

Path to rate hikes indicated in the BOJ's Outlook Report

The next Monetary Policy Meeting of the Bank of Japan (BOJ) will be held on June 15–16. In this column I set out the key points to watch in assessing the policy decision at that meeting.

As expected by markets, the policy rate was left unchanged at the April meeting. The main reasons given were the difficulty of assessing the economic impact of developments in the Middle East and the view that price developments were not yet so acute as to require hasty tightening. At his press conference immediately after the meeting, the Governor described developments in the Middle East as a supply shock and said it was appropriate, in principle, to “look through” temporary supply shocks (1).

Although the decision to hold rates was within expectations, I paid particular attention to the generally cautious tone regarding inflation in the communication (2). Importantly, a majority of the Policy Board (seven members) raised upside risks to prices for 2026 and 2027 relative to the baseline scenario — a point that is likely to matter for future policy judgments.

To recap the BOJ's baseline assumptions in April: tensions around the Middle East were assumed to ease gradually, and Dubai crude was expected to decline gradually from around \$105 per barrel toward about \$70. In the risk scenario, by contrast, Dubai crude was assumed to rise to around \$105 and remain elevated through the end of 2026; the economy would weaken further and inflation would be substantially higher (3).

Actual crude prices since then have been above the baseline assumptions and closer to the risk scenario. In other words, the upside risk to inflation has increased.

Will the objective of rate hikes shift toward containing inflation expectations?

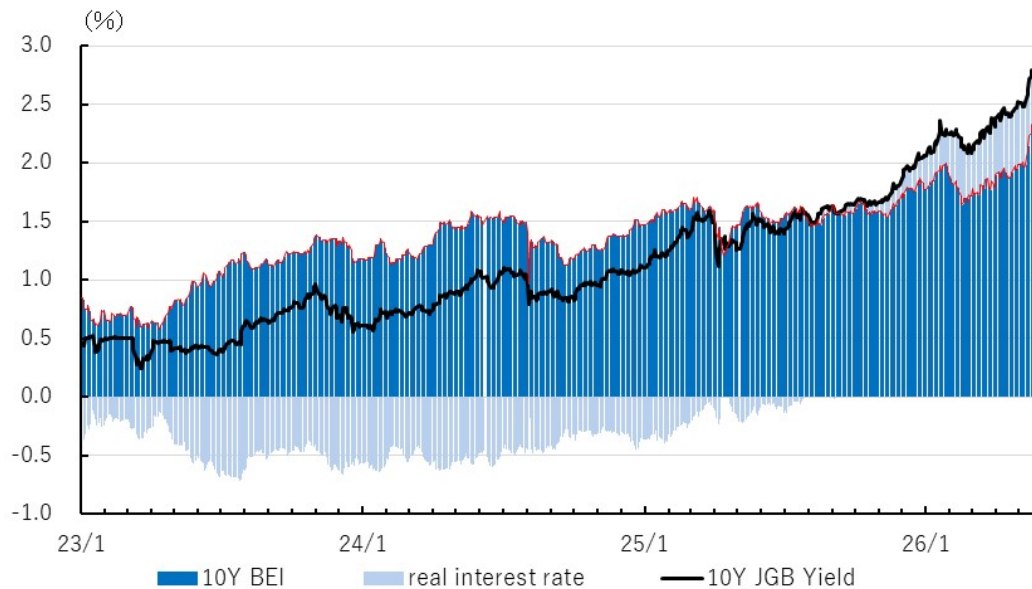
If upside risks to inflation materialize, the key issue for June will not simply be whether the BOJ raises rates, but whether the purpose of any rate increases changes. To date the BOJ has framed tightening as an “adjustment to the degree of monetary easing.” The important question is whether the BOJ will add objectives such as “containing upside risks to underlying inflation” and “suppressing inflation expectations.” Such a shift in stated objectives would affect the pace of future hikes and the BOJ's communication approach.

On May 15, the BOJ published the results of its hearings on price-setting behavior among consumption-related firms (4). The hearings show that pass-through of rising input and labour costs to selling prices is spreading steadily and that the majority of firms plan price increases in fiscal 2026. The report also notes that, depending on future Middle East developments, many firms could face additional cost increases and proceed with further price rises. The BOJ is likely to view these findings as a factor pushing up underlying inflation at the next meeting.

More directly, medium- and long-term inflation expectations of households, firms and financial market participants are critical. If those expectations do not remain consistent with the 2 percent price target, the BOJ could shift to a stance favouring faster and larger rate increases (5). Market-based measures of inflation expectations — for example the breakeven inflation rate implied

by nominal and inflation-linked government bond yields (BEI) — have been trending up (see Chart 1).

