dissolution of Lower House at the start of the Diet session

2026	Japan: BOJ	Japan: Government, etc.	US
Jan	**22–23:** MPM	**23:** Convening of ordinary Diet session	**27-28:** FOMC
Feb		**(1) Official announcement on 27 Jan and vote casting/counting on 8 Feb** **(2) Official announcement on 3 Feb and vote casting/counting on 15 Feb**	
Mar	**18-19**: MPM **31:** End of term for policy board member Noguchi	**15:** LDP annual convention **23:** First tally of responses for 2026 spring wage negotiations During Mar: Japan-US summit meeting	**17-18:** FOMC
Apr	**27-28:** MPM	**Passage of initial FY26 budget**	**28-29:** FOMC During Apr: US-China summit meeting
May			**15:** End of term for Chair Powell
Jun	**15-16:** MPM (Interim assessment of JGB purchase plan) **29**: End of term for policy board member Nakagawa	**14-16:** G7 summit **21**: End of ordinary Diet session During Jun: Cabinet approval of Basic Policies for Economic and Fiscal Management and Reform	**16-17:** FOMC
Jul	**30-31:** MPM	Early Jul: Final response date for 2026 spring wage negotiations	**28-29:** FOMC
Aug			Late-Aug: Jackson Hole Economic Symposium
Sep	**17-18:** MPM	**Formulation of economic stimulus package and convening of an extraordinary Diet session**	**15-16:** FOMC
Oct	**29-30: MPM**	Late-Oct: Announcement of basic framework for 2027 spring wage negotiation	**27-28:** FOMC
Nov		Late-Nov: Announcement of the policy for 2027 spring wage negotiations During Nov: APEC summit meeting	**3:** Midterm elections
Dec	**17-18:** MPM	Late-Dec: Cabinet decision on initial FY27 budget During Dec: G20 summit	**8-9**:FOMC
Note		By end-2026: Revision of three key national security documents	

Source: Various media reports; compiled by Daiwa.

IMPORTANT DISCLOSURES

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

Ratings
Issues are rated 1, 2, 3, 4, or 5 as follows:
1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices
Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities
Please refer to https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings
This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law
(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)
If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.
Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association