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Daiwa Securities

Daiwa's Economic View

BOJ's post-election options: Potential March rate hike, interest-rate risk scenarios

- April our base case for next rate hike
- High bar to March hike; would require sufficient upside risks to inflation to make BOJ concede it is behind the curve
- In March rate-hike scenario, long-term yields could near 3% by end-FY26

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Board member Masu's speech: Balanced message

On 6 February, Bank of Japan (BOJ) policy board Member Kazuyuki Masu delivered a speech at a meeting with business leaders in Ehime, in which he indicated that financial conditions "remain assuredly accommodative" and stated that, assuming that the BOJ's forecasts for economic activity and prices are realized, it will "adjust its degree of monetary accommodation." This was consistent with the BOJ's existing stance.

Mr. Masu noted that underlying inflation "is drawing very close to the 2 percent target," and stated that it will be vital to "ensure that, through timely and appropriate policy interest rate hikes, the underlying inflation rate remains below 2 percent." He also expressed caution about upside risks to inflation, noting the need to pay due attention to the possibility that "inflation triggered by the yen's depreciation may…affect underlying inflation." These remarks suggest some awareness of the potential need for preemptive rate hikes in the near future.

With the policy rate approaching the neutral range, Mr. Masu also stated that "it is critical to make sure that excessive rate hikes do not disrupt the virtuous cycle of a moderate rise in prices and wages that has finally begun to gain momentum in Japan. The Bank will therefore proceed cautiously with rate hikes," signaling his resistance to accelerating the pace of rate hikes. This is also consistent with an opinion in the Summary of Opinions from the January Monetary Policy Meeting (MPM), which we think can be attributed to Mr. Masu, that "if the pace of policy interest rate hikes is not too rapid, the Bank need not be overly concerned about the impact on firms' business performance."

◆ Summary of Opinions at Jan MPM (2 Feb 2026)

- Some firms with super-long-term investment projects and some small and medium-sized firms may be facing a heavy interest burden. However, for firms as a whole, the increased interest burden has been absorbed by the current solid business conditions to a large extent. If the pace of policy interest rate hikes is not too rapid, the Bank need not be overly concerned about the impact on firms' business performance.

At a minimum, we will need to wait for the 23 March release of the first-round responses from 2026 spring wage negotiations to confirm if the virtuous cycle between prices and wages is proceeding in line with Mr. Masu's view. Data on April price hikes will also be key in gauging how much companies are passing through the cost of wage hikes. Taking these factors into account, at this point we think Mr. Masu has not ruled out a rate hike as early as April but is not envisaging an even earlier move in March.

April hike our base case as views within BOJ shift to favor rate hikes

The 2 February Summary of Opinions from the January MPM included a number of opinions in favour of raising interest rates, suggesting that the BOJ could accelerate the pace of rate hikes. At his press conference following the January MPM, Governor Kazuo Ueda also indicated that he was alert to upside risks to inflation, stating that with exchange rates looking more likely to have a substantial effect on prices, "it is necessary to pay attention even to small movements."

At the press conference, Mr. Ueda also cited "the impact of past rate hikes" as one of the factors for judging the timing of the next hike, and indicated that the BOJ intends to gather information through interviews with firms on financial conditions, capex, and housing investment. It will likely collate this information via the Tankan survey to be released on 1 April and the branch managers' meeting report in early April. In other words, it is highly likely that the BOJ leadership also views April as the most likely candidate for the next rate hike.

◆ **BOJ Governor Kazuo Ueda's Regular Press Conference after Jan MPM (23 Jan 2026)**

- (Regarding changes in descriptions on exchange rates in the *Outlook Report),* one factor is that we are focusing on the possibility that domestic prices are becoming more responsive to exchange rates as wage and price-setting behaviors become more proactive. In addition, with the overall inflation rate having risen and underlying inflation also gradually rising toward 2 percent, even movements of the same magnitude as before now warrant closer attention. In other words, it is necessary to pay attention even to small movements.
- (On the impact of rate hikes) We do not necessarily intend to wait until the effects are reflected in the data for these variables; we aim to detect them at an earlier stage. In terms of how to do so, as I mentioned at the previous press conference, one approach is to monitor how the broader financial conditions that influence these variables are evolving. The other is to conduct frequent interviews with companies and other entities that make the decisions about business fixed investment and housing investment, and to carefully gather information on what their intentions are, which should give us a partial read on developments.