Chart1 Long Term Interest Rate and BEI in Japan



Source: Compiled by NRI based on Bloomberg data

Household and firm survey measures of inflation expectations will not be available until July. If those July data show a sharp rise, the subsequent pace of rate increases is likely to be faster than the relatively slow, half-yearly pace some market participants have discussed — possibly occurring every few months rather than every six months.

Using rate hikes to contain inflation expectations could also be aimed at curbing excessive real-estate investment. In its April Financial System Report, the BOJ noted rising property prices concentrated in metropolitan areas and an acceleration in land price increases (6). While these developments were not judged to pose systemic stability problems at that stage, the report pointed out that investment condominium transactions and commercial real-estate demand in the Tokyo area may be contributing to upward price pressure.

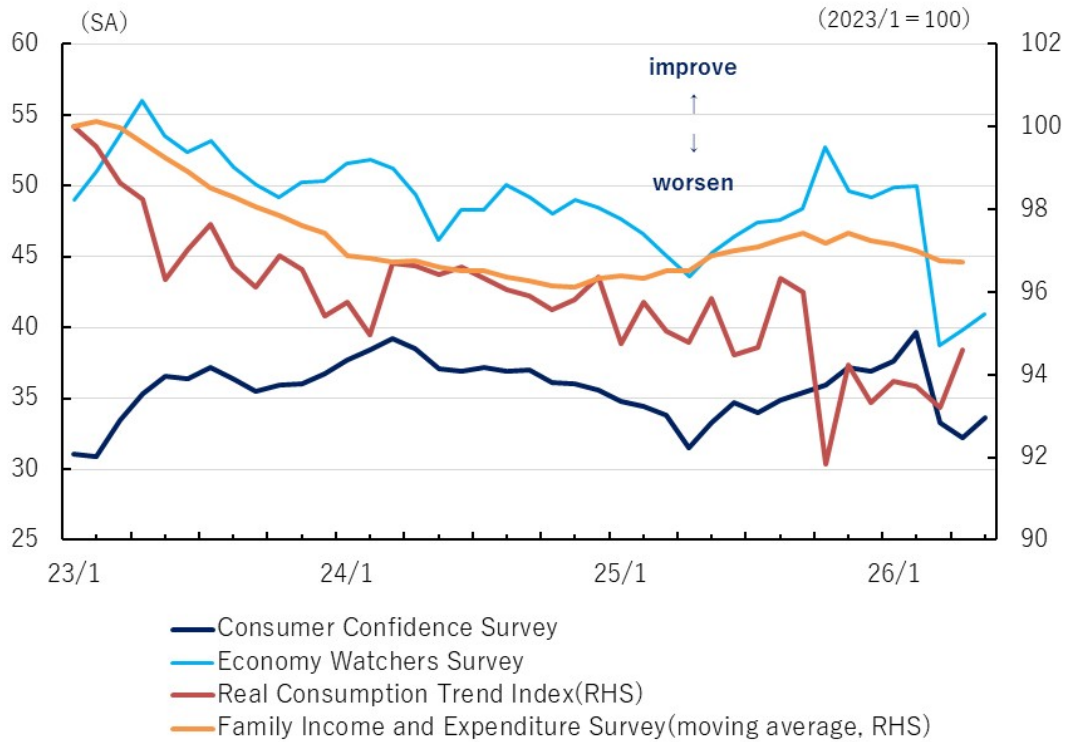
Will weak consumption be the constraint on rate hikes?

The main factor that could argue against tightening in June is concern about downside risks to the economy from higher rates, in particular the impact on household consumption. Through April, real consumption data show an ongoing weak trend, and household sentiment has deteriorated markedly since the deterioration in the Middle East situation (see Chart 2). If worries about employment and incomes become more visible, household sentiment could weaken further and lead to additional curtailment of consumption.

This spring's wage negotiations showed relatively high wage increases, including at small and medium-sized enterprises, similar to last year. But it remains unclear whether solid wage growth can be achieved and sustained through the current fiscal year. A late-May survey of SME sentiment

