
**31 July 2025**

# Some clouds may be lifting, but the Bank of Japan continues to circle

## Key takeaways

- Although no one expected the Bank of Japan (BOJ) to raise rates this week, BOJ Governor Ueda Kazuo suggested that the bank may want more clarity before it resumes policy normalization.
- Despite the reduction – though not the elimination – of risks from US-Japan trade friction, the BOJ is still uncertain about the outlook for the real economy and also must navigate domestic political uncertainty, all of which could delay additional rate hikes.

---

The Bank of Japan (BOJ) held rates steady again after its 30-31 July policy board meeting, but with the bank significantly increasing its forecast for inflation for FY2025, as well as modestly increasing its forecast for FY2026 and FY2027, the BOJ may once again be looking for an opportunity to resume policy normalization. However, though the US-Japan trade deal announced earlier this month has reduced some (but not all) of the uncertainty that has led the bank to pause its rate hikes, the BOJ is wary of the potential impact on the real economy – particularly on corporate profits and therefore the outlook for wage increases – and could therefore move more slowly than market expectations before it raises interest rates again.

In his remarks, BOJ Governor Ueda Kazuo acknowledged that the trade agreement between Japan and the United States reduces some of the uncertainty – he said that it appears Japan has avoided a “fall off the cliff” scenario that the bank viewed as a “tail risk” – but warned that “it is unlikely that the fog will clear all at once,” suggesting that it could take time for the impact of higher tariffs on corporate balance sheets to be clear. Ueda was circumspect when asked about how long it could take for the bank to feel confident about the impact of trade barriers on Japan’s real economy, stating that the bank will monitor the situation closely but that it is not possible to determine how long it will take to judge.

However, as the risks from US-Japan trade friction recede somewhat, domestic political uncertainty could be growing as a potential constraint on the BOJ's freedom of action. To some extent, it is simply a matter of uncertainty: without clarity on Prime Minister Ishiba Shigeru's political future, the possible timeline for selecting a replacement, and who that replacement could be, the BOJ will find it difficult to raise rates even if the economic outlook shifts in an unambiguously positive direction. It may also be reluctant to raise rates immediately after the transition to a new government, which at the current pace is unlikely before September at the earliest. Meanwhile, depending on how the LDP's leadership struggles resolve, the BOJ could potentially be facing a government with a "neo-Abenomics" orientation that seeks to use fiscal policy to boost growth while leaning on the BOJ to accommodate this policy shift.

The upshot is that the despite the upward revisions to the BOJ's inflation forecast and the bank's general interest in normalizing monetary policy, it is plausible that the BOJ will remain in a holding pattern for far longer than anyone anticipated after it raised short-term rates to 0.50% in January. Indeed, at times Ueda sounded outright dovish in his remarks Thursday, suggesting, for example, that since above-target inflation is driven by supply-side factors (like those that have pushed up food prices), he was unsure whether it would be desirable to reduce food prices by using monetary policy to reduce incomes and therefore spending on food. In general, Ueda suggested that he wants to see through some of the uncertainty around economic activity and focus on the basic question of whether wages and prices are rising hand in hand, pointing to a desire for far greater clarity on the state of Japan's real economy – to say nothing of a more stable political climate – before the bank is prepared to make additional monetary policy changes.

---

**Tobias Harris**
Founder and Principal
Japan Foresight LLC
tobias@japanforesight.com
+1.847.738.4048

---