

Economic Commentary (Oct BOJ MPM)

BOJ stands pat, but strikes hawkish tone

- BOJ leaves policy rate unchanged, Takata proposes hike
- Still highly alert to inflation overshoot; we see decision as "hawkish hold"
- BOJ judges underlying inflation has reached 2%, also speeds up ETF sales

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BOJ opts for hawkish hold

The Bank of Japan (BOJ) left the policy rate unchanged by an 8-1 vote at its 29-30 October Monetary Policy Meeting (MPM). Board member Hajime Takata proposed hiking to 1.5%, considering that "with underlying CPI inflation having reached the price stability target, the situation had shifted to a new phase in which the Bank needs to step up the pace of bringing the policy interest rate closer to the neutral interest rate so that it could make nimble responses." The majority voted down his proposal. Minister of State for Economic and Fiscal Policy Minoru Kiuchi gave priority to the Diet schedule and did not attend, his first absence since January 2026.

Takata had also proposed a back-to-back hike at the July MPM, following the June hike, so his dissent this time was no surprise. But given that he was the sole dissenter, the other members appear to judge that hiking at consecutive meetings is not necessary at this point.

However, the BOJ revised up its core-core CPI forecasts for FY27 and beyond in light of the surge in oil prices, and many members remain conscious of upside risks to prices throughout the projection period. While the BOJ left the policy rate on hold, the *Outlook for Economic Activity and Prices (Outlook Report)* confirms its strong wariness of an inflation overshoot. We think it is fair to describe this meeting as a "hawkish hold" (details below).

The BOJ also increased the pace of its ETF sales at the October MPM, from around Y330bn a year to around Y860bn (both on a book-value basis). It began selling ETFs in January 2026, and the sales have proceeded smoothly without a major impact on the market. Trading value across the stock market as a whole has also expanded. We think these two factors led the BOJ to judge that it could sell at a faster pace while still limiting the market impact. The change drastically shortens the time needed to complete the sales, from around 112 years to around 43 years.

Underlying inflation broadly consistent with 2%; focus shifts to confirming anchoring

The *Outlook Report* states that "underlying CPI inflation is at a level that is generally consistent with the price stability target of 2 percent, and is expected to remain at around that level." This effectively signals the BOJ's judgment that underlying inflation has reached 2%. The report goes on to say that "it will be important, from the perspective of sustainable and stable achievement of the price stability target, to examine the degree to which underlying CPI inflation is anchored at a level around 2 percent."

We think this framing can be read as giving the BOJ more flexibility in conducting monetary policy. Having confirmed that underlying inflation has reached 2%, the BOJ now enters a phase in which the focus is on anchoring it at around 2%, so that it drifts neither above nor below that level. The BOJ arguably now has more room to respond flexibly and nimbly to the data, whether by speeding up the pace of hikes or by pausing them.

However, the *Outlook Report* also states explicitly that, with underlying inflation now at a level consistent with 2%, "there is a risk that medium- to long-term inflation expectations will rise and underlying CPI inflation will deviate upward to a level above the price stability target, given that firms' behavior has been shifting more toward raising wages and prices and there are various factors that could drive up prices." The BOJ appears to be on high alert for a potential inflation overshoot.

The report also states that "Japan's financial conditions have remained accommodative." That assessment previously rested on real interest rates, firms' demand for funds and related indicators, and issuance conditions for CP and corporate bonds. We would highlight that the BOJ has now added "recent developments in asset markets, such as stock and foreign exchange markets" to that list.

Taking these points together, we think the conditions for faster rate hikes are largely in place, even if hikes at consecutive meetings are not needed. We expect the BOJ to keep raising rates at a pace of roughly once every three to four months for the time being, with the next hike at the December MPM.

Economic outlook: Revised up as global economy proves resilient

Policy Board members revised up their median real GDP growth forecast for FY26 to +0.7% (previously +0.6%), but revised down their FY27 forecast to +0.7% (previously +0.8%).

The FY26 upgrade appears to reflect the resilience the global economy has demonstrated, led by expanding AI demand. The FY27 downgrade likely reflects the upward revision to the price outlook. Despite this, the BOJ maintained its view that growth will exceed the potential growth rate throughout the projection period.

