【Fixed Income Commentary - Monetary Policy Navigator】

October MPM preview: BoJ expected to indicate that inflation is “at level consistent with” 2% target

(original Japanese report issued on October 26, 2026)

Key points

- We project BoJ will leave policy rate on hold at 1.25% at October meeting after raising rates in June and September
- Bank seen indicating that underlying inflation is “at a level consistent with” 2% target, 13 years after it was announced
- Policy conduct likely to continue to emphasize upside risks to prices for now; we anticipate additional rate hikes in December 2026 and April 2027

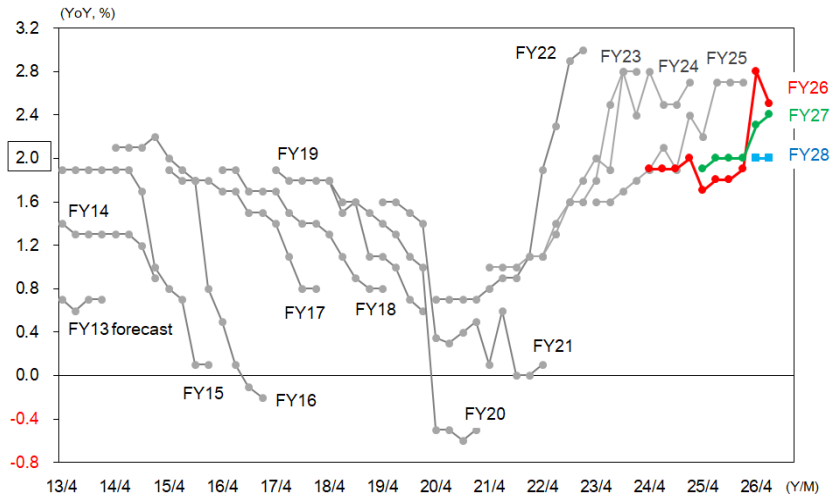
BoJ seen leaving policy rate on hold at 1.25%

The Bank of Japan will hold a Monetary Policy Meeting on October 29-30, with the official statement to be released on the second day along with the latest Outlook for Economic Activity and Prices (“Outlook Report”). We continue to forecast that the BoJ will keep the policy rate steady at 1.25%. With only a little over a month since the September hike and no new upside risks to inflation emerging, we expect the Bank to adopt a wait-and-see stance. We anticipate an 8-1 majority vote, with Hajime Takata, the most hawkish member of the Policy Board, dissenting in favor of back-to-back rate hikes.

BoJ expected to determine that inflation target has been achieved, 13 years after Joint Statement

There are a number of key points to watch at the meeting. First, in the Outlook Report, we expect the BoJ will conclude that the underlying rate of consumer price inflation (“underlying inflation”) is at a level generally consistent with the 2% price stability target. This would signal the Bank’s acknowledgment that the inflation target set jointly with the government in the January 2013 Joint Statement, some 13 years ago, has finally been achieved (Graph 1). However, simply touching the target once is not enough. The BoJ will now shift from a focus on the downside risks to inflation to a stance of monitoring risks in both directions. At his October 16 press conference following the G20 Finance Ministers and Central Bank Governors Meeting, BoJ Governor Kazuo Ueda said, “We cannot tolerate any further rise [in underlying inflation],” using stronger language than before to signal his determination to keep the upside risks to prices in check. As consecutive or larger rate hikes could become possible depending on circumstances, the Bank’s assessment of inflation warrants closer attention than in the past. We will also be watching to see whether the Takaichi administration, which has so far confined itself to stating that Japan is “not in deflation,” considers declaring an end to deflation.

