

Daiwa's Economic View

BOJ pushes back against an excessive unwinding of rate hike expectations

- Source-based report points to “December” and a “quarterly pace”

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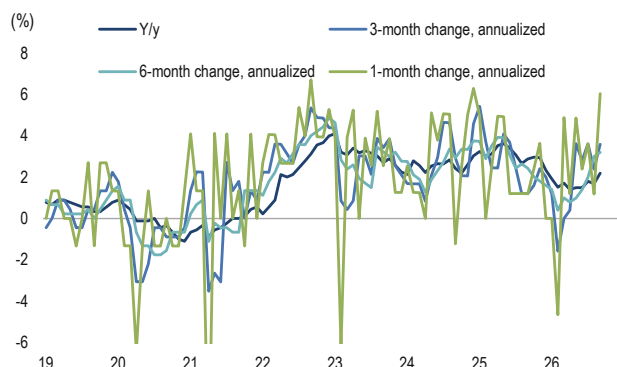


Underlying inflationary pressures strengthen

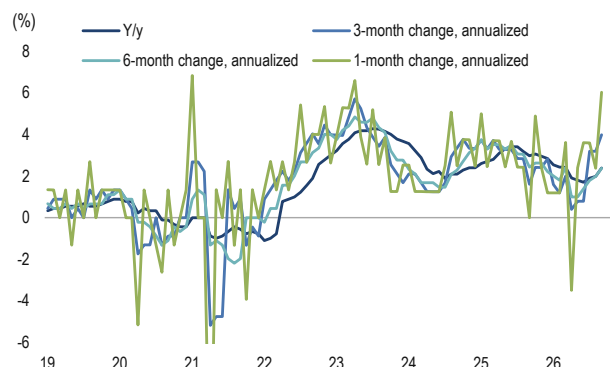
The nationwide CPI for September, released on 23 October, reinforced the need for the BOJ to continue raising interest rates. Core CPI excluding fresh food rose 2.1% y/y, up from 1.7% in August, while the BOJ-style core CPI excluding fresh food and energy accelerated to 2.4%. On a seasonally adjusted basis, both core CPI and the BOJ-style core CPI rose 0.5% m/m, indicating strength not only in y/y inflation but also in recent inflation momentum.

A notable feature of the latest data is that price increases have become more broad-based. While rice prices fell sharply, inflation in food excluding fresh food accelerated, and price increases became more widespread across daily necessities and durable goods. Services prices also increased. Although caution is warranted regarding temporary upward factors such as accommodation charges, price pass-through continues across a broad range of items even after accounting for such temporary factors.

Looking ahead, inflation could be pushed higher by the fading of the downward impact from government support for electricity and gas charges, as well as by the continued pass-through of previous increases in raw material, logistics, and labor costs. Rather than representing a one-month upside surprise, the September CPI suggested that vigilance against upside risks remained warranted as the underlying inflation rate converged to around 2%.

Momentum in Core CPI

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

Momentum in Core-core CPI

Source: MIC; compiled by Daiwa.

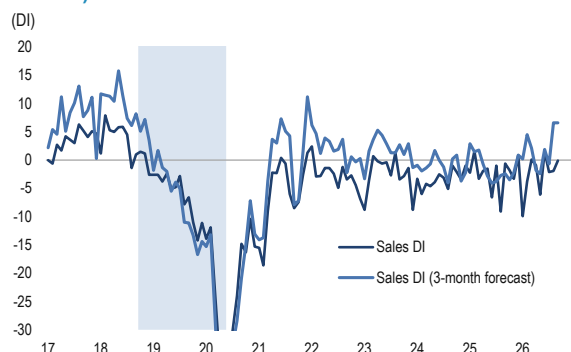
Strong initial momentum for the 2027 spring wage negotiations

[On the wage front, initial momentum heading into the 2027 spring wage negotiations is also strong.](#) In its basic plan for the spring labor-management wage negotiations, the Japanese Trade Union Confederation (Rengo) indicated benchmarks of a total wage increase centered on 6%, with a minimum of 5%, including annual pay increments, and a base pay increase centered on 4%, with a minimum of 3%. This marks the fourth consecutive year in which the demand level has been set at “at least 5%.” This time, however, the addition of a 6% central target for total wage increases and a 4% central target for base pay increases clearly indicates that, rather than weakening its stance relative to the previous year, Rengo aims to establish high wage increases as the norm and then seek still larger gains.

