Japan Macro Watch

BoJ preview: On hold, but laying groundwork for next rate hike

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BoJ to forego hike given domestic/overseas uncertainties

We expect the Bank of Japan (BoJ) to maintain its policy rate at 0.5% at the next monetary policy meeting (MPM) on 29-30 October. Market expectations for an October rate hike rose following two policy board members' surprise call for a rate hike at the previous 18-19 September MPM (see BoJ review: Two surprises, 19 September). However, expectations for an October hike fell sharply as the 4 October LDP leadership election shook up the domestic political landscape. While the 21 October prime ministerial election passed, we expect the BoJ to forego a rate hike at its October MPM given ongoing domestic political uncertainty and the difficulty of assessing the state of the US economy amid the government shutdown.

BoJ to lay groundwork for next rate hike

However, even if the BoJ remains on hold as we expect, we think it will send a hawkish message to prepare the way for its next rate hike. We expect it to nudge up its FY25 GDP growth forecasts based on data for the past three months, but leave its FY26-FY27 forecasts largely unchanged (Exhibit 1).

The more important focus will be the language in the meeting statement concerning the BoJ's economic and inflation forecasts and risk assessment; any revisions to the language that indicate the pace of growth or underlying inflation is slowing, or that "high uncertainties remain" about economic activity and prices at home and abroad, could be seen as a major step toward the next hike.

If policy board members other than Hajime Takata and Naoki Tamura (who argued for a rate hike at the September MPM) come out in favor of raising interest rates this would also send the message that the BoJ is closer to hiking.

Even without these changes, we expect BoJ Governor Kazuo Ueda to respond to the recent rise in inflation expectations by placing greater emphasis on underlying inflation and upside risks to prices at his post-MPM press conference (see Tug-of-war between rising inflation expectations and political uncertainty, 10 October). We think the market would likely view this as preparing the way for the next rate hike.

BoJ to stay cautious on overseas economies

However, we think the BoJ will stick with its cautious assessment of overseas economies. In a 3 October speech, Governor Ueda noted three key points in assessing economic and inflation trends: (1) overseas economies, particularly US job market trends, (2) the impact of tariff policy on Japanese firms' earnings, wages, and price-setting behavior, and (3) food price trends[1]. (continued overleaf)

[1] Speech by BOJ Governor Kazuo Ueda at 3 October meeting of business leaders in Osaka

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Overseas economies are a source of growing uncertainty, due mainly to the US's ongoing government shutdown, move to raise tariffs on China, and credit concerns in the banking system. Governor Ueda commented at a press conference following his 3 October speech that if the release of US economic data was delayed the BoJ would compensate by looking at related data and exchanging views with US policymakers at last week's annual meetings of the World Bank and IMF. However, we think the BoJ is unlikely to form a more constructive view of overseas economies, particularly the US, given the lack of official data and weak alternative data since the previous MPM.

Events this week have dispelled some (but not all) of the uncertainty surrounding domestic politics (see New LDP-JIP coalition: Policy & market implications, 20 October). This will keep the focus on negotiations between the political parties, and with minimal information available as yet about the outcome of talks we think most BoJ policy board members will be reluctant to push for a rate hike.

Data since last MPM generally upbeat

However, domestic economic data released since the September MPM remains solid.

September BoJ Tankan (released 1 October): There were no major changes from the previous survey, with corporate sentiment and capex plans remaining solid despite the impact of tariffs, though this was not new news. Companies' medium-term inflation expectations also rose again (see BoJ Tankan (Sep): Marginal support for BoJ hike, but no rush, 1 October).

BoJ branch manager meeting report (6 October): Companies remain cautious given their view that the impact of US tariffs has yet to feed through, and indicate high uncertainty about next year's wage increases. However, they have a strong sense of the need to increase pay in the face of labor shortages and inflation, and there are no signs at this point of significant changes in corporate wage-setting behavior.

