Daiwa Securities

Daiwa's Economic View

FICC Research Dept.

Key points surrounding underlying inflation: High oil prices and household resilience

- High crude oil prices may lead to negative real wage growth in latter half of 2026
- Two purchasing power sources (residual excess savings, increased net financial assets) to mitigate supply shocks

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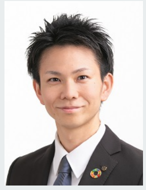


Within its conduct of monetary policy, the BOJ has been emphasizing underlying inflation trends, excluding temporary fluctuations. In particular, crude oil prices have been rising amid heightened tensions in the Middle East and the extent to which this supply shock impacts underlying inflation has become a critical factor when making policy decisions.

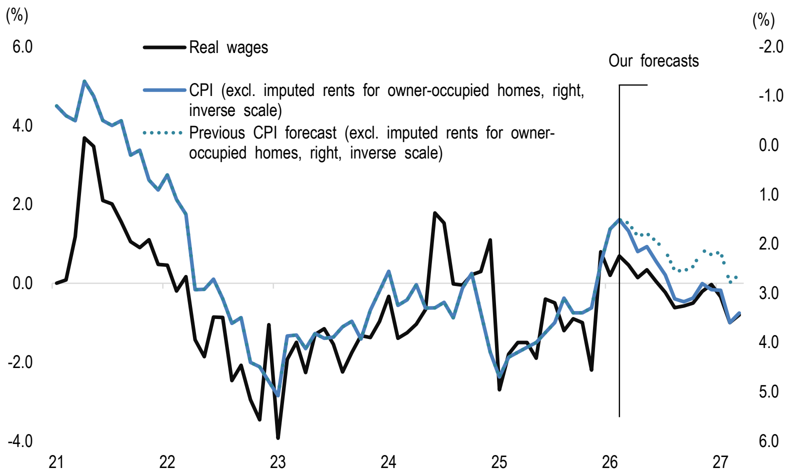
Generally, rising crude oil prices push up consumer prices through increases in gasoline prices, electricity rates, and other factors. Meanwhile, this could reduce households' real purchasing power and suppress demand, resulting in downward pressure on underlying inflation.

In particular, when assessing the magnitude of such downward pressure, the resilience of each economic entity to external cost-push pressures will be crucial. Especially for households, the key issue will be how much of the actual increased burdens they can absorb.

High crude oil prices and real wages: Downside risk on declining purchasing power in latter half of 2026

The results of the request tally for the 2026 annual spring labor-management wage negotiations pointed to solid wage increases. Specifically, the overall wage increase rate, including regular raises, was +5.94% (compared to +6.09% last year), while the base wage increase was +4.37% (compared to +4.51% last year). As such, it is highly likely that the results of the first round of responses to the 2026 annual spring labor-management wage negotiations, due out on 23 March, will be on par with last year's figures.

Forecasts for Real Wages and CPI (WTI crude oil $90 scenario)



Source: Ministry of Internal Affairs and Communications, Ministry of Health, Labour and Welfare; compiled by Daiwa.

That said, rising crude oil prices result in a real reduction in household disposable income. Gasoline prices tend to impact consumer prices relatively quickly. Meanwhile, electricity rates and other living costs are reflected with a certain lag through the fuel adjustment system and rate revision mechanisms.

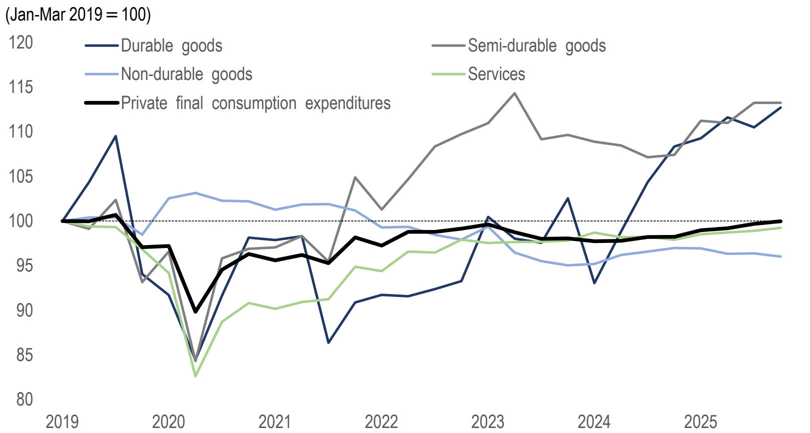
As such, if high crude oil prices persist, upward pressure on inflation will gradually intensify through the first half of 2026. Should nominal wage growth fail to keep pace, real wage growth could turn negative again toward the latter half of 2026.

That said, considering the ripple effects of rising prices, we think considerable time will be needed to accurately assess the extent to which actual price increases exert a restraining influence on household consumption trends. As such, the BOJ will likely examine the initial reaction in terms of price increases on demand through consumer sentiment indicators, the Bank's Tankan survey, and other data, along with anecdotal information collected from interviews with firms.