The BOJ also kept its assessment that "risks to economic activity are generally balanced."

FY26-28 Forecasts of Majority of Policy Board Members (y/y %)

	Real GDP	CPI (all items less fresh food)	(Ref) CPI (all items less fresh food and energy)
FY26	+0.7 ~ +0.8 [+0.7]	+2.4 ~ +2.6 [+2.5]	+2.4 ~ +2.5 [+2.4]
As of Jul	+0.6 ~ +0.7 [+0.6]	+2.3 ~ +2.7 [+2.5]	+2.3 ~ +2.6 [+2.5]
FY27	+0.6 ~ +0.8 [+0.7]	+2.4 ~ +2.7 [+2.6]	+2.4 ~ +2.7 [+2.7]
As of Jul	+0.7 ~ +0.8 [+0.8]	+2.2 ~ +2.5 [+2.4]	+2.2 ~ +2.7 [+2.6]
FY28	+0.7 ~ +0.9 [+0.8]	+2.0 ~ +2.1 [+2.0]	+2.2 ~ +2.4 [+2.3]
As of Jul	+0.7 ~ +0.8 [+0.8]	+2.0 ~ +2.2 [+2.0]	+2.1 ~ +2.3 [+2.2]

Source: BOJ; compiled by Daiwa

Notes: 1) Figures in brackets indicate the medians of the Policy Board members' forecasts (point estimates).

- 2) The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate -- namely, the figure to which they attach the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.
- 3) Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.
- 4) The forecasts in this Outlook Report do not take into account the impact stemming from factors such as the proposed temporary reduction in the consumption tax on food and beverages, which is currently being deliberated in the Diet. Assuming that the consumption tax cut will be applied to the prices of all items specified in the policy outline on tax reforms decided by the Cabinet in September 2026, the effects of the consumption tax cut on the year-on-year rates of change in the CPI figures for fiscal 2027 are estimated to be around minus 1.3 percentage points for the CPI (all items less fresh food) and around minus 1.4 percentage points for the CPI (all items less fresh food and energy).

Distribution of Real GDP Forecasts (majority of policy board members)

(%)	FY26		FY27		FY28	
	Jul-26	Oct-26	Jul-26	Oct-26	Jul-26	Oct-26
0.4						
0.5			1	1		
0.6	7	1		1		
0.7	2	6	2	5	4	2
0.8		2	5	1	4	5
0.9			1	1	1	2
1.0						
1.1						
1.2						
Upside	2	3	2	1	1	0
Downside	2	3	1	0	1	1
Balanced	5	3	6	8	7	8

Source: BOJ; compiled by Daiwa.

Price outlook: Still wary of upside risks

The BOJ revised up its price outlook in light of the renewed rise in oil prices¹. We would note that these forecasts do not take into account the impact of the consumption tax cut. If the BOJ factors this kind of policy into its forecasts, the resulting boost to private consumption could further lift its economic outlook. Stronger demand would also likely put upward pressure on the price outlook, aside from the mechanical drag from the tax cut itself.

Board members revised up their median core CPI forecast for FY27 by a relatively large margin, to +2.6% (previously +2.4%). However, we would focus in particular on the core-core CPI forecasts. Members lowered their FY26 core-core CPI forecast to +2.4% (previously +2.5%), but raised their forecasts for FY27 to +2.7% (previously +2.6%) and for FY28 to +2.3% (previously +2.2%).

These upgrades appear to reflect expectations that upward price pressure will persist across a wide range of items, beyond the recent rise in oil prices and its lagged pass-through to electricity bills and other charges. The FY26 core-core downgrade likely reflects price developments since July, given that the July forecast had already assumed a high rate of increase.

The FY28 core-core forecast of +2.3% is particularly important, as it shows inflation staying above 2% through the end of the projection period. This suggests the BOJ sees upward price pressure persisting over the medium to long term. It also maintained its assessment that, for the CPI outlook, "risks are skewed to the upside."