Opinion Survey on the General Public's Views and Behavior (10 October): Households' inflation expectations five years out rose again. This will likely prompt a sharper increase in the synthesized inflation expectations indicators that the BoJ positions as a key gauge of underlying inflation (see Tug-of-war between rising inflation expectations and political uncertainty, 10 October).

Other monthly data: Manufacturing activity remains subdued, but domestic spending and consumer sentiment remain solid (see Chartbook (Sep '25): External demand weak, domestic demand solid, 16 October). Sep real exports, announced on 22 Oct, also rebounded after slowing in Jul-Aug.

Data support rate hikes once uncertainty recedes

The solid domestic economic data imply that the BoJ is likely to raise rates in line with the improving outlook for economic activity and prices if uncertainties about the US economy and domestic politics recede.

We continue to expect the next rate hike in January 2026, but if domestic and overseas uncertainties subside over the next 1-2 months and financial markets remain stable, we think a hike at the December MPM would become more likely.

By the December meeting, the BoJ will have in hand much of the information that Governor Ueda views as key, including Japanese firms' 1H FY25 results and full-year earnings guidance (as a gauge of US tariffs' impact), major industry unions' wage hike demand for FY26 (see Wages update: Downside surprise, but focus shifts to FY26 Shunto, 8 October), rice price data following the latest harvest, and information on service price hikes in October (the start of fiscal 2H).

Given future uncertainty, we think the BoJ is unlikely to give a definitive signal at the October MPM of whether it will raise rates at the December or January meetings, but we will be watching the tone of Governor Ueda's comments at the post-MPM press conference to gauge how far off the next hike is.

Exhibit 1: A slight upward revision is expected for FY25, while forecasts for FY26-27 are expected to remain largely unchanged
BoJ policy board GDP/CPI forecasts vs. consensus

	BoJ (July)	BoJ (Oct f'cast)*	Consensus**
Real GDP			
FY25	0.6	0.8	0.8
FY26	0.7	0.6	0.7
FY27	1.0	1.0	0.8
CPI ex fresh food			
FY25	2.7	2.7	2.7
FY26	1.8	1.8	1.7
FY27	2.0	2.0	1.8
CPI ex fresh food and energy			
FY25	2.8	2.8	2.9
FY26	1.9	1.9	2.0
FY27	2.0	2.0	2.0

Source: Bank of Japan, Bloomberg, BofA Global Research *BoJ October forecasts are BofA's expectations for the October Outlook Report **Consensus forecasts are from Bloomberg's analyst survey conducted 2-9 October, (n=58)

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Exhibit 2: Some board members raised their risk assessments for the FY25 and FY26 inflation outlooks to a neutral stance in July
BoJ CPI ex Fresh Food forecasts

	FY25		FY26		FY27	
	Apr MPM	Jul MPM	Apr MPM	Jul MPM	Apr MPM	Jul MPM
2.9		○				
2.8		△△▼				
2.7		△○○▼▼				
2.6						
2.5						
2.4						
2.3	△△					
2.2	○▼▼					
2.1	▼▼					○
2.0	▼▼			△△	△○○	△○○○▼
1.9			△	○▼	△○▼	△
1.8			△△○	△○▼	○○	○○
1.7			▼▼			
1.6			▼▼	○▼		
1.5					○	
1.4			▼			

Source: Bank of Japan, BofA Global Research; Note: The locations of ○, △, and ▼ in the charts indicate the figures for each Policy Board member's forecasts to which they attach the highest probability. The risk balance assessed by each Policy Board member is shown by the following shapes: ○ indicates that a member assesses "upside and downside risks as being generally balanced," △ indicates that a member assesses "risks are skewed to the upside," and ▼ indicates that a member assesses "risks are skewed to the downside." The yellow-shaded figure refers to the median of the Policy Board members' forecasts.

