NATIXIS CORPORATE AND INVESTMENT BANKING

RESEARCH

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ASIA MACRO SNAPSHOT

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BoJ to move forward hike to September given accelerated inflation and government acquiescence after US joint intervention

The Bank of Japan (BoJ) is set to raise the policy rate by 25-bps on September 18th, as inflation pressure strengthens. On today's CPI report, the nationwide headline inflation expanded to +1.9% YoY in July from +1.6% YoY in June. What is more important is that all measures of underlying inflation rose faster. For example, the CPI adjusted for food and energy was up +1.4% YoY from +1.2% YoY **(Chart 1)**.

Higher CPI inflation has been driven by surging import prices at +29.1% YoY in July from elevated oil prices and weak Yen. In fact, today's CPI report revealed that prices of manufactured goods expanded to +3.2% YoY in July from +2.8% YoY in June. Moreover, general services rose to +1.4% YoY from +1.3% YoY. These results suggest that the lag in the transmission of import inflation on CPI could be shorter than six to twelve months, which is estimated by the Cabinet Office. These developments justify the BoJ's concern on upside risk of inflation.

Meanwhile, the government seems to have become more supportive of the BoJ's rate hike, which might could be, at least partially, explained as a quid-pro-quo to the US joint forex intervention to support the Yen. Japan's government bond yields have remained elevated on the back of higher inflation expectations led by the ambitious expansionary policy and the weak Yen, which can also be read as the BoJ having fallen behind the curve **(Chart 2)**. Furthermore, even after the coordinated intervention on July 31st, the Yen has lost much of the gains since, and sits again above USDJPY=159. Takaichi's administration may, thus, come to the conclusions that a bolder BoJ is needed to prop up the Yen back to reasonable levels and, thus, limit the pass through to inflation.

All in all, the BoJ is anticipated to hike by 25-bps to 1.25% in September, earlier than our previous call of October. Subsequently, the Bank is expected to raise the policy rate in January and July in 2027 to 1.75%. Governor Ueda already warned markets at the July meeting press conference of the need to be more vigilant on the upside inflation risk. That risk has materialized with today's CPI inflation so the hike should happen, all the more so given the renewed Yen weakness.

Chart 1
Japan: Nationwide CPI Inflation (YoY, %)

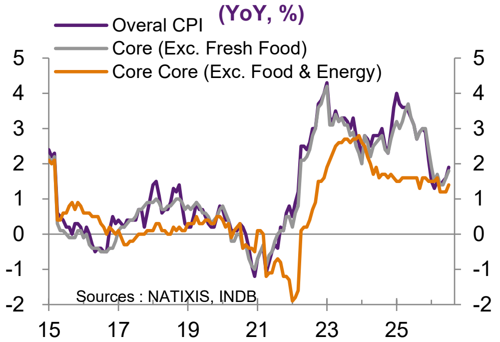
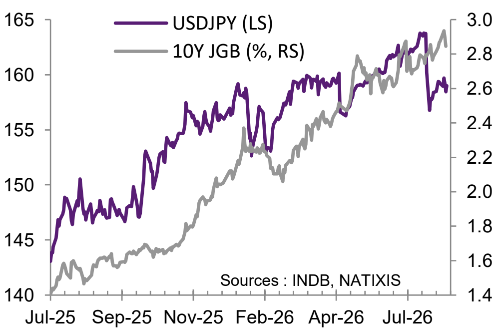


Chart 2
Japan: Financial Markets



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