The background factors include not only the strong wage increases achieved in recent years but also resilient corporate earnings, structural labor shortages, and continued competition for workers. Rengo has also set a medium-term target of raising wage levels in 2030 by around 15% from 2026 levels, seeking to turn high wage increases from a one-off development into sustained wage growth. At present, there are no signs that wage growth momentum is weakening significantly.

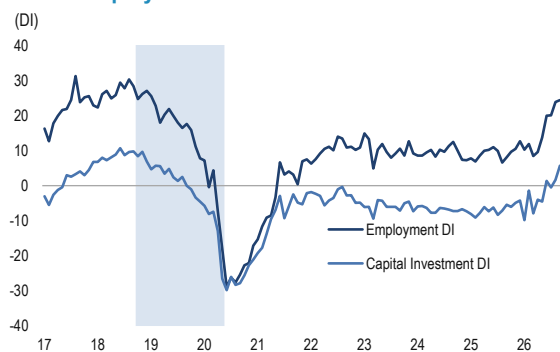
Of course, it is still too early to assess the final outcome of the spring wage negotiations. The key point is not to anticipate the final result, but rather that the initial momentum has proved strong enough to sustain expectations of continued high wage increases. Taken together with the September CPI, neither price nor wage developments appear likely to weaken the BOJ's normalization scenario. [The BOJ's focus has clearly shifted from “whether inflation will reach 2%” to “at what pace it should adjust the degree of monetary accommodation in order to establish inflation at around 2%.”](#)

Survey of SME Business Conditions: Sales DI and Sales DI (forecast)



Source: Japan Finance Corporation; compiled by Daiwa.

Survey of SME Business Conditions: Capital Investment DI and Employment DI



Source: Japan Finance Corporation; compiled by Daiwa.

“Underlying inflation has reached 2%” is already a given

Against this backdrop, Bloomberg published another source-based report on 23 October. According to the report, the BOJ believes that the underlying inflation rate, which it had previously described as “approaching 2%,” has been converging to around 2% and is likely to indicate in the *Outlook for Economic Activity and Prices* report (*Outlook Report*), which will be discussed at the 29-30 October Monetary Policy Meeting, that underlying inflation has reached the 2% target.

However, the view that underlying inflation has reached 2% has already been reported by many media outlets. [The BOJ's policy focus is already shifting from assessing whether inflation will reach 2% to assessing whether it will become established at around 2%.](#) As the author has previously noted, the latest source-based report can be viewed as reconfirming this shift in the focus of monetary policy.

The important point is to distinguish between “reaching 2%” and “becoming established at around 2%.” The fact that the underlying inflation rate has reached 2% does not mean that monetary policy normalization is complete. Rather, the BOJ is entering the next phase, in which it must determine the pace at which it should adjust the degree of monetary accommodation in order to sustain inflation at that level.

It is therefore insufficient to interpret the significance of the latest source-based report solely in terms of “the possibility that the *Outlook Report* will indicate that inflation has reached 2%.” What warrants attention is that the report provided specific guidance on the policy rate path beyond that point, referring to “December” and “a quarterly pace.”

Significance of the references to “December” and a “quarterly pace”

The key point in the latest source-based report is that it referred to the possibility that “maintaining the accelerated pace of quarterly rate hikes” could be appropriate and went so far as to state that “the December decision will be the focus” with regard to the timing of the next rate hike. While there is little urgency to deliver consecutive rate hikes in October, the possibility that the BOJ will face a decision at its December meeting cannot be ruled out. This suggests that the roughly quarterly pace of rate hikes may not be temporary.

The policy logic behind this view was also evident in comments made shortly beforehand by Deputy Governor Ryozi Himino. On 21 October, Deputy Governor Himino noted that, even after the policy rate was raised to 1.25% in September, real interest rates remained low and bank lending continued to grow strongly, meaning that “accommodative financial conditions remain in place.” He added that, if adjustments to the degree of accommodation were delayed while upside risks to prices remained high, this “could lead to an economic downturn.” He also expressed the view that underlying inflation was “quite close to 2%.”