Barriers to March rate hike

However, as our Chief Economist Kenji Yamamoto noted in a 5 February report, the effects of the coordinated rate check by Japan and the US to support the yen are already fading. Given the upside risks to inflation from the upcoming fiscal policy-driven demand stimulus and weakening yen, we think the timeframe for the BOJ's next rate hike is shifting from "April at the earliest" to "April at the latest."

That said, we think several hurdles need to be cleared to move up the next rate hike to March. The main constraints are: (1) a lack of data on the key variables needed for a policy decision, and (2) the fact that recent price data show a disinflationary trajectory.

Firstly, the tabulation of first-round responses from the 2026 spring wage negotiations will not have been released as of the March MPM, severely limiting the data the BOJ can use to assess the outlook for economic activity and prices. With recent price data also weaker than forecast, the primary trigger for a rate-hike decision in March would be further substantial weakening of the yen. Accordingly, the rationale for a rate hike would inevitably depend on exchange rate trends (more precisely, on monitoring the impact of exchange rate movements on underlying inflation). Note that since the government is responsible for exchange rate policy, the BOJ would need to frame its explanation not in terms of exchange rate levels per se, but rather in terms of their impact on economic activity and prices.

However, the BOJ's current monetary policy guidance states that "if its outlook for economic activity and prices will be realized, the Bank, in accordance with improvement in economic activity and prices, will continue to raise the policy interest rate." Under this framework, would the BOJ be able to argue that exchange rate movements alone make its baseline scenario more likely to materialize? We think it would be difficult to assert that short-term forex moves by themselves make achieving its outlook more likely.

If the BOJ were to raise rates in March, its policy focus would be perceived as having shifted from its long-held approach of confirming the uptrend in underlying inflation, mainly via the mechanism in which wages and prices rise in interaction with each other, to responding to near-term upside risks to inflation (i.e., correcting the perception that it has fallen behind the curve). This could create issues about consistency with its previous policy communications. These factors suggest a high bar to a March rate hike.

Conditions for and benefits from March rate hike

As discussed, a March rate hike would become plausible if sufficient upside risks to inflation emerge to force the BOJ to acknowledge that it has fallen behind the curve. Market trends (mainly exchange rates) will be particularly decisive in assessing the likelihood of a March hike. In the near term, the Takaichi administration's fiscal stance will be a focus of attention.

The LDP secured more than 310 seats in the 8 February Lower House election, surpassing the two-thirds threshold for a supermajority. Attention will now turn to Prime Minister Sanae Takaichi's remarks at the press conference scheduled for 18:00 JST on 9 February, as well as the party leadership and Cabinet appointments to be made after the start of the extraordinary Diet session, which is currently being lined up for 18 February. The unofficial announcement of the successor to BOJ board member Asahi Noguchi, expected in mid-February or later, will also be important in gauging the government's expectations for the BOJ. If the government's actions signal a more expansionary fiscal stance or a reflationary bent, the yen could weaken further.

We see the danger zone where the weaker yen could begin to substantially affect inflation at around Y165/$ (for details, see *Daiwa's Economic View: Critical thresholds for yen weakness: Weak yen/price mechanism*). If there is a risk of the yen weakening beyond 165, and rate hikes rather than forex market interventions are the preferred tool for addressing yen weakness, the probability of a March rate hike would increase.

We would also note that a Japan-US summit is scheduled to be held in the US on 19 March. The agenda is expected to focus on cooperation on Japan's investment in the US and the security environment, and could also include discussions on increasing Japan's defense spending. However, we would also note that the effects of the coordinated Japan-US rate check have quickly faded given concerns about PM Takaichi's perceived acceptance of yen weakness (she remarked that as a result of the weak yen, the Foreign Exchange Fund Special Account's investments are now "in great shape"). This suggests that if the BOJ were to hike in March, it could in a sense act as a justification to push back against US pressure over the forex trend.

Should the yen continue to weaken, we will also be watching for changes in the BOJ's messaging. Speeches are scheduled by board members Naoki Tamura on 13 February and Hajime Takata on 26 February, followed by Deputy Governor Ryozo Himino on 2 March. The content of Mr. Himino's speech will be key in assessing whether a March rate hike is on the table.

