# The BoJ: Rethinking the Rationale for Rate Hikes

November 21, 2026

## At its October MPM, the BoJ upgraded its assessment of underlying inflation

At its October 29–30 Monetary Policy Meeting, the Bank of Japan (BoJ) left its policy rate unchanged, as markets had expected. The major development was its upgraded assessment of underlying inflation.

Until September, the BoJ had said that:

"…underlying CPI inflation is expected to increase gradually, coming to a level that is generally consistent with the price stability target between the second half of fiscal 2026 and fiscal 2027 and remaining at around that level thereafter.." (1)

In October, it revised this assessment, stating that:

"…underlying CPI inflation is at a level that is generally consistent with the price stability target of 2 percent, and is expected to remain at around that level." (2)

In effect, the BoJ's outlook was realized at the earliest point in the period it had previously indicated—the second half of fiscal 2026 through fiscal 2027. Governor Ueda described the development as "one milestone." (3)

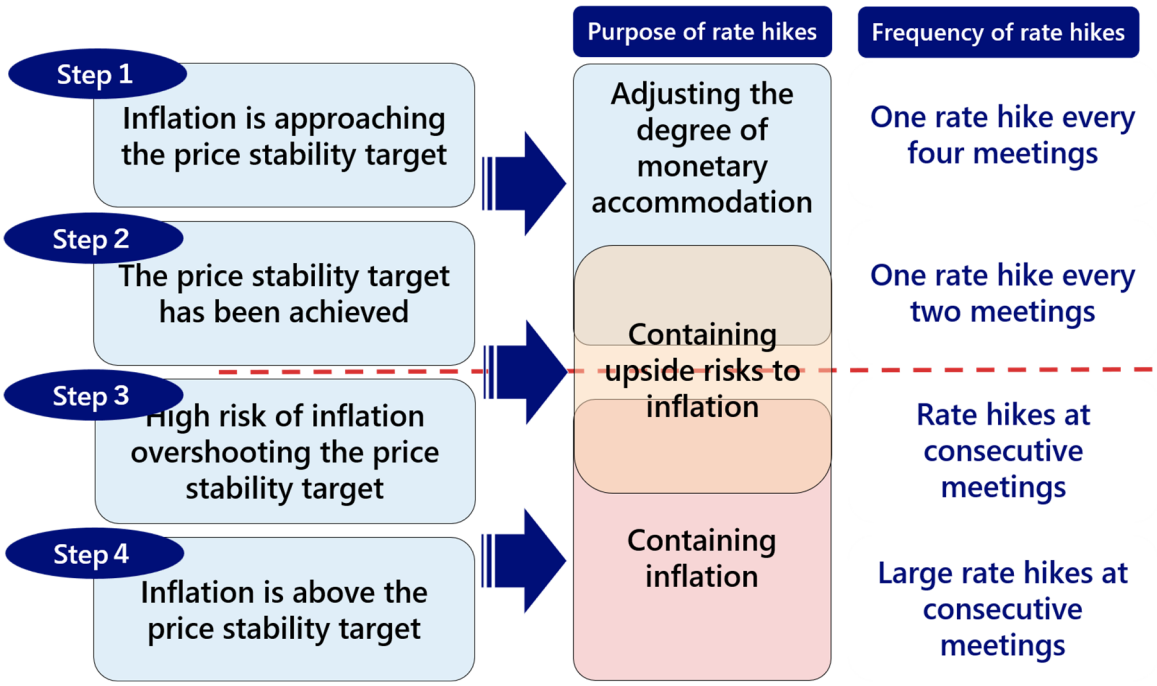
At the same time, the BoJ indicated that it was not yet confident that underlying inflation would remain stable at around 2% in the future. It would continue to assess inflation expectations, wage growth and the extent of price pass-through over the next one to two years.

## What is the purpose of further rate hikes?

The BoJ has indicated that it will continue to raise its policy rate in order to "adjust the degree of monetary accommodation." With underlying inflation now at a level consistent with the price stability target, the BoJ has entered a phase in which it seeks to bring accommodative financial conditions closer to neutral and contain the risk of an upside inflation surprise—i.e., the risk of inflation rising more than expected (Figure 1, Step 2).

At his previous press conference, Governor Ueda said that the decision whether to raise rates consecutively or by a larger amount would depend on whether the risk of inflation rising significantly above the target was high, or whether inflation had already exceeded the target. In other words, if upside inflation risks intensify or underlying inflation rises substantially above 2%, the purpose of rate increases could change and the pace of tightening could accelerate (Figure 1, Steps 3 and 4). The BoJ's stated intention is to continue raising rates for now in order to avoid such an outcome.