Graph 1: BoJ Policy Board's price outlook



Source: MUMSS, from BoJ materials

BoJ likely to remain wary of upside risks to prices

The content of the Outlook Report should also be important to monitor in relation to the Bank's "change in policy phase." We expect the BoJ to raise its real GDP growth forecasts (Table 1) for FY26 and FY27 from the July projections of +0.6% and +0.8%, respectively, to reflect recent developments. We think the risks to economic activity will remain "generally balanced." The inflation forecasts for FY26 and FY27 may be revised slightly higher in response to rising costs and the recent rebound in crude oil prices. Based on its analysis, the Bank has concluded that companies are passing on higher costs more quickly than before, and we expect it to reaffirm that the risks to its inflation outlook are "skewed to the upside." It is also likely to reiterate that "there is a risk that [underlying inflation] will deviate upward to a level above the price stability target of 2%."[1]

Table 1: BoJ's outlook for economic activity and prices in the July Outlook Report

(%, the median forecast, the forecast ranges of the majority members are in parentheses)

	Real GDP	CPI (all items less fresh food)	(Reference) CPI (all items less fresh food and energy)
FY26	**0.6** < 0.6 ~ 0.7 >	**2.5** < 2.3 ~ 2.7 >	**2.5** < 2.3 ~ 2.6 >
Apr	0.5 < 0.4 ~ 0.7 >	2.8 < 2.8 ~ 3.0 >	2.6 < 2.5 ~ 2.7 >
FY27	**0.8** < 0.7 ~ 0.8 >	**2.4** < 2.2 ~ 2.5 >	**2.6** < 2.2 ~ 2.7 >
Apr	0.7 < 0.6 ~ 0.8 >	2.3 < 2.3 ~ 2.4 >	2.6 < 2.6 ~ 2.7 >
FY28	**0.8** < 0.7 ~ 0.8 >	**2.0** < 2.0 ~ 2.2 >	**2.2** < 2.1 ~ 2.3 >
Apr	0.8 < 0.7 ~ 0.8 >	2.0 < 2.0 ~ 2.2 >	2.2 < 2.1 ~ 2.4 >

Risk balances

July	With regard to the risk balance, risks to economic activity are generally balanced. **Regarding the outlook for the CPI, risks are skewed to the upside.** As for underlying CPI inflation, **there is a risk that it will deviate upward to a level above the price stability target of 2 percent,** given factors such as firms' behavior shifting more toward raising wages and prices and medium- to long-term inflation expectations continuing to rise. **It is necessary to pay due attention to keep such a risk from materializing and thereby exerting an adverse impact on the economy afterward.**

Source: MUMSS, from BoJ materials (emphasis by MUMSS)

Table 2: BoJ's guidelines for the conduct of monetary policy presented at the September MPM

As for the future conduct of monetary policy, 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 AIrelated 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. With the price stability target of 2 percent, the Bank will conduct monetary policy as appropriate from the perspective of sustainable and stable achievement of the target.

Source: MUMSS, from BoJ materials

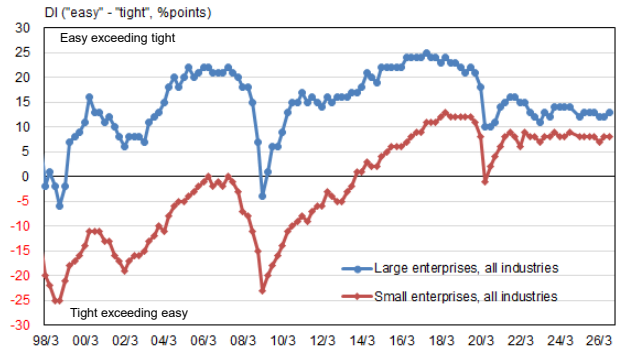
[1] It appears that the BoJ's projections will not factor in the impact of the consumption tax cut currently under deliberation in the Diet.

