



J A P A N

F O R E S I G H T

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BOJ will send useful signals even with Ueda absent

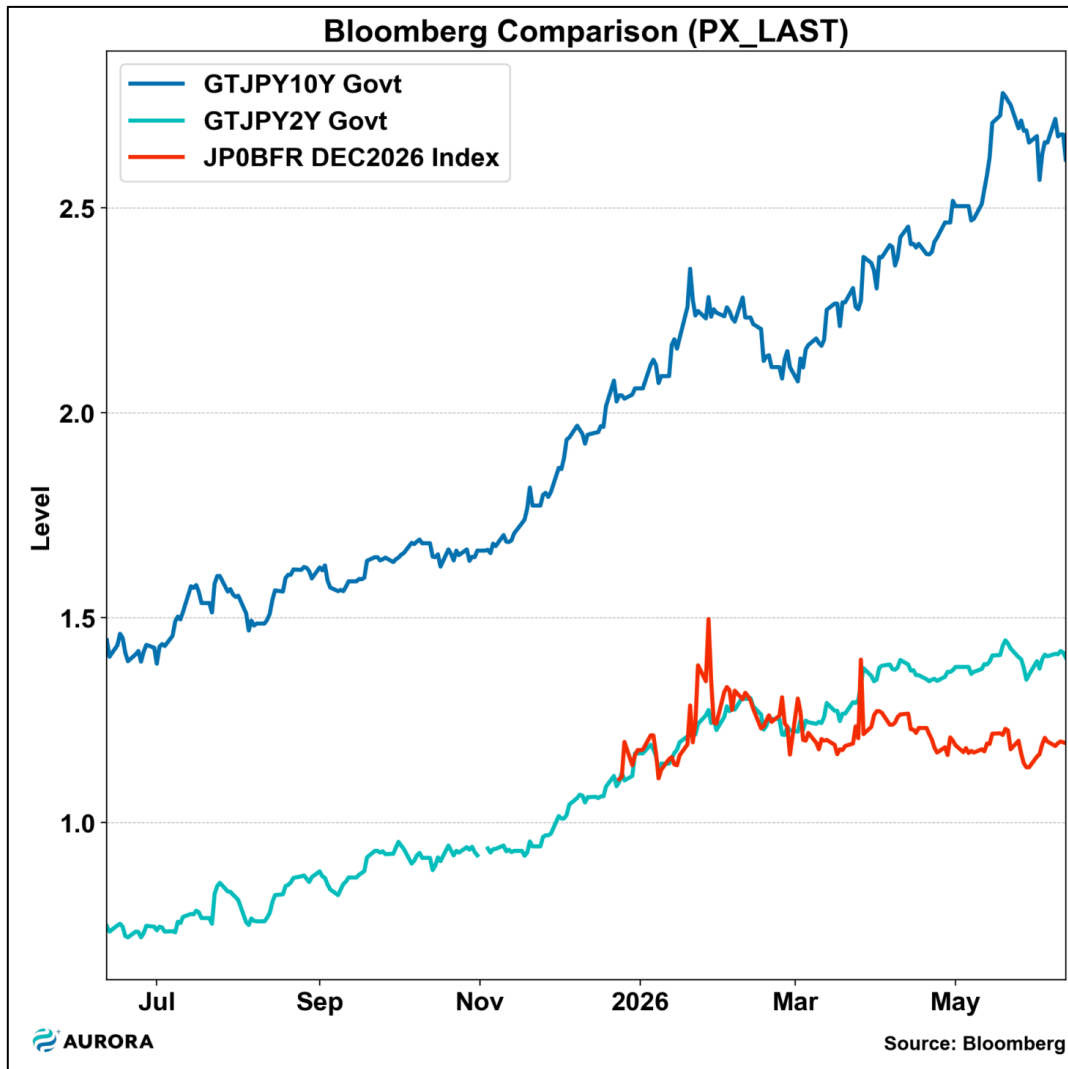
Key takeaways

- The Bank of Japan (BOJ) is prepared to raise rates to 1% and could also announce that it will freeze the pace at which it will reduce bond purchases in 2027.
- With Governor Ueda Kazuo hospitalized, the BOJ's communication may be particularly cautious, but the meeting could still provide insight into the bank's intentions while providing a snapshot of the structure of the market for Japanese government debt going forward.