Figure 1: The relationship between the price stability target and rate hikes

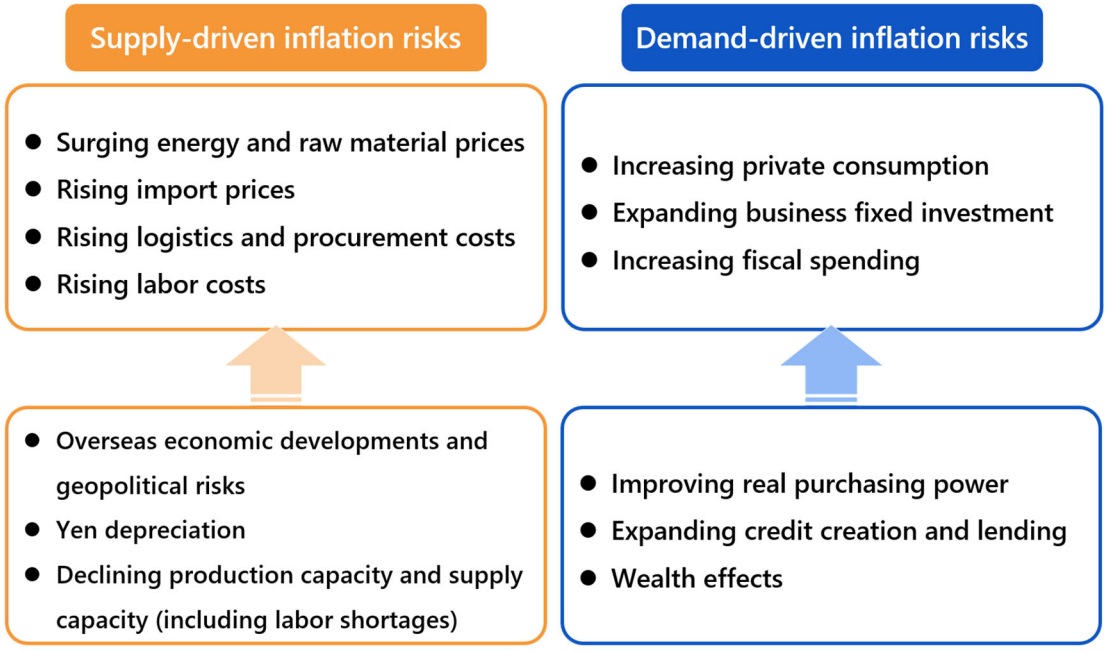



Source: Nomura Research Institute

### Containing inflation risks is important, but the BoJ's explanation has not been clear

The inflation risks the BoJ is monitoring can be broadly divided into supply-driven and demand-driven risks (Figure 2).

Figure 2: Types of inflation risk




Source: Nomura Research Institute

What policy responses are available to the BoJ in the face of these risks? Monetary policy is generally ineffective against supply-driven inflation risks; it is primarily a tool for addressing demand-driven inflation. The purpose of the rate increases currently envisaged can therefore be understood as raising interest rates to a neutral level—one consistent with the state of the economy—and adjusting today's "accommodative financial conditions" so as to prevent excessive demand growth. Such demand could arise, for example, from increased investment driven by credit creation and lending, or higher consumption resulting from wealth effects. Indeed, the Governor has also explained at press conferences that the Bank will raise interest rates to a neutral level. (3)

At the same time, the BoJ's latest Outlook for Economic Activity and Prices stated that "policy interest rate hikes by the Bank in response to developments in economic activity and prices as well as financial conditions are considered to alleviate upward pressure on prices and thereby underpin private consumption." (2)

Easing upward pressure on prices through rate increases implies moving beyond a neutral rate to a restrictive financial stance and thereby curbing demand. The inconsistency between these explanations appears to suggest that there is no unified view within the BoJ on how far it should go in "adjusting the degree of monetary accommodation."

As the economic environment evolves, it is healthy for Policy Board members and BoJ staff to express a range of views. Nor is consensus among Board members ultimately necessary, given that monetary policy decisions are made by majority vote. Nevertheless, the communication provided by the Governor at press conferences and in the Outlook Report has a significant bearing on fundamental questions such as why rates are being raised and how far they will go.

Whether the BoJ can provide a convincing explanation to the public as it raises rates at future meetings will depend on its ability to gather information and communicate its reasoning. Ahead of next fiscal year's shunto wage negotiations, the BoJ needs to understand how firms intend to set wages and, in tandem, how they plan to pass on costs. In addition to the Tankan, it will need to make full use of its nationwide branch network to collect and analyze granular, firm-level information. When communicating its decisions, the BoJ must also explain clearly what effects it intends rate increases to have, and through what channels they are expected to improve public welfare.

In my view, the BoJ must continue to take account of the risk that rate hikes could suppress demand excessively. The Summary of Opinions focused on the effects of rate increases on firms. Given the recent weakness in household consumption, however, it is equally important to analyze how sensitive consumption is to interest rates. If the risk that consumption will fail to recover as the BoJ expects becomes more apparent, the possibility remains that it could pause rate increases before the policy rate reaches a neutral level.

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