¹ Regarding crude oil prices, the July *Outlook Report* assumed that Dubai crude oil prices would decline from around \$80/barrel to around \$70/barrel toward the end of the projection period. This assumption has now been revised, with prices expected to decline from around \$105/barrel to around \$70/barrel toward the end of the projection period.

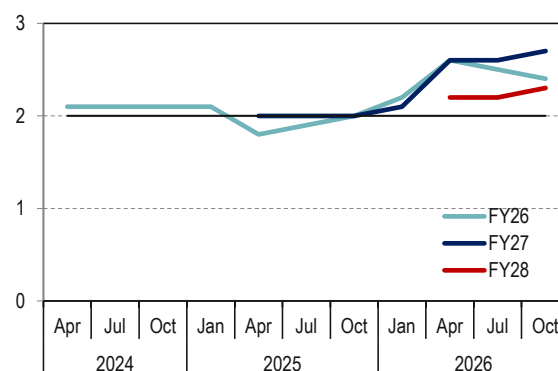
Against this backdrop, the BOJ is clearly mindful of "the risk of underlying CPI inflation deviating upward to a level above the price stability target of 2 percent." With the BOJ having judged at today's meeting that underlying inflation has reached 2%, its biggest concern has now shifted to preventing an overshoot above 2%. We think its upcoming rate decisions will prioritize risk management aimed at preventing such an overshoot.

Distribution of Core CPI Forecasts (majority of policy board members)

(%)	FY26		FY27		FY28	
	Jul-26	Oct-26	Jul-26	Oct-26	Jul-26	Oct-26
1.9						
2.0					6	6
2.1			1		1	2
2.2			1		2	1
2.3	2	1	1			
2.4		1	3	2		
2.5	3	5	2	2		
2.6	2	1		3		
2.7	1	1	1	1		
2.8	1			1		
2.9						
Upside	8	6	7	6	3	3
Downside	0	1	1	1	2	0
Balanced	1	2	1	2	4	6

Source: BOJ; compiled by Daiwa.

Core-core CPI Forecasts as of Each MPM (majority of policy board members)



Source: BOJ; compiled by Daiwa.

Governor Ueda's press conference: Watch judgment on underlying inflation, how BOJ will confirm anchoring

We expect Governor Kazuo Ueda to maintain a broadly data-dependent stance at his press conference, given high uncertainty overseas, including the US political calendar (the 3 November midterm elections). We think the three key points to watch will be (1) the reasons for judging that underlying inflation has reached 2% and the yardsticks for judging whether it is anchored, (2) the BOJ's assessment of financial conditions, and (3) how strongly Ueda hints at action at the December MPM.

We will be watching in particular which data the BOJ relied on in judging that underlying inflation has reached 2%, and which indicators it will use to judge whether inflation has become anchored. Rengo's basic plan for the 2027 spring wage negotiations sets a higher wage-increase guideline than in 2026, at "around 6%, at least 5%." We will also be watching for any shift in the BOJ's view of the risk that underlying inflation overshoots 2%. Board members Toichiro Asada and Ayano Sato are seen as doves, and we think their assessment of the 2% judgment will also be an important gauge of how each member sees prices.

Main Contents of Outlook Report

● Baseline Scenario of the Outlook for Economic Activity

Oct 2026	Japan's economy is expected to continue growing moderately, albeit at a decelerated rate, in fiscal 2026. This is because, although the rise in energy and raw material prices since early spring reflecting the impact of the situation in the Middle East is expected to push down economic activity, the economy is likely to be underpinned by factors such as the government's various measures and accommodative financial conditions, in addition to an increase in global AI-related demand. Japan's economic growth rate is likely to rise moderately from fiscal 2027 onward, since it is projected that the adverse effects of high energy and raw material prices will wane and that a virtuous cycle from income to spending will gradually intensify.
(Jul 2026)	Japan's economy is expected to continue growing moderately, albeit at a decelerated rate, in fiscal 2026. This is because, although the rise in crude oil prices since early spring reflecting the impact of the situation in the Middle East is expected to push down economic activity, the economy is likely to be underpinned by factors such as the government's various measures and accommodative financial conditions, in addition to an increase in global AI-related demand. Japan's economic growth rate is likely to rise moderately from fiscal 2027 onward, since it is projected that the adverse effects of high crude oil prices will wane and that a virtuous cycle from income to spending will gradually intensify.

