

Daiwa's View

How will BOJ confirm that inflation has become established at 2%?

- From “reaching 2%” to “becoming established at 2%”: The next focus is the sustainability of wage growth

Kenji Yamamoto

81-3-5555-8784

kenji.yamamoto@daiwa.co.jp

Daiwa Securities Co. Ltd.



Underlying inflation cannot be allowed to rise above 2%

At his 16 October press conference, BOJ Governor Kazuo Ueda said that the underlying inflation rate was “broadly close to 2%,” before adding that **“a further rise from here cannot be tolerated.”** He also indicated that, while the BOJ had previously tolerated an increase in underlying inflation toward 2%, once it reaches 2%, a major policy objective will be to keep it firmly established around that level. This can be seen as a clearer articulation of his assessment at the press conference following the September meeting that **“the phase of monetary policy has changed.”**

In our previous report entitled [How will BOJ conduct monetary policy after “reaching 2%”?](#), we argued that BOJ monetary policy was shifting from a phase aimed at raising underlying inflation to 2% to one aimed at stabilizing it at around 2%. Governor Ueda's latest remarks appear to confirm precisely this shift. Merely reaching 2% inflation is not the goal. Maintaining a state in which inflation remains stable at around 2%, without deviating significantly above or below that level, will be important for the conduct of monetary policy going forward.

Regarding whether the BOJ will determine that underlying inflation has actually reached 2%, Governor Ueda said that the Policy Board would “hold thorough discussions and reach a conclusion” at the 29–30 October Monetary Policy Meeting. Meanwhile, he assessed economic data released since the September meeting as having moved “broadly in line with the outlook.” He also said that his exchanges of views with overseas policymakers during his latest trip had not yielded “any significant information that appeared to contradict his own assessment.”

This assessment is also consistent with source-based reporting by Bloomberg published after [the coverage discussed in our previous report](#). According to Bloomberg, while the BOJ is likely to leave its policy rate unchanged at the October meeting, it may upgrade its assessment of underlying inflation from “approaching 2%” to “broadly around 2%.” However, this would not immediately be regarded as the achievement of the price stability target, and the BOJ is reportedly expected to continue raising interest rates while financial conditions remain accommodative. Economic activity and prices since the September meeting have evolved in line with the BOJ's outlook, and upside risks to inflation have not intensified sufficiently to warrant rate hikes at two consecutive meetings. However, an additional rate hike at the December meeting has reportedly not been ruled out.

The Bloomberg report did not provide any new information significant enough to warrant changing the policy view set out in our previous report. Nevertheless, Governor Ueda's latest remarks have further clarified the direction of policy: the BOJ will distinguish between “reaching 2%” and “becoming established at 2%,” and adjust the degree of monetary accommodation as it assesses whether the latter has been achieved.

Underlying inflation is approaching 2%

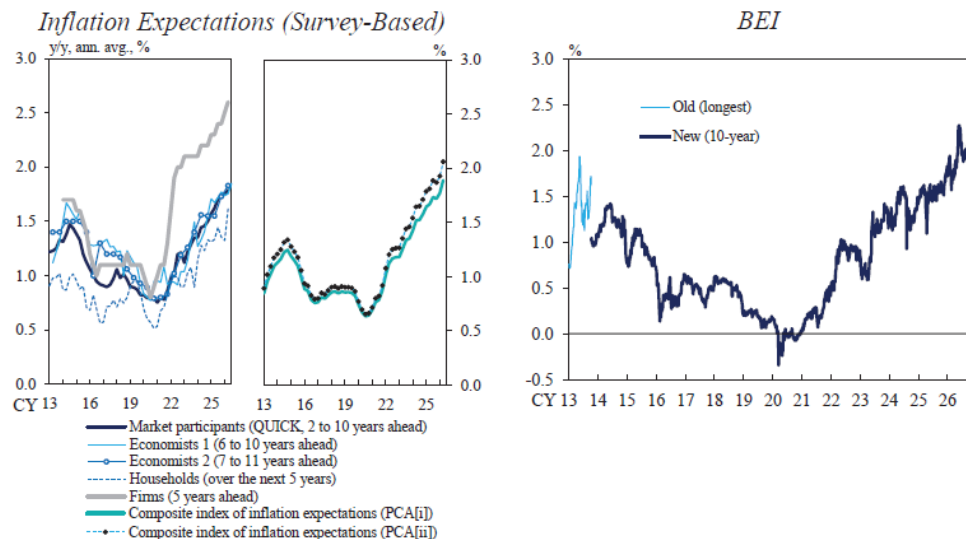
Indeed, the indicators used to assess underlying inflation increasingly suggest that it is approaching 2%, a trend the BOJ is recognizing more clearly. Particularly important among these are medium- to long-term inflation expectations.

