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**Preview: BoJ To Increase Rates in September,
But Further Tightening To Occur Only Slowly**

by

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15 September 2026

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Executive Summary

- ✧ **Expected Decision:** *The Bank of Japan (BoJ) is likely to raise its policy rates in September.* In the upcoming monetary policy meeting, we expect the BoJ to raise its policy rate by 25bp to 1.25%, after holding it at 1% in an 8-1 vote in July.

On forward guidance, the BoJ is expected to remain data-dependent, with further hikes guided by the impact of past tightening and incoming economic, inflation and financial data. Inflation risks remain tilted upward amid stronger wage-price dynamics, yen weakness and higher energy costs. But we don't expect an acceleration of the tightening cycle; additional hikes will occur in 2027 not this year.

On its balance sheet, the BoJ will pause its bond taper from April 2027, maintaining monthly JGB purchases at around ¥2tn while retaining flexibility to adjust purchases if needed.

- ✧ **Policy Discussion:** *The case for further BoJ tightening has strengthened,* supported by stronger Q2 growth, a 1.6% y-o-y rise in corporate investment and 2.4% real wage growth in July. Alongside persistent inflation and yen weakness, the data support another hike despite higher energy costs. Following June's increase to 1%, 97% of surveyed economists expect a 25bp hike to 1.25% in September, while 89% see rates reaching at least 1.5% by March 2027 and the median terminal-rate estimate stands at 1.75%.

Expectations of faster tightening, alongside US pressure and capital repatriation, have supported the yen to around ¥153 per dollar. However, expansionary fiscal policy could complicate the outlook. Budget requests reached a record ¥143.1tn, near pandemic-era levels, raising concerns over fiscal discipline as borrowing costs remain at three-decade highs. Planned consumption-tax cuts and additional bond issuance could add further upward pressure to long-term yields.

Key Picture: Bank of Japan Forecasts – 2025-2027 – From the January 2026 Outlook

	Latest Reading	2026f		2027f		2028f	
		July Report	April Report	July Report	April Report	July Report	April Report
GDP (real growth, y-o-y)	0.7	0.6	0.5	0.8	0.7	0.8	0.8
Inflation* (%, y-o-y)	1.9	2.5	2.8	2.4	2.3	2.0	2.0

Source: Bank of Japan 'Outlook for Economic Activity and Prices' April and July 2026. Note: 1. Forecasts are for the fiscal year (FY) in Japan from April 1 - 31 March of the following year; 2. Latest GDP reading for Q2 -2026; 3. Latest inflation reading for July 2026.

Analysis

- ✧ **EXPECTED DECISION:** *On September 18, we expect the Bank of Japan (BoJ) is expected raise its policy rates.* In the upcoming monetary policy meeting, we expect the BoJ to raise its key short-term interest rate to 1.25%, the highest level in about 31 years. At its July meeting, BoJ voted 8-1 to leave its benchmark interest rate unchanged at 1.00%.

In terms of *forward guidance*, the BOJ will underline that future rate moves will be guided by the impact of past hikes on lending, financing conditions and economic activity. In the last meeting, while noting that financial conditions remain accommodative and continue to support economic activity, the Bank assessed growth risks as broadly balanced but inflation risks as skewed to the upside, driven by stronger wage-price dynamics, AI-related demand, yen weakness, and Middle East-related energy prices. It reiterated that further policy tightening will be guided by incoming economic, inflation, and financial data. In our view potential yen weakness alone will not trigger a front loading of further rate hikes.

Indeed, we don't expect an acceleration of the tightening cycle. Some market analysts expect the BoJ to hike again this year, as early as October as a BoJ Board member suggested that a hike larger than 25bps may be necessary. Our view is that the BoJ will continue its hiking cycle at a slower pace unless there is an unlikely acceleration of the inflation rate. Further yen weakness will not lead to a front loading of rate hikes as it could be rather addressed with further FX intervention. We expect the next BoJ hike to occur only in January 2027 to a policy rate of 1.5%, followed by another only in the middle of 2027, which would bring the policy rate to 1.75%.

