

Daiwa's Economic View

FICC Research Dept.

What rising food prices suggest about future rate hike decisions

- The stickiness of food price increases is a crucial factor considered in rate hike decisions
- While sharp rises in food prices are primarily driven by supply factors, there is a risk of prolonged supply shocks
- Longer-term food price increases brought by climate change are another risk to consider

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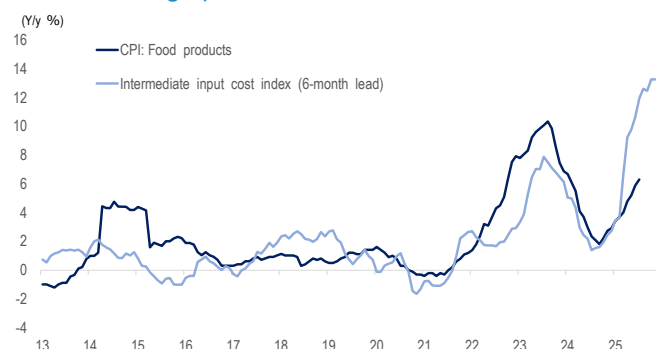
Reasons for the sharp rise in food prices

With food prices continuing to drive inflation, how the BOJ interprets food inflation is critical to its monetary policy decisions. Central banks, including the BOJ and the Fed, currently use a look-through strategy for supply shocks, waiting to see whether the impacts are transitory. Thus, when evaluating current food inflation, the key question is not whether it is demand- or supply-driven but rather whether it is transitory or sticky. If sticky, it could affect consumer sentiment and inflation expectations, [potentially leading to a rise in the underlying inflation rate \(general price level\), and that would necessitate a monetary policy response.](#)

To assess whether the recent food inflation is sticky, we first look at intermediate input costs in the food and beverage manufacturing sector. We estimated the intermediate input cost index (including wages) by referencing [the BOJ's April 2022 Outlook Report \(BOX3\)](#).

As shown below, it has increased significantly since mid-2024, and that increase was passed on to final prices, raising the CPI for food products (processed foods). The main driver of rising intermediate input costs has been the increase in agricultural, forestry, and fishery product prices. The rice supply shock that began last year contributed significantly to the rise in intermediate input prices in the food and beverage manufacturing sector. In contrast, the increase in other input costs, such as food processing and labor costs, was less than that for agricultural, forestry, and fishery products. The BOJ's view that the current rise in food prices is a supply shock ([as stated by Governor Ueda on 27 May](#)) seems reasonable.

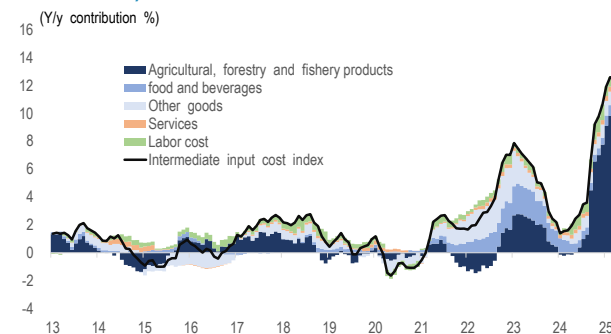
Y/y Change in Intermediate Input Cost Index (food and beverages)



Source: Ministry of Internal Affairs and Communications (MIC), Cabinet Office, BOJ; compiled by Daiwa.

Note: The intermediate input cost index is calculated by using the weightings of intermediate inputs and labor costs in the domestic production value of the food and beverage manufacturing industry from the 2015 Input-Output Tables together with the CGPI and SPPI price data, and employee compensation.

Intermediate Input Cost Index (food and beverages, y/y contribution)

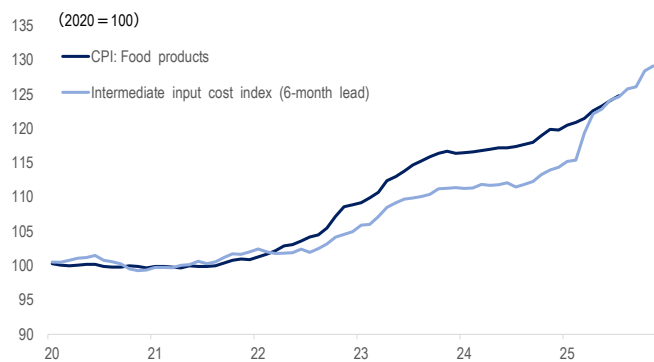


Source: MIC, Cabinet Office, BOJ; compiled by Daiwa.

