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Central bank independence is the foundation underpinning currency strength

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- There has been criticism that the government's assignment to the BoJ of a "dual mandate" – aiming to achieve both stable inflation and strong economic growth – could lead to political pressure to restrain rate hikes. However, this is a policy choice within the scope of the obligation to coordinate with the government stipulated in Article 4 of the Bank of Japan Act: "In recognition of the fact that currency and monetary control is a component of overall economic policy, the Bank of Japan shall always maintain close contact with the government and exchange views sufficiently, so that its currency and monetary control and the basic stance of the government's economic policy shall be mutually compatible". It represents an attempt to shift from the European Central Bank (ECB) model, under which price stability is the sole mandate, to the Federal Reserve Board (FRB) model, under which both price stability and maximum employment are mandated. Naturally, the FRB remains independent under its dual mandate. Central bank independence means that monetary policy is conducted separately from the government's short-term political considerations. Sharing with the government a framework for policy objectives established by law does not in itself constitute an impairment of independence.

- In the Honebuto (Basic Policy on Economic and Fiscal Management and Reform), the government clarified its definition of a "strong economy": "Under the achievement of the 2% price stability target, establish economic growth exceeding 1% in real terms and 3% in nominal terms as quickly as possible, and subsequently raise it further." This is significant because it quantifies the state towards which the Japanese economy should aspire. It also clarifies the meaning of Article 2 of the Bank of Japan Act: "Currency and monetary control by the Bank of Japan shall be aimed at achieving price stability, thereby contributing to the sound development of the national economy." Meanwhile, according to the BoJ's Outlook Report, its forecasts for real GDP growth in FY26, FY27 and FY28 are only +0.6%, +0.8% and +0.8%, respectively, meaning that growth would remain below the government's target of more than 1%.

- The recovery in economic growth must still be regarded as only halfway complete. On the other hand, inflation is projected to remain in the 2% range throughout the same period, suggesting no concern about excessive inflation substantially exceeding the price stability target. The government is seeking to revitalise the Japanese economy and realise a "strong economy" by expanding strategic public-private investment. As progress is made in expanding strategic investment, the BoJ would gradually raise its policy rate, with the real policy rate moving out of negative territory once companies shift from a saving surplus to an investment surplus. In the asymmetric situation in which "prices are stable but growth is weak", the continued uncertainty surrounding progress in expanding strategic investment is precisely the fundamental challenge complicating the BoJ's conduct of monetary policy in the context of its dual mandate.

- It is normal and sound for the government and the BoJ to share policy objectives within a legal framework and coordinate their management of the economy. However, if monetary policy were changed in response to pressure tantamount to interference in domestic affairs by a foreign government, central bank independence would be fundamentally undermined. The currency of a country whose central bank is vulnerable to external pressure would lose market confidence and could not remain strong over the long term. According to Kyodo News, the decisive factor

behind the exceptional coordinated JPY-buying intervention by the Japanese and US governments– the first in 28 years– was BoJ Governor Kazuo Ueda's strong indication that the policy rate would be raised "at an early stage from September onwards". Several Japanese government officials explained that this was because "the US was concerned that delays in raising rates would cause excessive JPY depreciation, leading to further inflation and higher long-term interest rates, with repercussions for global financial markets". A senior official was also quoted as saying: "Ueda's remarks were highly valuable in negotiations with the US. On the other hand, the BoJ has now been left with no option other than a rate hike at its next Monetary Policy Meeting on 17-18 September".

- **Furthermore, after the Japanese and US finance ministers issued a joint statement on foreign exchange intervention, Kyodo News reported that the US had privately asked the Japanese government to encourage the BoJ to raise rates. US Treasury Secretary Scott Bessent was reportedly concerned that an increase in US interest rates in tandem with higher Japanese long-term interest rates could cool the US economy, suggesting that the US also had a motive to intervene in Japan's monetary policy. If foreign government intervention had effectively forced the BoJ to raise rates, the independence of its monetary policy must be regarded as having been seriously compromised. The problem would not end there. If suspicion that "this is being driven by external pressure" were to become entrenched in the market during future rate-hiking phases, rate hikes would cease to function as a factor supporting an appreciation of JPY. In contrast, distrust of a central bank that had lost its independence could weaken confidence in JPY and paradoxically generate further depreciation pressure. It is necessary to recognise once again that central bank independence is itself the foundation underpinning currency strength.**

The following is a summary of our published reports

What is needed to correct JPY depreciation is not rate hikes but investment expansion (12 August 2026)