Recent measures of inflation expectations have shown divergent trends. Inflation expectations among households and firms have declined somewhat recently, while forecasts by experts such as economists and market participants have continued to rise. Inflation expectations are therefore not increasing uniformly. In Jul–Sep 2026, expected inflation among households and firms declined slightly, while forecasts by experts continued to rise.

Nevertheless, taking an overall view of expectations among multiple groups, including households, firms, and experts, medium- to long-term inflation expectations can be assessed as having risen to around 2%. The composite index of inflation expectations, which is constructed by extracting the common component from the inflation expectations of households, firms, and experts presented in the BOJ's *Outlook for Economic Activity and Prices* report, also exceeded 2% for the first time in Apr–Jun. Although the index is expected to decline slightly in Jul–Sep owing to lower expectations among households and firms, the various indicators available to date do not, in our view, materially alter the assessment that underlying inflation expectations are around 2%.

These developments in inflation expectations are also consistent with Governor Ueda's assessment that underlying inflation is "broadly close to 2%." The important question is not whether inflation expectations are currently rising further, but whether medium- to long-term inflation expectations, which have risen to around 2%, can remain at that level. The focus is shifting from "reaching 2%" to "becoming established at 2%."

Underlying Inflation



Notes: 1. For details on the left two panels, see Bank of Japan, Monetary Affairs Department, "The Concept and Measurement of Underlying Inflation," *Bank of Japan Review Series*, no. 26-E-5 (March 2026).

2. In the right panel, the BEI (break-even inflation) rate is the yield spread between fixed-rate coupon-bearing JGBs and inflation-indexed JGBs. Inflation-indexed JGBs issued since October 2013 are designated as "new," while the rest are designated as "old." Figures for "old (longest)" are calculated using yield data for issue No. 16 of inflation-indexed JGBs, which matured in June 2018.

Sources: Bloomberg; Consensus Economics Inc., *Consensus Forecasts*; ICER, *ESP Forecast*; QUICK, *QUICK Monthly Market Survey <Bonds>*; Bank of Japan.

Source: Reprinted from materials for a speech by BOJ Policy Board Member Koeda.

It is also difficult to argue, based on recent price developments, that inflationary pressures have clearly receded. Japan's domestic corporate goods prices rose 6.8% y/y in September, slowing from 7.6% in August, and declined m/m for the second consecutive month. However, import prices have begun rising again against the backdrop of higher crude oil prices. In addition, cost indicators constructed using corporate goods prices and services producer prices suggest that the rate of increase in the BOJ-style core-core CPI could rise through the Jan–Mar 2027 quarter.

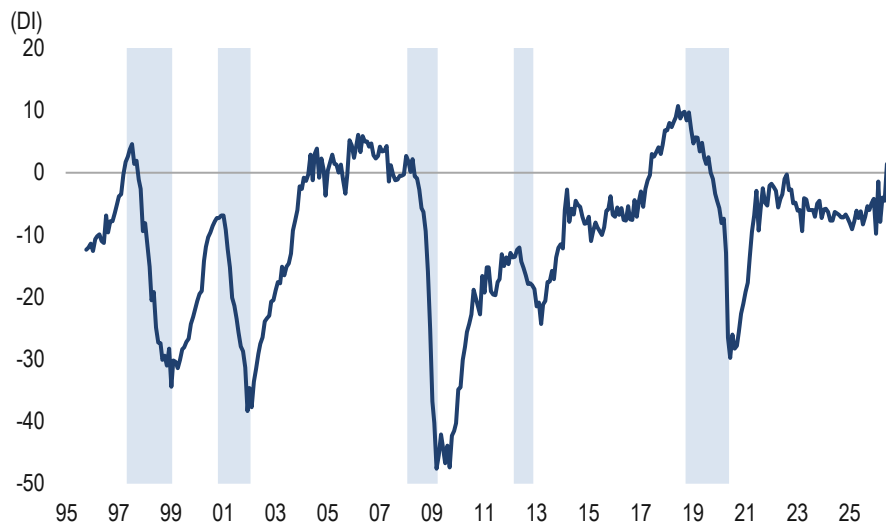
Economic activity is evolving in line with the BOJ's outlook

Nevertheless, the fact that underlying inflation is approaching 2% does not mean that the pace of rate hikes needs to be accelerated immediately. Weakness remains in private consumption, while capital expenditure is solid. Private-sector machinery orders excluding orders for ships and from electric power companies rose 5.2% m/m in August, confirming the resilience of domestic capital expenditure demand, including in AI-related sectors. While the increase in interest rates to date does not appear to have significantly dampened firms' appetite for capital expenditure, rising costs and labor shortages are constraining the actual implementation of investment.