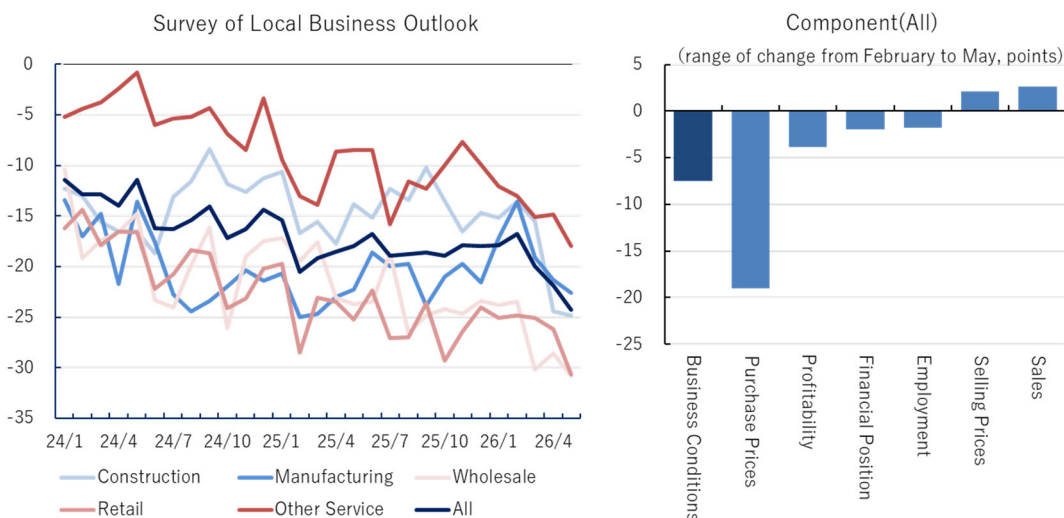
showed deterioration across industries: rising input costs over the past three months have squeezed profitability and worsened cash flow conditions (see Chart 3) (7).

Chart2 Household Confidence and Real Consumption



Source: Compiled by NRI based on the "Economy Watchers Survey" and "Consumer Confidence Survey" by the Cabinet Office, and the "Family Income and Expenditure Survey" and "Consumption Trend Index" by the Ministry of Internal Affairs and Communications

Chart3 Local Business Confidence



Source: Compiled by NRI based on Chamber of Commerce and Industry, "Quick Survey System of Local Business Outlook"

If, contrary to expectations, firms cannot deliver the planned wage increases or are forced to cut bonuses — in short, if household incomes are negatively affected — household sentiment would deteriorate further and become a headwind for consumption.

In this way, the BOJ is facing an environment where multiple factors are intertwined, making policy decisions particularly challenging to navigate. This underscores the importance of central bank communication. Looking ahead, it will be increasingly important to clarify, from a comparative perspective with past episodes, the transmission mechanisms and expected effects of rate hikes. It is also important to state the objectives of tightening explicitly. Especially in a situation where anchoring inflation expectations across a broad range of economic agents is a key policy priority, effectiveness will be enhanced by raising public awareness of the inflation target and explaining policy intentions in clear and accessible terms (8).

Anchoring inflation expectations to the 2 percent price target can be regarded as synonymous with maintaining confidence in the central bank. Whether a rate hike will lead to heightened confidence in the BOJ will depend in no small part on the outcome of the Governor's press conference following the policy meeting — the importance of which has increased further (9).

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(2) Bank of Japan, "Summary of Opinions at the Monetary Policy Meeting" (minutes and main opinions for the meeting held 27–28 April 2026), 12 May 2026.

https://www.boj.or.jp/en/mopo/mpmsche_minu/opinion_2026/opi260428.pdf

(3) Bank of Japan, "Outlook for Economic Activity and Prices" (April 2026, full text).

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According to the BOJ's simulation, real GDP would be lower than the baseline by 0.1 percentage point in 2026 and 2027 and by 0.2 percentage point in 2028, while the inflation rate would be higher

than the baseline by 0.3 percentage point in 2026, 0.7 percentage point in 2027, and 0.3 percentage point in 2028 under the risk scenario.

(4) Bank of Japan, “Sakura Report Supplement: Changes in Price-Setting Behavior of Regional Consumption-Related Firms and Price Revision Plans for Fiscal 2026” (hearings conducted January–April 2026). Note that the hearing period does not fully capture some of the effects from the Middle East situation.

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(5) Beaudry, Paul; Cormac O’Dea; and Franck Portier. “The Central Bank’s Dilemma: Look Through Supply Shocks or Control Inflation Expectations?” NBER Working Paper No. 31741, National Bureau of Economic Research, 2023.

(6) Bank of Japan, Financial System Report (April 2026).

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(7) Chamber of Commerce and Industry, Quick Survey System of Local Business Outlook, May 2026 results.

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(8) Blinder, Alan S.; Michael Ehrmann; Jakob de Haan; and David-Jan Jansen. “Central Bank Communication with the General Public: Promise or False Hope?” *Journal of Economic Literature* 62, no. 2 (2024): 425–457.

(9) According to media reports, on June 10 the Bank of Japan announced that Governor Ueda will be absent from next week’s Monetary Policy Meeting and press conference. Vice Governor Himino will chair the meeting proceedings, while Vice Governor Uchida will conduct the press conference in his place.