The most important question is whether food inflation is transitory or sticky, regardless of what caused it. The increase in intermediate input costs in the food and beverage manufacturing sector tends to be passed on to prices with a lag. As noted by [Ichikawa and Yamamoto \(2025\)](#), food price increases are likely to persist for at least six months.

Another source of concern is the recent rise in prices for rice and other fresh foods caused by the summer heatwave. The Japan Meteorological Agency's three-month forecast (Sep-Nov) anticipates higher-than-average temperatures, and if this leads to another rise in agricultural, forestry, and fishery product prices, it would increase the risk of food price inflation continuing into 2026.

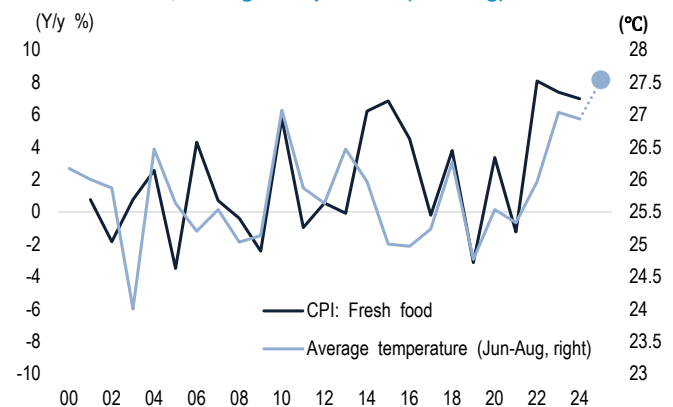
Intermediate Input Cost Index, Food Product CPI



Source: MIC, Cabinet Office, BOJ; compiled by Daiwa.

Note: Intermediate input cost index for the food and beverage manufacturing sector.

Fresh Food CPI, Average Temperature (Jun-Aug)



Source: Japan Meteorological Agency, MIC; compiled by Daiwa.

Global heatwave inflation and climate change

However, food inflation has not been limited to Japan. The FAO Food Price Index, published by the United Nations Food and Agriculture Organization (FAO), has recently turned upward in year-on-year terms. This index is a weighted average price index of global prices for cereals, vegetable oils, dairy products, meat, and sugar, with the 2014-2016 average set at 100, weighted by export volumes.

The FAO attributes global food inflation from 2021 to 2023 to two main factors: (1) fiscal and monetary measures to stimulate demand, and (2) supply shocks from geopolitical conflicts, adverse weather, and rising input costs. However, the recent acceleration in global food prices also appears to be heavily influenced by an increase in global temperatures and other abnormal weather patterns.

Japan's import price index for food has slowed on declines in meat prices, but the FAO index suggests there may be upward pressure on future food import prices (on a contract currency basis). This would mean that Japan's food prices are susceptible to upward pressure from heatwaves both in and outside of Japan.

Over the longer term, global warming could become a structural factor driving price increases. The Intergovernmental Panel on Climate Change (IPCC) predicts that without stronger decarbonization policies, average temperatures could rise about 3.2°C by 2100 (with a range of 2.2–3.5°C). That much warming could worsen crop yields and increase crop improvement and input costs, which would result in sustained upward pressure on food prices.

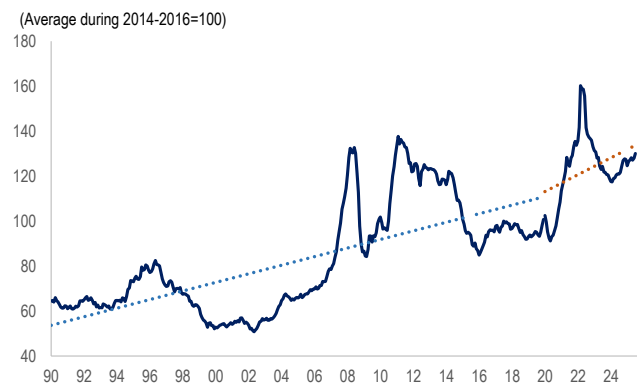
Considering these factors, the risks surrounding food inflation are unlikely to be merely temporary, and the impacts from rising intermediate input costs and weather-related factors could persist through 2026. Over the longer term, there is a risk that climate change will exert constant upward pressure on prices. This makes it inappropriate to dismiss rising food prices as mere relative price fluctuations; they should be incorporated into policy decisions as a factor affecting the general price level.