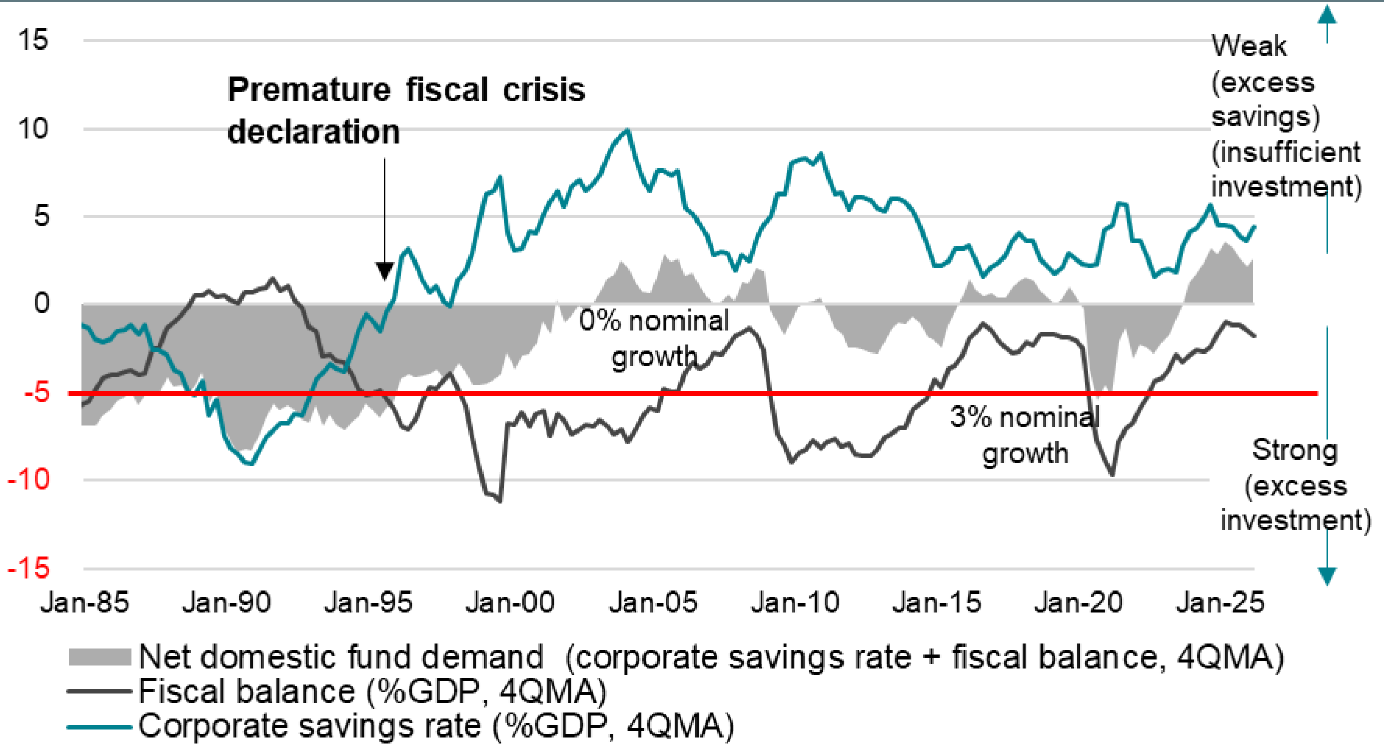
With the JPY remaining weak, the conventional view attributes its weakness primarily to the interest rate differential between Japan and the US. The explanation is that, because the BoJ remains cautious about raising interest rates under its dual mandate, there is little prospect of the interest rate differential narrowing. However, a more fundamental factor is the “asymmetry in investment power”. In the US, massive AI-related investment has been added to strategic public-private investment, bringing the spending power of the government and corporations (net domestic fund demand, defined as the corporate saving rate plus the fiscal balance) to around -10% of GDP. The figure for the Eurozone is around -3%. By contrast, in Japan, the strategic investment envisaged under Sanaenomics by the Takaichi administration has yet to get fully underway. Net domestic fund demand has disappeared. Under the logic of the Mundell-Fleming model, this structural difference attracts capital towards the US and generates persistent pressure for JPY depreciation. The interest rate differential is merely one aspect of the outcome, and the prescription that “raising interest rates alone would stop JPY depreciation” misdiagnoses the fundamental nature of the problem. The Honebuto, adopted in July 2026, effectively neutralised the primary balance surplus target, which had previously been an obstacle to investment expansion, and established a new investment framework. As a result, strategic public-private investment would begin in earnest with the execution of the FY27 budget. We believe only once this investment expansion materialises would the gap in investment power between Japan and the US narrow and a structural correction of JPY depreciation begin.

The impact of JPY-buying foreign exchange intervention was perceived as “limited”. However, intervention has significance as a “deterrent”. JPY depreciation provides a tailwind for the investment expansion strategy by strengthening export competitiveness and attracting inward investment. However, it would take considerable time for the benefits of investment expansion to reach households in the form of higher labour productivity and higher real wages. If JPY depreciation were to go too far during this transition period, higher import prices could squeeze households and create a risk that domestic demand would falter. For this reason, the target level of JPY weakness that balances household burden and encourages corporate investment is considered to be in the vicinity of the JPY150 range. Importantly, the government does not appear to be seeking to “substantially correct the JPY towards appreciation”. Its objective is merely to deter excessive JPY depreciation, rather than actively steer the currency towards appreciation. Direct relief for the burden on households would be provided through proactive public finance, including income tax and VAT cuts.