Background for resilient consumption despite negative real wage growth, importance of purchasing power

However, periods of negative real wage growth have been repeatedly observed in the past. In fact, while real wage growth remained negative in 2025, recent data shows that despite sluggish real wages, private consumption growth was solid in the Oct-Dec 2025 real GDP (second preliminary estimate). In other words, at least in terms of macro statistics, the deterioration in real wages has not led to an immediate and significant drop in private consumption.

Private Final Consumption Expenditure by Type



Source: Cabinet Office; compiled by Daiwa.

In this manner, we think that there are two main factors behind the underlying reason for sustained robust consumption, despite negative real wage growth. First, the excess savings accumulated since the pandemic have underpinned consumption during the current phase of rising prices. Second, one possibility is that the wealth effect generated by rising stock prices has supported household consumption trends, including consumer sentiment, to a certain extent.

Based on the above considerations, when anticipating the impact of rising crude oil prices on underlying inflation, judging the outlook for consumption based solely on real wage trends would probably not be sufficient. The key point is to take into account how much purchasing power remains when considering the level and composition of assets held by households.

Purchasing power/resilience from the perspective of household assets

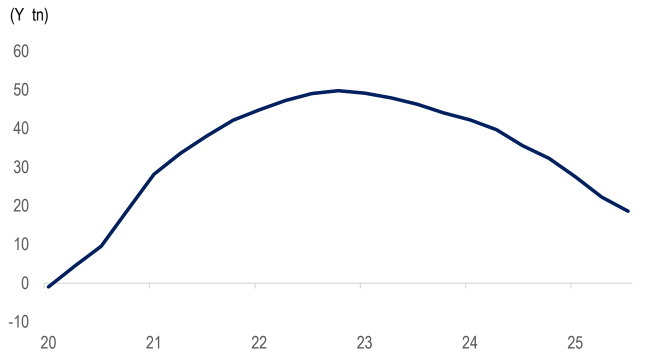
The most important indicator for assessing household resilience to consumption shocks is likely cash and deposits. Cash and deposits provide the highest liquidity and serve as the primary buffer for households to respond to increased spending caused by rising prices over the short term.

Households have accumulated up to Y50tn in cash and deposits as additional savings since 2020, due to suppressed consumption during the COVID-19 pandemic. During the post-pandemic consumption recovery phase, such excess savings were expected to drive a consumption rebound. However, actually, it seems like it served as a buffer against the decline in real purchasing power caused by rising prices.

As a result, household excess savings began to decline from 2023, reaching just under Y20tn as of Jul-Sep 2025. Even though this is a simplified calculation, if we assume a 50% increase in crude oil prices to have a +0.6% impact on the CPI, the macro-level full-year increase in household expenses would be "approx. Y2.0tn = nominal household final consumption expenditure: approx. Y340tn × increased inflation portion: +0.6ppt." (For further details please see our *Daiwa's Economic View "Impact of renewed Middle East risks on Japan's economy, monetary policy."*) The remaining excess savings could serve as a sufficient buffer to mitigate the impact of rising crude oil prices over the short term.

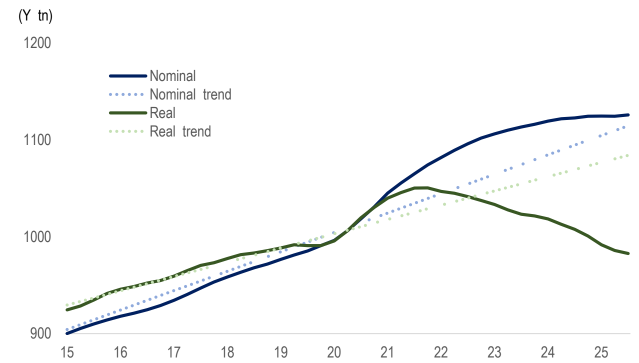
That said, looking at the real cash and deposit balance discounting inflation, it is evident that since the latter half of 2022, it has fallen significantly below the historical trend line for savings and continues to decline. This suggests that while nominal cash and deposit balances have accumulated more compared to past periods, they still have not kept pace with rising inflation.

Household Excess Savings



Source: BOJ; compiled by Daiwa.
Note: Excess savings are calculated by subtracting the estimated value from the trend line of household cash and deposits (from 2015 to end-2019) from the actual stock of cash and deposits (4-quarter backward moving average).

Deviation of Household Cash & Deposit Balance from Trends



Source: BOJ; compiled by Daiwa.
Note: The dotted lines represent the trend lines for household cash and deposits from 2015 to end-2019. Nominal refers to the nominal balance of household cash and deposits (4-quarter backward moving average). Real refers to the nominal balance adjusted for inflation using the household consumption deflator.