◆ BOJ Deputy Governor Himino (21 Oct 2026)

Given the rise in medium- to long-term inflation expectations, underlying inflation is approaching 2%. Accommodative financial conditions have been maintained even after the rate hike and continue to support economic activity. Achieving price stability through the appropriate conduct of monetary policy is important not only from the standpoint of supporting growth investment, but also because it contributes to sustainable economic growth. **If adjustments to the degree of monetary accommodation are delayed while upside risks to prices remain high, this could lead to an economic downturn.**

The BOJ is not concerned only about the downward pressure that rate hikes may exert on the economy. It also recognizes that falling behind in adjusting monetary accommodation while upside risks to prices remain high could lead to a future economic downturn. While the current policy rate remains some distance below the neutral rate, the BOJ also needs to carefully assess the impact of its previous rate hikes on financial conditions. The BOJ's current baseline path appears to be to use October to make that assessment and then move again in December if necessary.

Why, then, was it necessary to provide such a specific timeline, referring to “December” and a “quarterly pace,” at this point? This is likely the key point of the latest source-based report.

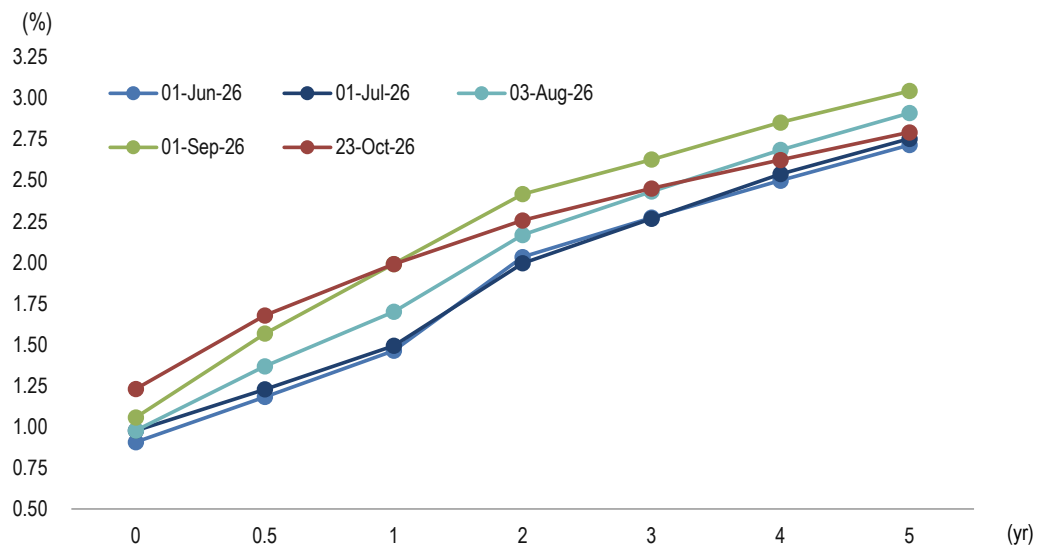
As expectations of higher yields receded globally amid credit concerns originating overseas, rate hike expectations also declined in Japan. In the market, the implied probability of a rate hike in Japan began falling earlier than the corresponding probabilities in the US and Europe, where the credit concerns originated, and the implied probability of a December rate hike temporarily declined into the 60% range. However, looking at Japan's domestic fundamentals, the September CPI indicated strong underlying inflationary pressures, while initial momentum heading into the 2027 spring wage negotiations remains strong. BOJ Deputy Governor Himino also indicated that financial conditions remained accommodative even after the policy rate was raised to 1.25%.

Although domestic prices, wages, and financial conditions have not moved in a direction that would significantly weaken the rate hike scenario, the market has begun to partially unwind the BOJ's normalization scenario solely in response to the external environment. The latest source-based report should be regarded as a measure of pushback against this market move.

Even if the BOJ leaves rates unchanged in October to assess the impact of its previous rate hikes, this would not represent a retreat in the rate hike cycle. With the underlying inflation rate converging to around 2% and vigilance against upside risks increasing, a December rate hike followed by further hikes at a pace of roughly once a quarter remains a credible policy path.

The message for the JGB market is also clear. The decline in yields caused by overseas credit concerns, which provides a cushioning effect, needs to be distinguished from an actual retreat in the BOJ's normalization scenario. The latest source-based report can be characterized as the BOJ pushing back against an excessive unwinding of rate hike expectations and the resulting prospect of an extreme decline in JGB yields.

Market Expectations for Japan's Policy Interest Rate



Source: Bloomberg; compiled by Daiwa.

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