<Risk balance>

Oct 2026	Risks to economic activity are generally balanced.
(Jul 2026)	Risks to economic activity are generally balanced.

● Baseline Scenario of the Outlook for Prices

Oct 2026	The y/y rate of increase in the consumer price index (CPI, all items less fresh food) is likely to accelerate to a level clearly above 2 percent. This is because, with moves to pass on wage increases to selling prices continuing, the rise in crude oil prices is expected to push up prices, mainly of energy and goods, and the rise in the prices of semiconductors and other items, reflecting the increase in global AI-related demand, and the depreciation of the yen thus far are likely to lead to an increase in prices, mainly of durable goods. Thereafter, with the waning of the effects of high crude oil prices, the rate of increase is expected to decline toward around 2 percent in the second half of the projection period. Meanwhile, with a sense of labor shortage continuing to be strong, the mechanism in which wages and prices rise moderately in interaction with each other has been operating, and medium- to long-term inflation expectations are at around 2 percent.
(Jul 2026)	The y/y rate of increase in the consumer price index (CPI, all items less fresh food) is likely to accelerate to a level clearly above 2 percent from the second half of fiscal 2026. This is because, with moves to pass on wage increases to selling prices continuing, the rise in crude oil prices to date is expected to push up prices, mainly of energy and goods, and the rise in the prices of semiconductors and other items, reflecting the increase in global AI-related demand, and the recent depreciation of the yen are likely to lead to an increase in prices, mainly of durable goods. Thereafter, with the waning of the effects of high crude oil prices, the rate of increase is expected to decline toward around 2 percent in the second half of the projection period. Meanwhile, with a sense of labor shortage continuing to be strong, it is projected that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained, and that medium- to long-term inflation expectations will rise.

<Timing of Achievement of the Price Stability Target>

Oct 2026	Underlying CPI inflation is at a level that is generally consistent with the price stability target of 2 percent, and is expected to remain at around that level.
(Jul 2026)	Underlying CPI inflation is expected to increase gradually, coming to a level that is generally consistent with the price stability target between the second half of fiscal 2026 and fiscal 2027 and remaining at around that level thereafter.

<Risk balance>

Oct 2026	Risks are skewed to the upside.
(Jul 2026)	Risks are skewed to the upside.

● Conduct of Monetary Policy

Oct 2026	Given that underlying CPI inflation is at a level that is generally consistent with the price stability target of 2 percent and financial conditions have been accommodative, the Bank will continue to raise the policy interest rate and adjust the degree of monetary accommodation, in response to developments in economic activity and prices as well as financial conditions. In this regard, it will consider the timing and pace of adjustment, while examining the likelihood of realizing the baseline scenario of the outlook for economic activity and prices and the risks to the outlook, including the impact of factors such as the situation in the Middle East, the expansion in AI-related demand, and developments in foreign exchange rates. In particular, the perspective of stabilizing underlying CPI inflation at a level around 2 percent becomes important in order to keep the risk of underlying CPI inflation deviating upward to a level above the price stability target of 2 percent from materializing and thereby exerting an adverse impact on the economy afterward.
(Jul 2026)	Given that underlying CPI inflation has been approaching 2 percent and financial conditions have been accommodative, the Bank will continue to raise the policy interest rate and adjust the degree of monetary accommodation, in response to developments in economic activity and prices as well as financial conditions. In this regard, it will consider the timing and pace of adjustment, while examining the likelihood of realizing the baseline scenario of the outlook for economic activity and prices and the risks to the outlook, including the impact of the situation in the Middle East, the expansion in AI-related demand, and developments in foreign exchange rates. In particular, the perspective of stabilizing underlying CPI inflation at a level around 2 percent becomes important in order to keep the risk of underlying CPI inflation deviating upward to a level above the price stability target of 2 percent from materializing and thereby exerting an adverse impact on the economy afterward.

Source: BOJ; compiled by Daiwa.

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