Y/y Change in FAO Food Price Index and Import Price Index (food, contract currency basis)



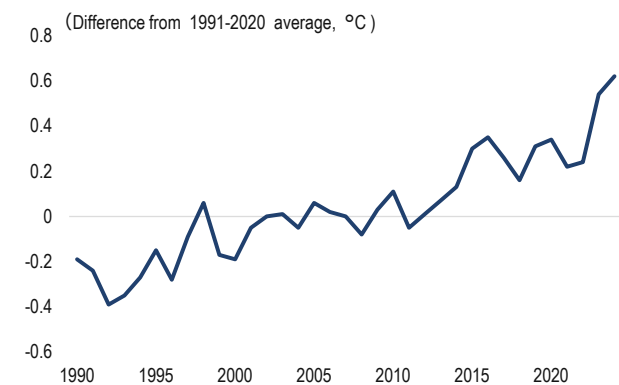
Source: FAO, BOJ; compiled by Daiwa.

FAO Food Price Index (level)



Source: FAO; compiled by Daiwa.

Global Average Temperature



Source: Japan Meteorological Agency; compiled by Daiwa.

Central bank policy decisions regarding climate change

In November 2022, then-BOJ Deputy Governor Masayoshi Amamiya gave a speech on climate and finance, where he pointed out that climate change is a critical issue for central banks in terms of both financial system stability and price stability.

For financial system stability, he identified two key risks: (1) physical risks from climate change-induced disasters and sea-level rise causing losses for businesses and households, and (2) transition risks from technological innovation and changes in consumer preferences as economies shift toward decarbonization, with economic impacts on businesses and households. These risks could alter both the quantity and quality of financial institutions' lending and investments and have a negative impact on the financial system.

As for price stability, Amamiya noted that the increasing scale and frequency of natural disasters due to climate change could lead to price fluctuations, and said that climate change is a factor that could have very large impacts on the economy, prices, and financial conditions over the medium to long term.

This suggests that while the BOJ views short-term food price increases from climate-related supply shocks as transitory, it acknowledges that climate change poses medium- to long-term risks to the economy and prices.

It is difficult to make the case that the heatwaves of the past two to three years will definitely continue as an immediate manifestation of structural climate change risks. However, the walking back from decarbonization policies under the Trump administration in the US could be a factor that heightens medium- to long-term climate change risks, and this may mean that long-term risks

are increasing. If these conditions persist, the day when climate change-induced food price increases become a structural factor may not be far off.

Some observers already consider weather disruptions from climate change to be a structural change. In a June speech, BOJ policy board member Naoki Tamura noted that the rise in fresh food prices was largely due to weather disruptions brought by climate change, and that this upward pressure is likely to continue. Long-term food price increases driven by climate change should be considered a risk.

◆ **Speech by BOJ policy board member Naoki Tamura (25 Jun 2025)**

The third point involves developments in the price of fresh food. As fresh food prices fluctuate significantly in line with one-off factors, changes in these prices are considered to be temporary, which is why fresh food is often excluded when assessing underlying inflation. In fact, developments in fresh food prices, when averaged out, more or less tracked overall price developments until around 2021, albeit with large fluctuations (Chart 7). However, since the beginning of 2022, although the extent of fluctuation has remained large, the rate of increase in fresh food prices has risen much faster than that in overall prices, even when averaged out. **This is mainly attributable to (1) lower supply capacity due to labor shortages, (2) an increase in utility and shipping costs and various other costs, and (3) higher personnel costs for producing fresh food. These factors cannot be considered temporary. Furthermore, there is a significant impact from irregular weather due to climate change, and many point out that such factors will continue to push up prices.** The same holds true for food other than fresh food. A rise in the price of fresh food and other food has a significant negative impact on households and substantially affects their inflation expectations, which can give rise to sustained upward pressure on prices. I therefore believe it necessary to closely monitor developments in fresh food prices.

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