Governor Ueda also assessed the Japanese economy since the September meeting as having evolved "broadly in line with our outlook." He added that financial conditions "remain accommodative" even after the policy rate was raised to 1.25%, and said that the BOJ would "continue to raise the policy rate and adjust the degree of monetary accommodation."

The BOJ's current assessment therefore appears to be that, while there is no need to rush into consecutive rate hikes as economic activity and prices evolve in line with its outlook, conditions also do not warrant halting rate hikes. Given that underlying inflation is approaching 2% and financial conditions remain accommodative, future rate hikes will increasingly be aimed not at raising underlying inflation to 2%, but at adjusting the degree of monetary accommodation to stabilize it at around 2% and prevent it from overshooting that level.

Survey of SME Business Conditions: Capital Investment DI



Source: Japan Finance Corporation; compiled by Daiwa.

The next focus is whether wage growth becomes established

How, then, will the BOJ confirm that underlying inflation has become established? [One important factor will be the 2027 spring wage negotiations.](#) According to several media reports last week, the Japanese Trade Union Confederation (Rengo) is considering setting its wage increase demand for the 2027 spring wage negotiations, including both pay scale increases and regular pay increases, at "5% or more." This would mark the fourth consecutive year since 2024 in which Rengo has called for wage increases of 5% or more. For SMEs with fewer than 300 union members, Rengo plans to seek "6% or more." It is also considering setting 5% or more as the minimum level overall and expressing an "intention to aim for 6%." The wage increase achieved in the 2026 spring wage negotiations was 5.01%, remaining in the 5% range for the third consecutive year, while the increase among SMEs was limited to 4.69%.

The point to watch here is not simply whether wage growth in 2027 will exceed the previous year's level. On 8 October, Rengo Chair Tomoko Yoshino said that "the breadth of wage increases is steadily expanding, but it is difficult to say that many people are experiencing an

improvement in their living standards.” She added that “further efforts are needed to establish wage increases as a broadly accepted social norm.”

Just as the BOJ is shifting its emphasis for underlying inflation from “reaching 2%” to “becoming established at 2%,” what now matters for the spring wage negotiations is whether labor and management can move from achieving a high wage increase on a one-off basis to a situation in which both sides assume that strong wage increases will continue every year.

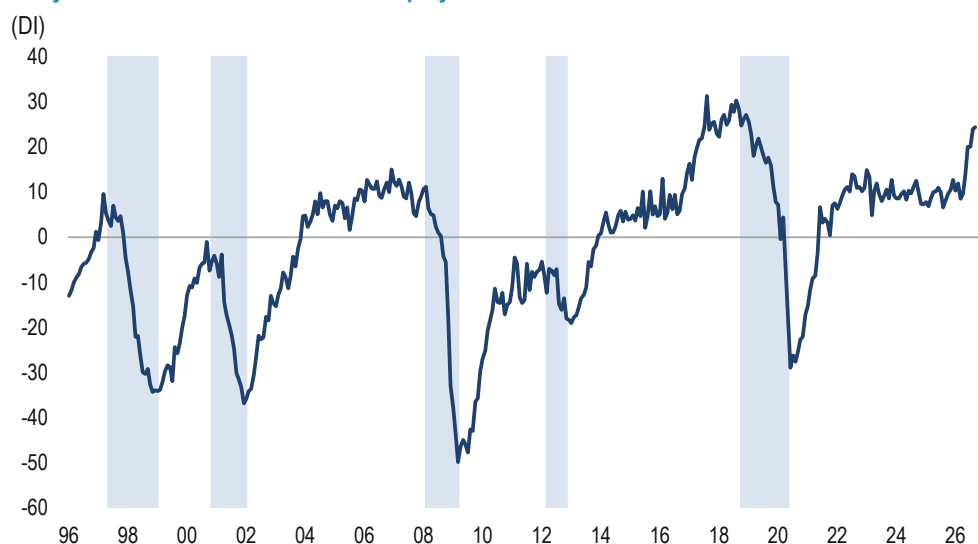
In this regard, attention should be paid not only to the fact that Rengo is moving toward calling for “5% or more” for the fourth consecutive year, but also to its consideration of positioning 5% as the “minimum level” and adding language such as “aiming for 6%” or “centered around 6%.”

According to media reports, amid calls for 5% or more to be treated as the minimum level, Rengo is considering also expressing its intention to aim for 6% in an effort to secure a higher wage increase, or adding the wording “centered around 6%” to emphasize its determination to achieve a higher wage increase. Accordingly, in the 2027 spring wage negotiations, it will be necessary to consider not only whether strong wage growth continues for a fourth year, but also the possibility that the pace of wage growth could accelerate again.