The Bank of Japan (BOJ) will hold its next policy board meeting from 15-16 June. BOJ Governor Ueda Kazuo and other officials have already signaled that the bank is prepared to raise short-term rates another twenty-five basis points to 1.0%, their highest level since 1995. The BOJ sees its own internal measurements of inflation, stripping out the impact of government policies to suppress retail prices, outpacing its 2% inflation target; the producer price index has also surged, rising 6.3% year-over-year in May (import prices rose 15.5% year-over-year), and, with the bank anticipating that businesses will begin passing through input costs to consumers faster, it is determined not to fall behind the curve in monetary tightening.

The key question therefore is whether the bank will offer clear messaging regarding the path for subsequent rate hikes in its communication on Tuesday. With Ueda absent from next week's meeting due to his hospitalization, it seems unlikely that Deputy Governor Uchida Shinichi, who will hold the post-meeting press conference in Ueda's stead, will deviate markedly from the governor's cautious, data-driven messaging. Uchida, a career BOJ official, has only recently been released from the hospital after months-long treatment for leukemia. The BOJ's approach to past rate hikes since it began monetary normalization in 2023 has been to pause following rate hikes to monitor their impact.

While the build-up of inflationary pressures in the economy due to the Hormuz crisis could induce greater urgency, Ueda's caution and ongoing pressure from the Takaichi government for the bank to go slowly makes it unlikely that the BOJ will consider another rate hike before Q4. That said, with other central banks hiking and the yen again at JPY 160/USD, Uchida will have to thread the needle in his turn in Ueda's seat.



The other messaging from the BOJ next week will be on adjustments to its plans for tapering long-term Japanese government bond purchases. The bank is reportedly exploring “pausing” its tapering: once its monthly JGB purchases decline to JPY 2.1tn monthly in Q1 2027, it will stabilize its purchases at that level from April 2027 onward. As Ueda said in a speech on 3 June, the BOJ sees progress in the normalization of JGB markets but may decide to pause its tapering to give financial market participants more time to adjust their portfolios. This decision, communicated well in advance of the meeting, could limit its impact on Tuesday. However, the BOJ’s deliberations on its “passive quantitative tightening” will necessarily call attention to the structural change in demand for JGBs just as the Takaichi government is preparing to outline significant new outlays, including Prime Minister Takaichi Sanae’s decision on a consumption tax cut

and the government's growth strategy, which will include strategic investments backed by "bridging bonds" that could increase gross issuance in the near term. Meanwhile, over the coming months it will also be outlining its intentions for increasing defense spending, with little clarity on whether the government will be willing or able to raise taxes to offset the larger budgets.

In short, next week's meeting could throw into relief the extent to which the market for JGBs has changed. Even with the BOJ "stabilizing" its long-term JGB purchases at roughly JPY 25tn per annum, it would be allowing roughly JPY70tn per annum of its bond holdings to reach maturity, leaving the Ministry of Finance (MOF) to secure buyers for an additional JPY 45-50tn in rollover bonds, at higher interest rates. Depending on the ultimate shape of the Takaichi government's "responsible fiscal expansion" program, its new issuance could also surpass the roughly JPY 30tn the government has been issuing annually. Meanwhile, the Government Pension Investment Fund and other institutional investors, which were pushed to diversify their portfolios and professionalize their operations as part of Abenomics, cannot easily increase their JGB holdings, and the demand from life insurance companies has declined. It may be little surprise that MOF is looking to retail investors as an under-utilized source of demand for JGBs; a MOF study group in May discussed ways to design government bonds to appeal to retail investors, whose demand for JGBs has grown (it rose 36% in FY2025) but still held only JPY 6tn. A study group led by former prime minister Kishida Fumio previously proposed to Prime Minister Takaichi that it needs to take steps to encourage greater JGB purchases by individual investors, including by changing rules that have prevented investors from using their tax-advantaged Nippon Individual Savings Accounts (NISA) to purchase JGBs directly.

The upshot is that next week's BOJ meeting is unlikely to alter the overall picture of a BOJ still committed to a cautious approach of gradual interest rate increases and gradual quantitative tightening, at the same time that the Takaichi government is pursuing a course of action that could increase the supply of Japanese government bonds as a moment when investors are finding better returns elsewhere. Perhaps the most important line from Ueda's 3 June speech was a warning: that "in exceptional circumstances such as a rapid rise in long-term interest rates, the Bank could make nimble responses by, for example, increasing the amount of JGB purchases.

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