BoJ expected to maintain guidance for further rate hikes

The Bank's monetary policy guidance is also likely to undergo some revisions. Table 2 shows the wording adopted at the September meeting, when the policy rate was increased. We think the phrase "given that underlying CPI inflation has been approaching 2%" may be replaced with something along the lines of "given that underlying CPI inflation is at a level generally consistent with the 2% inflation target." We do not anticipate any other notable changes and expect the Bank to reiterate its view that "financial conditions have been accommodative." The September Tankan showed little change in the DIs for corporate financial positions and bank lending attitudes (Graphs 2 and 3) while the corporate loan demand DI in the October edition of the Senior Loan Officer Opinion Survey on Bank Lending Practices at Large Japanese Banks rose from the previous survey, indicating stronger demand for funds. At least in bank lending, there is little evidence that rate hikes have had a significant impact. At his September 18 press conference, Governor Ueda explained that he assesses financial conditions from three broad perspectives: 1) interest rates, 2) bank lending, and 3) asset markets. He said that "interest rates, particularly in the long- and super-long-term sectors, have become considerably more restrictive. The other two channels remain somewhat accommodative, but we intend to keep a close eye on future developments" (translation by MUMSS).

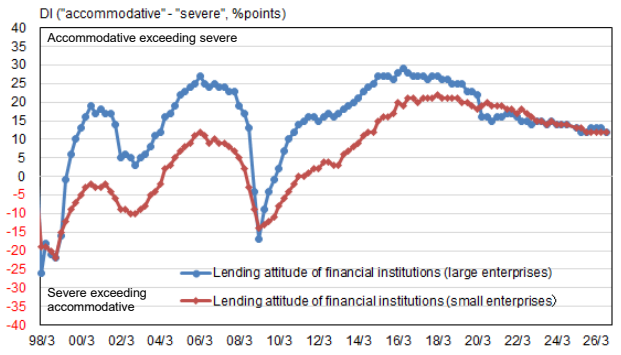
At the post-meeting press conference, the governor is likely to explain the contents of the Outlook Report as outlined above while refraining from specifying the timing of the next rate hike, saying that the decision will depend on economic activity, prices, financial conditions, and the Bank's assessment of risks. Last week the markets moved into "risk-off" mode, with equities falling, the yen strengthening, and bonds rallying. If financial markets are still risk-averse at the time of the press briefing, he may say that market sentiment will also be taken into account when deciding the appropriate pace of future rate hikes.

Graph 2: DI for corporate financial positions



Source: MUMSS, from BoJ materials

Graph 3: DI for bank lending attitudes



Source: MUMSS, from BoJ materials

We expect the next hike in December, but developments in global financial markets bear watching

We continue to expect the BoJ to raise the policy rate to 1.50% at the December 2026 meeting and to 1.75% at the April 2027 meeting, thus completing its adjustments to "the degree of monetary accommodation." Maintaining a three-month interval between tightening moves would imply the hike at the December 17-18 meeting would be followed by another at the March 17-18 meeting next year. But given the increased sensitivity of deposit and mortgage rates to rate hikes, we think the Bank would probably prefer to avoid raising rates immediately before the fiscal year-end. As such, the April Outlook Report meeting, at which the BoJ will

first present its forecasts for FY29, seems a more natural choice. Moreover, consumers may defer purchases of nonperishable processed foods in March if the consumption tax cut takes effect in April 2027, and retail price developments in the wake of the tax cut also remain uncertain. By the April 27-28 meeting, the Bank would have had more opportunities to gather anecdotal evidence on post-tax-cut consumption and retail price trends, thus providing a stronger justification for its policy decision.

The upside risk scenario for the terminal rate relative to our forecast is one in which demand and supply shocks combine to lift underlying inflation, prompting the BoJ to continue raising rates even after real rates turn positive. In the downside risk scenario for the terminal rate, where the Bank stops tightening at 1.25% or 1.50% or pauses its rate hikes, prolonged instability in global financial markets increases the downside risks to economic activity. In this regard, we intend to keep a close eye on global developments in equities and exchange rates.

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10:00 JST, October 26, 2026

Appendix A

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