On the other hand, labor unions’ actual wage demands have already been running at around 6% over the past three years. It would therefore be premature to anticipate a substantial acceleration in actual wage growth solely on the basis of the reference to “6%.” It will be necessary to examine the demand levels of the major industry unions and individual labor unions as they become available, as well as how employers respond.

For the BOJ, what matters is both the “magnitude” of wage growth, namely whether the momentum of wage increases strengthens further, and its “sustainability and breadth,” namely whether that momentum continues and spreads across the economy. Will strong wage increases spread beyond large corporations to SMEs? Will firms maintain their willingness to raise wages amid structural labor shortages? And will higher wages feed through to services prices and other prices, sustaining the wage-price cycle? These factors will be important in assessing whether underlying inflation will become established at around 2%.

Survey of SME Business Conditions: Employment DI



Source: Japan Finance Corporation; compiled by Daiwa.

The final outcome of the 2027 spring wage negotiations will not be known for some time, but the direction of the negotiations will gradually become clearer. Rengo's basic plan for the spring labor-management wage negotiations will be released in October, followed in November by a draft of the “Report of the Special Committee on Management and Labor Policy” compiled by the Japan Business Federation (Keidanren) and draft wage demands from the major industry unions.

From year-end into the new year, some companies will also begin announcing wage increases early. Even without waiting for the concentrated round of responses in March, considerably more information on the positions of both labor and management and their specific demand levels will be available by December.

At the October meeting, the BOJ will only be able to assess, based on materials such as Rengo's basic plan, whether the environment for continued strong wage growth remains in place. By December, however, more information will be available on the positions of management and the major industry unions, enabling the BOJ to make a more concrete initial assessment of whether strong wage growth will continue in 2027.

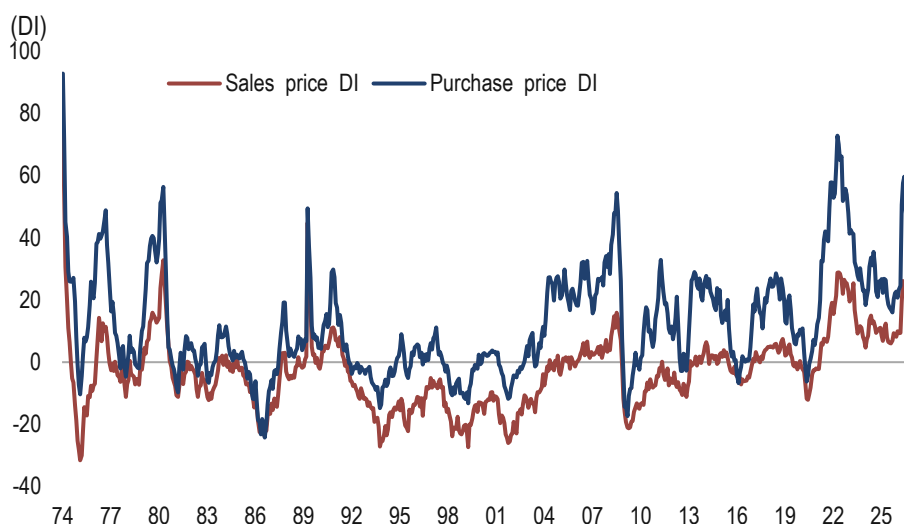
From a policy of “aiming for 2%” to one of “stabilizing inflation at around 2%”

In light of Governor Ueda's latest remarks, the key issue in assessing the BOJ's policy outlook is no longer simply whether underlying inflation has “reached” 2%. The BOJ appears to have entered a phase in which it will adjust the degree of monetary accommodation while assessing both whether underlying inflation, having risen to around 2%, will become established at that level and whether there is a risk that it will overshoot 2%.

The 2027 spring wage negotiations should likewise not be assessed solely in terms of whether the figure is 5% or 6%. The relevant questions are whether strong wage growth will continue for a fourth year, whether the pace of wage growth will accelerate further, and whether its breadth will expand from large corporations to SMEs. It will be necessary to assess both whether wage increases become established as a “norm” and sustain the wage-price cycle, and whether this could cause underlying inflation to overshoot 2%.

The BOJ's conduct of monetary policy is shifting from a phase of “aiming for 2%” to one of “stabilizing inflation at around 2%.” The first question is what assessment of underlying inflation will be presented at the October meeting. Beyond that, key factors determining the timing and pace of future rate hikes are as follows: (1) the extent to which evidence accumulates that wage and price developments are becoming firmly established, including evidence from the 2027 spring wage negotiations, and (2) whether signs of an overshoot intensify.

Survey of SME Business Conditions: Sales Price DI, Purchase Price DI



Source: Japan Finance Corporation; 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, Investment Management Association of Japan, Type II Financial Instruments Firms Association, Japan Security Token Offering Association