31 July 2026

BOJ holds but anticipates higher inflation from multiple sources

Key takeaways

- The Bank of Japan (BOJ) did not deliver a surprise rate hike, but Governor Ueda Kazuo sent a strong message that the bank is worried about the possibility for above-target inflation in the near term, pointing to another hike as early as September.
- Prime Minister Takaichi Sanae's political difficulties may give the BOJ more space to hike, as the prime minister can ill afford the negative political and market reactions that perceived intervention in monetary policy would bring.

The Bank of Japan's (BOJ) policy board performed as expected on Friday, 31 July, voting by an 8-1 margin to hold short-term rates at 1.0%. While the Ministry of Finance's (MOF) intervention in the foreign exchange markets Thursday – estimated to be as much as JPY 7tn and reportedly accompanied by a rate check by the US Treasury – prompted some speculation that the BOJ could be prepared to deliver another boost to the yen with a surprise hike, BOJ Governor Ueda Kazuo kept to the familiar script instead of delivering a jolt to markets.

Nevertheless, although the bank revised its inflation forecast downward for FY2026 in its quarterly outlook from 2.8% to 2.5%, citing the impact of government policies to contain gasoline and utility price spikes, it remains more concerned about an upward price shock than slower growth. The quarterly report, after all, raised the FY2027 projection slightly, from 2.3% to 2.4%, suggesting it expects that the impact of the government's policies to fade. Additionally, the one dissent was a hawkish dissent, with Takata Hajime wanting a hike to 1.25%. Meanwhile, Ueda delivered a hawkish message in his press conference, warning that the BOJ cannot overlook the risk that inflation overshoots its 2% target, pointing to not only the impact of the ongoing conflict in the

Middle East but also yen weakness and price increases for AI-related goods passing through to other parts of the economy. The bank also remains highly sensitive to corporate price-setting behavior, anticipating that businesses are starting to pass through the impact of rising wholesale prices. After all, the producer price index rose 7.1% year-over-year in June and the Tokyo consumer price index (CPI), a leading indicator for nationwide CPI, rose 2.0% in July year-over-year, suggesting that, the Takaichi government's policies notwithstanding, consumer inflation is in fact becoming more visible.

Ueda's messaging suggests that the BOJ's 17-18 September policy board meeting is a live possibility for another rate hike, particularly if data continues to point to retailers passing along wholesale price increases to consumers. The governor suggested that the bank's pace of hiking could accelerate and repeated his desire to not fall behind the curve. With Prime Minister Takaichi Sanae on the defensive – and the US Treasury keen to see the yen strengthen – Ueda may have more political space to hike again in September than might otherwise have been the case, assuming that the board finds that the data merits it. The Takaichi government's desire to maintain market confidence in the government's finances and stabilize the market for Japanese government bonds at a moment when its management of macroeconomic policy will be closely scrutinized could induce a certain amount of restraint towards the BOJ in the near term. In short differently, Takaichi may not be able to afford the additional pressure that leaning on the BOJ would bring from within her own party, from opposition benches, from financial markets, and from Washington at a sensitive moment for her government.

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