In terms of *balance sheet policies*, the BoJ also announced that it will pause its bond tapering programme from April 2027, maintaining monthly purchases of around ¥2 trillion (\$12.5 billion) in Japanese government bonds. The Bank will discontinue its annual reviews of the tapering plan, while retaining the flexibility to adjust the pace of bond purchases at future policy meetings if conditions warrant.

- ✧ **POLICY DISCUSSION:** *The case for further BoJ tightening has strengthened ahead of the September meeting.* Q2 growth was revised higher, corporate investment rose 1.6% y-o-y and real wages increased 2.4% in July, their strongest gain since 2021. Together with persistent inflation and yen weakness, the data suggest the economy can withstand another rate increase despite higher energy costs from the Middle East conflict. Following June's hike to 1%, a September increase to 1.25% is now almost fully priced, with 97% of surveyed economists expecting a hike, up from 57% previously.

Attention is therefore shifting from whether the BoJ will hike to how quickly tightening continues. More than a third of economists expect rates to reach 1.5% by year-end, while 89% see at least 1.5% by March 2027 and 62% expect 1.75% or higher by end-Q2. The median terminal-rate estimate remains 1.75%, although 40% now see 2% or higher. Expectations of faster tightening, alongside US pressure and signs of capital repatriation, have already supported the yen to around ¥153 per dollar, near its strongest level since February.

In our view unless the inflation rate surges and significantly overshoots its target the BoJ will be wary of accelerating its pace of hikes as front loaded tightening may slow down the economy in undesirable ways. Yen weakness alone doesn't force the BoJ to hike sooner and faster as this can be partially addressed via FX intervention. An inflation surge is unlikely as inflation expectations seem to be anchored around the 2% inflation target; the global core CPI has been below 2% for a while and even modest increases in it ahead – driven by energy prices, AI related costs and weaker yen – will not push it above target; new national prints of CPI will show little inflation. The BoJ statement and the Governor's press conference will provide signals on whether the BoJ is concerned about an inflation overshoot, about yen weakness and about the impact of further rate hikes on the level of economic activity. Those signals will provide some evidence on whether rate hikes could accelerate relative to our view of a slow pace of hiking.

Fiscal policy could complicate the outlook. Budget requests for the next fiscal year reached a record ¥143.1tn, near pandemic-era levels, as the Takaichi government pursues an expansionary agenda. With

government borrowing costs already at three-decade highs, nearly three-quarters of surveyed economists said the requests raise concerns over fiscal discipline. These concerns could intensify as the final budget, planned consumption-tax cut on food and required bond issuance become clearer, potentially adding upward pressure to long-term yields even as the BoJ continues tightening.

- ✧ **MACROECONOMIC ANALYSIS:** *Japan's Q2 growth was revised higher, strengthening the case for a widely expected BoJ rate hike in September.* Japan's economy grew faster than initially estimated in Q2, with annualized GDP growth revised to 1.4% (*p*: 1.1%), while quarterly growth was upgraded to 0.4% (*p*: 0.3%). The revision largely reflected a smaller decline in business investment, which fell 0.9% (*p*: -1.2%), while private consumption was flat. Net trade added 0.5ppts to growth, offsetting a 0.1ppt drag from domestic demand. Meanwhile Composite PMI rose to 53.5 in August (*p*: 53.4; July: 52.7), the highest since February and the 17th consecutive month of expansion. Growth strengthened across manufacturing and services, while new orders rose at one of the fastest rates in three years.

Headline inflation accelerated to 1.9% y-o-y in July (*p*: 1.6%), the highest this year, while core inflation rose to 1.8% (*p*: 1.6%; *e*: 1.8%) and core-core inflation to 1.9% (*p*: 1.7%). Energy prices increased for the first time since November despite government subsidies, reflecting higher oil costs, while fresh food inflation jumped to 7%. Services inflation also edged up to 1.2%, suggesting firms are gradually passing higher labour costs onto consumers.