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- Takayasu Kudo, Japan economist

Rates: Focus on the number of members proposing hike

As mentioned above, maintaining the policy rate is the consensus for the October 2025 meeting, with market pricing for an additional hike at the October MPM only around 10%. The key focus for the rate market at the October meeting will likely be the number of board members advocating for a rate hike. At the September MPM, two members—Tamura and Takata—voted against keeping the policy rate unchanged, expressing the view that an additional 25bp rate hike was necessary. Based on their recent speeches, both are expected to propose a rate hike again at the October meeting. However, if the number of members proposing a hike increases from two to three, it would be a surprise.

That said, the market is priced in at over 80% for the BoJ by January 2026, a decision to hold the policy rate at the October MPM is unlikely to trigger a rally in medium-term JGBs. Given that the size of the supplementary budget for FY2025 may not exceed that of FY2024, the near-term risk of a steepening JGB curve appears to have receded.

- Tomonobu Yamashita, Rates strategist

FX: BoJ/Fed MPM and US-JP summit may boost USD/JPY

The risk for next week is tilted toward a rise in USD/JPY. First, the BoJ's MPM is expected to result in no change. Our economists anticipate a hawkish tone on domestic developments, but they also expect the Bank to maintain a cautious stance in assessing overseas economic conditions.

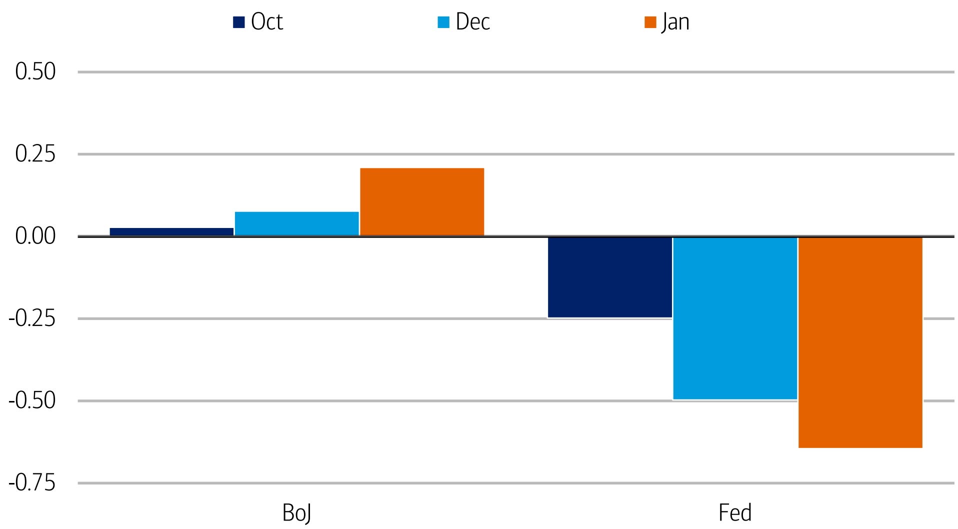
Currently, the market is fully pricing in rate cuts by the Federal Reserve in October and December, with more than 50% priced for January. On the other hand, a 25 basis point rate hike by January is priced in at over 80% for the BoJ (see Chart 3). The FOMC meeting is also scheduled for next week.

The U.S. rates market appears to be pricing in a weakening labor market. Our base case is that the BOJ will raise rates in January, while the Fed will cut rates next week and then hold steady until the end of Chair Powell's term. Therefore, it is the pricing of U.S. rates that seems too dovish, although this could also reflect heightened uncertainty due to the ongoing government shutdown. If Governor Ueda emphasizes such uncertainties, the market may react with yen depreciation.

Additionally, a Japan-U.S. summit is scheduled for next week. In terms of the foreign exchange market, if discussions progress on 1) Japanese investment in the U.S. based on a bilateral investment agreement, or 2) Japan's increased defense spending, these could boost USD/JPY (see: FX Watch: Q&A on JPY – domestic risks skewed to a weaker yen 13 October 2025).

Exhibit 3: Policy rate expectations for the next three policy meetings for the BoJ and Fed (cumulative change, % points)

Market expects continued rate cuts by Fed and a hike by BoJ by Jan



Source: Bloomberg

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- Shusuke Yamada, FX/rates strategist

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