Daiwa's Economic View

How will BOJ respond to weak GDP? — Examining the path to achieving 2% inflation

- A more important perspective than weak GDP figures is the wage–price cycle
- The Achievement of the price stability target is drawing nearer
- Upside risks are reduced by recent GDP and price developments as well as the yen's appreciation

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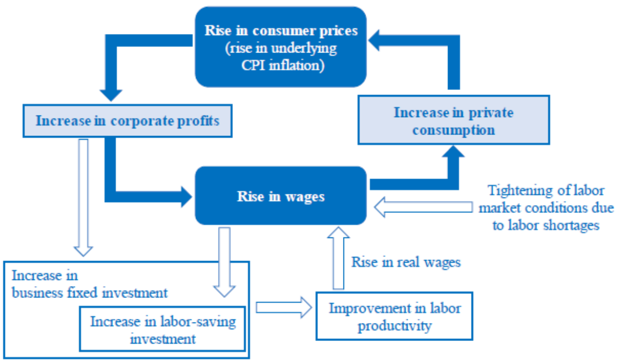
The Oct-Dec 2025 GDP data, released on 16 February, showed only marginal positive real growth, a weak result. In this report, we will analyze how the weaker-than-expected Oct-Dec GDP will affect the BOJ's policy decisions. We will also examine the timing and sustainability of achieving the 2% price stability target, based on trends in wages, prices, and productivity in FY2025.

Focus should be on the wage-price cycle, not GDP figures

When evaluating monetary policy, the most critical perspective is not the GDP figure itself, but whether the mechanism for a virtuous wage-price cycle is strengthening. In a speech on 25 December 2025, Governor Kazuo Ueda stated that "The Bank projects that this mechanism, in which the cycle between wages and prices operates, will function steadily; in other words, rather than a temporary rise in prices driven mainly by cost-push factors, the Bank expects that a situation in which people engage in economic activities on the assumption that moderate inflation will continue going forward, resulting in the sustainable and stable achievement of the 2 percent price stability target."

In evaluating the wage-price cycle, the BOJ seems to be focusing on three perspectives:
(1) Whether companies can secure profits while passing on wage costs to sales prices.
(2) Whether rising corporate profits lead to further wage growth and increased personal consumption.
(3) Whether these trends can be sustained over time.
Regarding (3) in particular, a key confirmation point is whether labor productivity is increasing through higher capital investment.

Cycle Between Wages and Prices



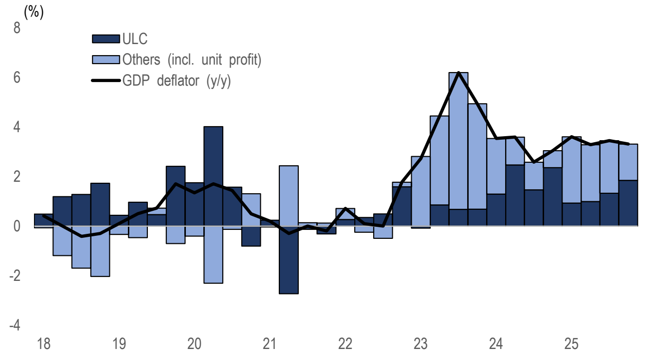
Source: Reprinted from materials of speech by BOJ Governor Ueda.

Confirming the wage-price cycle

We will use the latest Oct-Dec GDP data to confirm this cyclical mechanism. Looking at the GDP deflator, we can see a balanced growth in both unit profit (UP), which indicates profit per unit of output, and unit labor cost (ULC) amid rising prices. This implies that in 2025, even with the impact of tariffs, companies were able to pass on rising wage costs to sales prices without a significant squeeze on corporate profits. In other words, the first condition—"whether companies can secure profits while passing on wage costs"—has likely already been met.

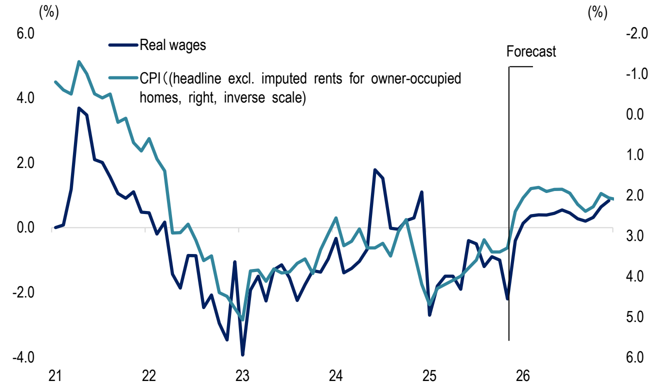
Meanwhile, the second perspective—whether rising corporate profits will lead to wage growth and increased personal consumption—can be positioned as a point to be confirmed heading into FY26. That said, the results of the 2026 spring wage negotiations are likely to be high, and a turn to positive growth in real wages appears imminent. In other words, confirmation on this point is also progressing.

Factor Decomposition of GDP Deflator



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

Forecasts for Real Wages



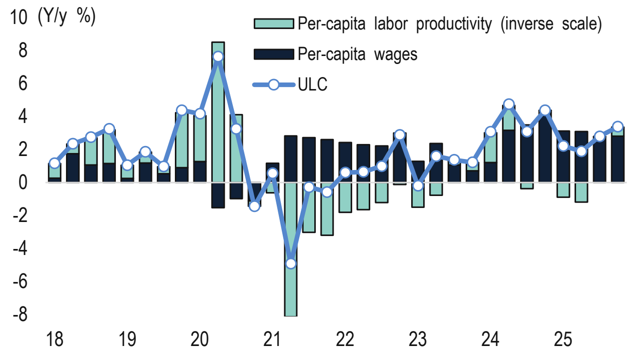
Source: MIC, Ministry of Health, Labour and Welfare (MHLW); compiled by Daiwa.