The BoJ expects core inflation to move clearly above its 2% target later this fiscal year as higher wages, oil prices and yen weakness feed into prices. The latest data strengthen the case for further tightening, with the BoJ widely expected to raise rates from 1% to 1.25% in September and potentially accelerate the pace of hikes thereafter.

Japan's unemployment rate fell to 2.4% in July (*p*: 2.5%), as involuntary job losses declined. The job availability ratio remained at 1.18, equivalent to 118 vacancies per 100 job seekers, indicating that labour-market conditions remain relatively tight despite a slight decline in employment. Real wages rose 2.4% y-o-y in July, the strongest gain since 2021 and the seventh consecutive increase, while nominal wages jumped 4.7%, the fastest pace since 1997. Base pay also accelerated to 4.1%, its strongest growth since 1992, pointing to broad-based wage gains rather than a boost solely from bonuses

- ✧ **MARKET IMPLICATIONS:** *A stronger yen, expectations of near-term BoJ tightening and elevated oil prices weighed on sentiment, particularly exporters and growth stocks.* AI- and semiconductor-related shares showed pockets of strength, but geopolitical risks and higher bond yields kept the broader market under pressure. Since the last meeting on July 22, the 10-year JGB yield increased by 26 bps to 3.00% (+93 y-t-d). 2Y JGB rose by 40 bps 1.84% (+68 y-t-d). *The yen strengthened to around ¥153 per dollar from ¥156 the previous week*, near its strongest level since February, amid expectations of a near-term BoJ hike and faster subsequent tightening. US Treasury Secretary Scott Bessent's support for Japan's policy direction added to the yen's momentum. USD/JPY declined by 5.5% to around 154 since the last meeting (-1.6% y-t-d). *Japanese equities fell over the week.* Since the last meeting in July and as of September 14 Nikkei 225 fell by 4.0% to 63,492.99 (+23% y-t-d).

➤ **APPENDIX (Macro Background):** *Japan's economy expanded, marking its third consecutive expansion, supported by government spending and net trade.* Japan's Q2 GDP growth was revised up to an annualized 1.4% (p: 1.1%), supported by less-weak business investment. GDP grew 0.4% q-o-q in Q2 2026 (p: 0.3%), marking a third consecutive quarter of expansion. Government spending rose 1.7% (p: 1.6%), while business investment fell less than initially estimated, declining 0.9% (p: -1.2%). External demand added 0.5ppts to growth, as exports rose 0.4% and imports fell 1.7%. Meanwhile, private consumption was flat, down from 0.4% growth in Q1, as elevated cost pressures weighed on households. In Q2, the economy expanded 0.7% y-o-y (p: 0.5%).

Composite PMI hit its highest level since February, driven by stronger manufacturing and services activity. In August, Jibun Bank composite PMI rose to 53.5 (c: 53.4; p: 52.7). Services PMI increased to 52.5 (c: 52.3; p: 51.2). Manufacturing also rose to 54.9 (c: 55.1; p: 54.5).

Japan's unemployment rate fell to its lowest since July 2025. The unemployment rate edged down to 2.4% in July (c: 2.5%; p: 2.5%). The number of unemployed declined by 80K to 1.67 ml. In July, Japan's average cash earnings jumped by 4.7% y-o-y (c: 3.9%; p: 4.0%), the strongest gain since 1997, while real wages increased 2.4%, their seventh consecutive monthly rise.

Inflation accelerated to the highest since December 2025, partly due to reduced energy subsidies. In July, CPI inflation edged up to 1.9% y-o-y (p: 1.6%). Food inflation accelerated by 3.2% (p: 6.4%). Core inflation increased by 1.8% y-o-y in July (c: 1.8%; p: 1.6%).



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