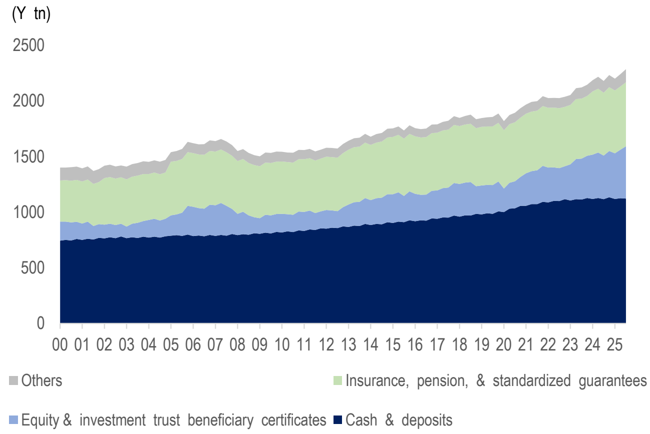
To what extent does increase in net financial assets indicate purchasing power?

Meanwhile, when considering household cash and deposits, it is important to note that the shift from savings to investment is progressing. Actually, examining household stock from the Flow of Funds Accounts Statistics reveals that since 2023, while the growth in cash and deposits has slowed, the balance of stocks, investment trust beneficiary certificates, and other securities has increased significantly.

As such, when confirming the trend for household net financial assets (difference between financial assets and liabilities after deducting liabilities from financial asset balances), net financial assets have increased significantly on a nominal basis compared to past trends. Also, even on a real basis, there is generally a gradual upward trend in line with the overall pattern. The increase in net financial assets balance on a real basis is seen as at least contributing positively to household real purchasing power and underpinning the current robust level of private consumption.

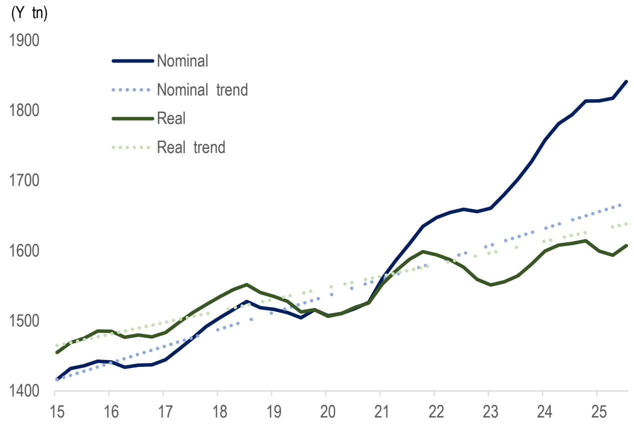
That said, the recent escalation of tensions in the Middle East, accompanied by falling stock prices, is likely to have a negative impact on net financial asset balances. This is a point that warrants attention. If the situation involves a larger stock price correction than is already the case, the impact on households could be greater than expected.

Balance of Household Financial Assets



Source: BOJ; compiled by Daiwa.

Deviation of Household Net Financial Assets from Trends



Source: BOJ, Cabinet Office; compiled by Daiwa.
Note: The dotted lines represent the trend lines for household net financial assets from 2015 to end-2019. Nominal refers to the nominal balance of household net financial assets (4-quarter backward moving average). Real refers to the nominal balance adjusted for inflation using the household consumption deflator.

Conclusion: Perspectives on monetary policy during periods of rising crude oil prices

Based on the above considerations, even if a temporary supply shock occurs due to rising crude oil prices, we believe at this juncture it is unlikely that macroeconomic consumption will decline significantly, leading to substantial downward pressure on underlying inflation. This is due to the short-term buffers that are in place, such as households' nominal excess savings.

That said, the current resilient consumption may depend more on stock factors, such as the wealth effect through excess savings and rising stock prices, than on flow factors like improvements in real wages. As such, if escalating tensions in the Middle East, coupled with persistently high crude oil prices, trigger a significant stock market correction beyond current levels, there would be an undeniable risk that the impact on household consumption trends could become more pronounced than previously anticipated. In particular, we should pay close attention to future sentiment indicators such as the Economic Watchers Survey and the Consumer Confidence Index, which can capture the initial responses.

Meanwhile, from the perspective of factors pushing up underlying inflation, it is also important to note that the recent escalation of tensions in the Middle East is likely to exert downward pressure on the yen. Given that the BOJ has been increasingly vigilant about higher-than-expected inflation risks since January 2026, (even though this depends on market fluctuations, including equities and crude oil) even if tensions in the Middle East were to persist for an extended period, provided that such conditions exert upward pressure on prices through yen depreciation, we believe it is highly likely that interest rate hikes toward the neutral rate of interest level will continue, backed by macroeconomic resilience.

However, even after raising the policy interest rate to around 1%, which is seen as the lower bound of the neutral rate of interest, if tensions in the Middle East continue to escalate, the BOJ will likely enter a phase of more carefully assessing financial market conditions and trends for the economy and inflation. In that case, in addition to crude oil and forex trends, as well as their impacts, we think that whether the momentum for wage increases continues heading into the 2027 annual spring labor-management negotiations will become a key checkpoint for determining additional rate hikes.

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