The third perspective is a somewhat longer-term view: that the formation of this price mechanism stimulates labor mobility and capex, thereby increasing productivity and enhancing the sustainability of the cycle. Looking at this from the breakdown of ULC, we can see that since the Jul-Sep 2025 quarter, a decline in per-capita labor productivity has been a factor pushing up ULC. However, labor productivity per hour worked has continued to rise recently.

The definitions of per-capita labor productivity and labor productivity per hour worked are as follows:
・Per-capita labor productivity = Real GDP / Number of employed persons
・Labor productivity per hour worked = Real GDP / (Number of employed persons × Working hours)
In other words, the decline in per-capita labor productivity, while labor productivity per hour worked is rising, is mainly due to a reduction in working hours.

When evaluating the sustainability of the wage–price cyclical mechanism, we should emphasize efficiency in the production process—namely, how much value added is generated per unit of time—and place less weight on fluctuations in the number of employed persons or total working hours. From this viewpoint, it is appropriate to emphasize labor productivity per hour worked. A detailed analysis will be provided in a separate report. detailed analysis will be provided in a separate report, but for now, the data suggests an increasing likelihood that improvements in labor productivity will contribute to the mechanism's sustainability.

Factor Decomposition of ULC



Source: Cabinet Office, MIC; compiled by Daiwa.

Labor Productivity Growth (y/y)

Source: Cabinet Office, MIC, MHLW; compiled by Daiwa.

Based on the above, the phase of confirming whether profits can be secured while passing on wages to prices has already passed. We are now likely transitioning to a stage of assessing whether rising corporate profits can lead to wage growth and consumption expansion. Furthermore, the possibility is increasing that such dynamics will become sustainable through productivity improvements. Although the Oct-Dec 2025 GDP result was weak, it can be said that the wage-price cycle is beginning to function.

In his speech on 13 February, policy board member Naoki Tamura stated that “I believe it is quite possible that, as early as this spring, the price stability target of 2 percent can be judged to have been achieved if it is confirmed with a high degree of certainty that wage growth in 2026 will be in line with the price stability target for the third consecutive year.” In our view, this timing is approaching.

Hurdles to achieving the "price stability target"

However, the “price stability target” was set in the January 2013 joint statement by the government and the BOJ, and is a concept closely tied to a government declaration of an exit from deflation. The Takaichi administration is seen as having little incentive to declare an end to deflation at present, given that its concrete policy operations will be ramping up going forward. This communication with the government will likely be a major hurdle to achieving the “price stability target.” Furthermore, the weak Oct-Dec GDP result will likely complicate this communication. Under the circumstances, even if the policy rate were raised to 1%, it is unlikely that the BOJ would explicitly declare the achievement of the “price stability target.”

On the other hand, as board members Tamura and Koeda have pointed out, after underlying inflation reaches 2%, the BOJ may demonstrate a stance of focusing on how firmly it has taken hold. In that case, while gauging the neutral interest rate and the degree to which underlying inflation is anchored at 2%, the BOJ may conduct flexible monetary policy operations in response to economic and price developments.

◆ **Speech by policy board member Junko Koeda (20 Nov 2025)**
- Overall, I believe that underlying inflation is about 2 percent. Still, I believe, in order to achieve the price stability target, it is important to examine the extent to which underlying inflation has remained stable or been anchored.

◆ **Speech by policy board member Naoki Tamura (13 Feb 2026)**
- In determining whether the 2 percent price stability target has been achieved, I would argue that the last piece of the puzzle is the sustainability of this mechanism. As I mentioned earlier, I believe it is quite possible that, by the time the warm weather arrives this spring, the 2 percent price stability target can be judged to have been achieved if it is confirmed that wage growth will be in line with the price stability target for the third consecutive year.

Outlook for the next rate hike

The "Summary of Opinions" from the January meeting indicates that caution toward upside inflation risks—via the exchange rates and fiscal policy—is spreading within the BOJ. If the pace of rate hikes were to be accelerated relative to the previous norm of "once every half year," the primary driver would likely be a rise in such upside risks.

On the other hand, Oct–Dec GDP was weak, and weakness in prices was also notable in the December and January CPI readings. In addition, yen appreciation after the Lower House election is also a factor suppressing upside inflation. The meeting held on 16 February between Prime Minister Takaichi and Governor Ueda is described as an "exchange of views on general economic and financial conditions," but it cannot be denied that the weak GDP data released that morning may have had some influence on their discussion.

Meanwhile, there are many fiscal and political events ahead: the announcement of policy board member appointments on 25 February (successors to Noguchi and Nakagawa); formulation of a public–private investment roadmap for advanced technologies and growth sectors slated for March; reflection into the summer growth strategy; and discussions in the national council on consumption tax cuts and refundable tax credits becoming fully underway through the summer. Depending on their content, concerns about fiscal policy and inflation could resurge. If fiscal or inflation concerns intensify, the pace of yen depreciation could accelerate.

Within the BOJ, voices have been raised such as "current financial conditions are still considerably accommodative" and "the Bank should not take too much time examining the impact of raising the policy interest rate, and should proceed with the next step, a rate hike, without missing the appropriate timing" (Jan Summary of Opinions). In other words, based on current economic and price developments, the BOJ likely does not view the cost of accelerating the pace of raising the policy rate to 1% as particularly significant.

Under these circumstances, we currently anticipate the next rate hike in the Apr-Jun 2026 quarter (especially April). As for a rate hike at the March meeting—when sufficient information is not yet fully available—we assume the cost of executing such a move would be high (for details, please refer to *Daiwa's Economic View: BOJ's post-election options: Potential March rate hike, interest-rate risk scenarios*).

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