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Economic Commentary (Sep BOJ MPM)

BOJ ups pace of rate hikes, but some board members remain cautious

- BOJ hikes to 1.25%, shortening interval between hikes to around three months
- Statement keeps warning about upside inflation risk, suggests BOJ will continue to frontload hikes
- Two dovish members dissent; focus at Governor Ueda's press conference on whether he can maintain stance that every meeting is live

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BOJ hikes in response to upside inflation risk, shortens interval between hikes to around three months

The Bank of Japan (BOJ) voted 7-2 at its 17-18 September Monetary Policy Meeting (MPM) to raise its guideline for the uncollateralized overnight call rate from around 1% to around 1.25%. With just three months having passed since its previous hike in June, the interval between them has clearly shortened from the previous pace of roughly once every six months. This is also the first time since 1990 that the BOJ has raised its policy rate after only three months. However, Board members Toichiro Asada and Ayano Sato both voted against the hike, showing that some members of the Policy Board remain cautious about raising rates.

As at the previous meeting in July, the statement flagged three factors that could push inflation higher: “the situation in the Middle East,” “the expansion in AI-related demand,” and “developments in foreign exchange rates.” The BOJ also maintained its view that "as for underlying CPI inflation, there is a risk that it will deviate upward to a level above the price stability target of 2 percent, given factors such as firms' behavior shifting more toward raising wages and prices and medium- to long-term inflation expectations rising." The BOJ's decision to hike early reflects the priority it places on responding to these upside inflation risks (i.e., on avoiding falling behind the curve).

Assessment of financial conditions also supports decision to hike

The BOJ's assessment of financial conditions also supported the decision. The statement retained its assessment that “Japan’s financial conditions have been accommodative,” noting that real interest rates have remained low mainly in the short- to medium-term zone, firms’ and other entities’ demand for funds has increased, and financial institutions’ lending attitudes have remained proactive.

We would highlight the BOJ's judgment that "accommodative financial conditions are expected to be maintained after the change in the policy interest rate." The hike brings the policy rate above the lower end of the estimated neutral rate range of +1.1% to +2.5%, yet the BOJ has not changed its view that financial conditions remain accommodative.

In short, the BOJ remains wary of an inflation overshoot and still judges financial conditions to be accommodative. Given this, we see nothing in the statement that would give the BOJ reason to slow its pace of hikes, at the very least. We think the statement suggests that the BOJ is highly likely to keep hiking at a faster pace than the previous roughly once every six months.

Contents of Statement at Sep 2026 BOJ MPM

Red bold text indicates points highlighted by the author	
Economic conditions	Japan's economy has recovered moderately, although some weakness has been seen in part, partly due to the impact of the situation in the Middle East (see Attachment). Regarding the outlook, Japan's economy is expected to continue growing moderately. This is because, although the impact of the situation in the Middle East is expected to push down economic activity, the economy is likely to be underpinned by factors such as the government's various measures, in addition to an increase in global AI-related demand.
Prices	The year-on-year rate of increase in the consumer price index (CPI, all items less fresh food) has been moderately rising recently, as upward pressure on prices in business-to-business transactions has started to spill over into consumer prices and moves to pass on wage increases to selling prices have been continuing. In this situation, medium- to long-term inflation expectations have continued to rise, and underlying CPI inflation has been approaching 2 percent. As explained, Japan's economic activity and prices have been developing generally in line with the baseline scenario presented in the July 2026 *Outlook for Economic Activity and Prices*.
Financial conditions	Japan's financial conditions have been accommodative. Real interest rates have remained at low levels, mainly in the short- to medium-term zone. Firms' and other entities' demand for funds has increased, and financial institutions' lending attitudes have also remained proactive. Moreover, issuance conditions for CP and corporate bonds have remained favorable.
Background to rate hike	In view of the aforementioned developments in economic activity and prices, risks, as well as financial conditions, the Bank judged it appropriate to adjust the degree of monetary accommodation from the perspective of sustainable and stable achievement of the price stability target of 2 percent. **Accommodative financial conditions are expected to be maintained after the change in the policy interest rate, continuing to firmly support economic activity.**
Risk factors	Attention continues to be warranted on the impact that the situation in the Middle East, the expansion in AI-related demand, and developments in foreign exchange rates have on Japan's economic activity and prices. **As for underlying CPI inflation, there is a risk that it will deviate upward to a level above the price stability target of 2 percent, given factors such as firms' behavior shifting more toward raising wages and prices and medium- to long-term inflation expectations rising.**
Conduct of monetary policy	As for the future conduct of monetary policy, given that underlying CPI inflation has been approaching 2 percent and financial conditions have been accommodative, the Bank will continue to raise the policy interest rate and adjust the degree of monetary accommodation, in response to developments in economic activity and prices as well as financial conditions. In this regard, it will consider the timing and pace of adjustment, while examining the likelihood of realizing the baseline scenario of the outlook for economic activity and prices and the risks to the outlook, including the impact of the situation in the Middle East, the expansion in AI-related demand, and developments in foreign exchange rates. In particular, **the perspective of stabilizing underlying CPI inflation at a level around 2 percent becomes important in order to keep the risk of underlying CPI inflation deviating upward to a level above the price stability target of 2 percent from materializing and thereby exerting an adverse impact on the economy afterward**. With the price stability target of 2 percent, the Bank will conduct monetary policy as appropriate from the perspective of sustainable and stable achievement of the target.

Source: BOJ; compiled by Daiwa.

Two dovish members vote against hike

Meanwhile, the market was also watching how Asada and Sato, both appointed under the administration of Prime Minister Sanae Takaichi, would vote at this meeting.