(Minami)

Key Schedule

※Blue text: Events with unconfirmed date

2026	Japan: BOJ	Japan: Government/key indicators	US
Feb	**6:** Speech by board member Masu **13:** Speech by board member Tamura **26:** Speech by board member Takata	**8:** Lower House election (vote casting/counting) **9: PM Takaichi 's press conference** 18: Convening of special Diet session (nomination of Prime Minister, followed by Cabinet appointment)	
Mar	Unofficial announcement of successor to policy board member Noguchi **2:** Speech by Deputy Governor Himino **18-19:** MPM **31:** End of term for policy board member Noguchi	**15:** LDP convention **19 (US time):** Japan-US summit **23:** First-round responses from 2026 spring wage negotiations	**17-18:** FOMC **19:** Japan-US summit
Apr	**27-28: MPM**	Passage of FY26 initial budget **1:** BOJ Tankan (Mar survey) **Early Apr:** BOJ branch managers' meeting	**28-29:** FOMC During Apr: US-China summit meeting
May			**15:** End of term for Fed Chair Powell

Source: Various media reports; compiled by Daiwa.

Yield outlook under March rate hike scenario (Kawahara)

While the bar to a March rate hike therefore remains high, we look below at the outlook for yields in the scenario where the yen weakens in the wake of the election and effectively forces the BOJ to hike in March.

This scenario assumes that USD/JPY moves from the current upper-150s to above 160 and heads toward 170. Rather than strengthening toward the roughly 150 level that we think the BOJ assumed in its end-FY26 price outlook, the yen would instead continue to weaken.

If exchange rates follow this path, the inflation outlook would also shift. At 150, the core-core CPI would decline from its current level of around 2.7% toward 2% by the end of FY26. At 170, however, it would only fall to the low- to mid-2% range and would likely remain there in FY27 (when the BOJ forecasts 2.1%), keeping it above the BOJ's 2% target.

To prevent these conditions from locking in inflation at above 2%, we assume the BOJ would hike more quickly toward a higher policy rate. Our FY26 forecasts in this scenario therefore assume that the BOJ proceeds with rate hikes in March, July, December, and April 2027 (see table for details).

In this scenario, we also assume a terminal policy rate of at least 1.75%, compared with 1.5% in our base case, with the April 2027 hike bringing the rate to 1.75%.

Front-running rise in long-term yields, assumptions for our outlook

We look next at the outlook for long-term yields based on the above policy rate path.

Recent long-term yield movements show an accelerating uptrend since mid-November 2025. Compared with the historical relationship between long-term yields and the policy rate, yields have risen to levels that price in rate hikes considerably further ahead. Our analysis suggests that end-November and end-December yields priced in around 0.5 additional hikes relative to their previous fair value, while as of end-January they had risen to price in roughly 1.5 additional hikes.

We base our outlook under this risk scenario on the assumption that this remains the case, with long-term yields continuing to price in 1.5 additional hikes relative to fair value.

Rate hikes that do not result in tightening to continue

Under this scenario, the BOJ would hike more quickly and to a higher terminal rate than in our base case. However, yen depreciation driven by the market's assessment of fiscal policy would outpace rate hikes, creating the consensus that even somewhat more aggressive hikes would not be enough to redress the yen's weakness. As a result, the yen would remain weak and BOJ rate hikes would still not result in tighter financial conditions.

In this scenario, the dynamic we have previously highlighted where the BOJ applies the brakes via gradual rate hikes while the government steps on the accelerator with fiscal policy would grow somewhat more pronounced on both sides. Stepping harder on the brake and accelerator at the same time does not affect the net outcome. We do not assume that the brake will be applied more forcefully than the accelerator.

Yield curve and yield levels

We would expect the above conditions to result in a roughly parallel upshift in yields across the curve. However, the absolute level of yields would change significantly.

In our base case, we forecast a 10-year JGB yield around the mid-2% range by end-FY26. In the above risk scenario, the 10-year yield would near 3% by end-FY26. We would also expect it to exceed 3% at some points during FY26.

We position the March rate-hike scenario in this report as a risk scenario. Please refer to our other publication for details on our base case.

(Kawahara)

Japanese Yield Outlook Under March Rate Hike Scenario

(%)	FY25			FY26									
	Jan-Mar			Apr-Jun			Jul-Sep			Oct-Dec			End-Mar 2027
	Lower limit	Upper limit	Term-end	Lower limit	Upper limit	Term-end	Lower limit	Upper limit	Term-end	Lower limit	Upper limit	Term-end	Term-end
Policy rate			1.00			1.00			1.25			1.50	1.50
2yr	1.30	1.60	1.45	1.45	1.75	1.60	1.60	1.90	1.75	1.70	2.00	1.85	
5yr	1.60	2.10	1.85	1.75	2.25	2.00	1.90	2.40	2.15	2.00	2.50	2.25	
10yr	2.00	2.80	2.40	2.15	2.95	2.55	2.30	3.10	2.70	2.40	3.20	2.80	2.90

Source: Compiled by Daiwa.

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