Their votes offered a clue to the administration's stance at a time when US government officials have repeatedly voiced support for frontloading BOJ hikes, and a guide to the Policy Board's dynamics after the terms of Board members Hajime Takata and Naoki Tamura expire in July 2027.

Asada dissented on the grounds that "with the rate of increase in the CPI (all items less fresh food) being below 2 percent recently, it could not necessarily be said that the economic situation was strong." Sato dissented on the grounds that "current economic and price developments did not appear to have substantially accelerated compared to before."

The two dissents appear to have come as a dovish surprise to the market. The yen's weakening after the statement's release likely also reflects a perception that some Policy Board members remain more cautious than the market had expected.

We see two takeaways from the dissents. First, the two dissenting members were both selected under the Takaichi administration. Their votes suggest that people close to the administration and reflationists may still be cautious about further hikes under current economic and price conditions, although this result alone does not establish the administration's intentions.

Second, the result also has important implications for policy conduct from July 2027, when the terms of hawkish members Takata and Tamura are due to expire. If their successors hold economic views closer to those of Asada and Sato, the Policy Board may no longer reach decisions to hike in response to upside inflation risk as smoothly as it has to date.

We would also note that no member put forward an overly hawkish proposal, such as a 50bp hike, at this meeting. Policy Board members appear to accept a faster pace of hikes, but broadly agree that the BOJ has not yet reached the point where larger individual hikes are needed.

Changes to Climate Response Financing Operations

The BOJ also changed the terms of its Funds-Supplying Operations to Support Financing for Climate Change Responses (Climate Response Financing Operations). It switched the loan rate to a floating rate and set upper limits on the amount of loans, including the total amount. It also revised the loan rates for the Funds-Supplying Operation to Support Financial Institutions in Disaster Areas and the Funds-Supplying Operations against Pooled Collateral. Loans outstanding under the Climate Response Financing Operations stood at around Y25tn as of July 2026. The BOJ has now capped total loans at Y50tn and the maximum amount of loans for each counterparty at Y10tn.

Financial institutions have been making growing use of the Climate Response Financing Operations as a stable, low-cost source of funding. The changes appear designed to reduce the funding advantage of using the facility, while also putting a brake on further growth in the amount of funds supplied. They suggest that, as monetary policy normalization proceeds, related operations are also shifting toward business-as-usual mode.

Governor Kazuo Ueda's press conference: Can he maintain stance that every meeting is live?

The statement made two points clear: (1) the BOJ remains wary of upside inflation risk, and (2) financial conditions will remain accommodative even after the hike. Some caution remains among the Policy Board, but the BOJ is highly likely to keep hiking at a faster pace than the previous roughly once every six months for the time being.

The market is mainly interested in how much faster that pace could be. US and European central banks have delivered a succession of hawkish rate hikes since the start of September, and oil prices have risen as the situation in the Middle East worsened. US Secretary of the Treasury Scott Bessent has also voiced support for monetary policy normalization in Japan, and the yen weakened after the release of today’s BOJ statement. Together, these factors arguably make it easier for the BOJ to communicate hawkishly and step up its warnings about upside inflation risk.

However, we think it unlikely that the BOJ itself has any preconceptions at this point about the timing of its next and subsequent hikes. The market has already priced in a pace of roughly once every three months to a reasonable extent. That will likely make it difficult for Ueda to signal an even more hawkish stance at today’s press conference.

In that sense, the biggest focus at the press conference will be whether he can maintain his stance that every meeting is live. If he stresses vigilance toward upside inflation risk while maintaining his stance of judging the possibility of further hikes meeting by meeting, his message would be consistent with the early hikes the market is pricing in. In contrast, if he makes comments about wanting to assess the impact of today’s hike or notes that there are things the BOJ needs to confirm, the market could scale back the expectations for frontloaded hikes that it has partly priced in.

We will also be checking whether the BOJ's assessment of upside inflation risk has changed since the July MPM, given the latest developments in the Middle East and in forex markets. Another focus will be how Ueda sees a faster pace of hikes affecting the domestic economy.

Change in the Guideline for Money Market Operations (Sep 2026 MPM)

Economic activity and prices: Developing generally in line with the baseline scenario

Economic activity: Japan's economy has recovered moderately, despite the impact of the situation in the Middle East
- ✓ Increase in global AI-related demand
- ✓ Improvement in the employment and income situation
- ✓ The government's various measures

Prices: underlying CPI inflation has been approaching 2 percent
- ✓ High year-on-year rate of increase in the PPI
- ✓ Upward pressure has started to spill over into consumer prices
- ✓ Continued rise in medium- to long-term inflation expectations

Risks: The situation in the Middle East, Expansion in AI-related demand, Developments in foreign exchange rates

There is a risk that underlying CPI inflation will deviate upward to a level above the price stability target of 2 percent

Financial conditions: Japan's financial conditions have been accommodative

Adjusting the degree of monetary accommodation from the perspective of sustainable and stable achievement of the price stability target of 2 percent

Short-term interest rate : raised to "around 1.25%"
(uncollateralized overnight call rate) (previously "around 1.0%")

- Accommodative financial conditions are expected to be maintained, continuing to firmly support economic activity.
- The Bank will continue to raise the policy interest rate and adjust the degree of monetary accommodation, in response to developments in economic activity and prices as well as financial conditions.
- The Bank will consider the timing and pace of adjustment, while examining the likelihood of realizing the baseline scenario and the risks to the outlook.
- The perspective of stabilizing underlying CPI inflation at a level around 2 percent becomes important.

Source: Reprinted from BOJ materials.

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