The Takaichi administration has imposed a “dual mandate” on the BoJ, making strong economic growth a responsibility alongside price stability. Some have criticised this as “political pressure to restrain rate hikes” and expressed concern that the BoJ’s independence is being undermined. However, the dual mandate falls within the framework of coordination with the government under Article 4 of the Bank of Japan Act. It represents an attempt to shift the monetary policy framework from an ECB-style approach focused solely on price stability towards an FRB-style approach in which both price stability and maximum employment are responsibilities, rather than an erosion of the BoJ’s independence. Furthermore, if the BoJ were behind the curve in raising interest rates, market expectations of rapid rate hikes should be forming, but there are no economists forecasting such a scenario. As long as rapid rate hikes are not priced into market expectations, it cannot be argued that the BoJ is behind the curve. Moreover, if the market were suppressing its expectations for rate hikes after factoring in political pressure, expectations of a substantial overshoot in the inflation rate should be forming, but there are no economists forecasting such a scenario.

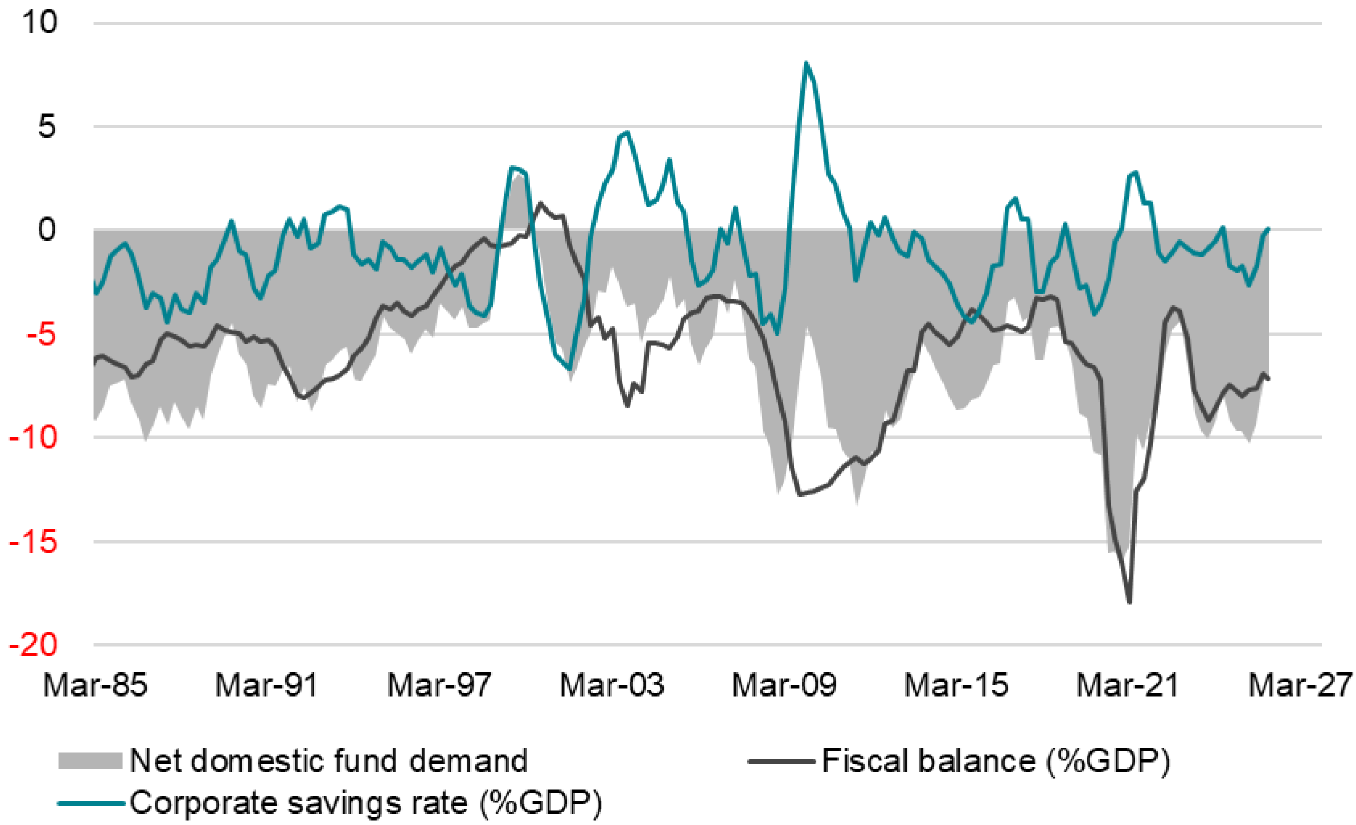
The scenario that warrants the greatest caution is an attempt to force JPY appreciation through rapid BoJ rate hikes. Monetary tightening amid intensifying global investment competition would weaken domestic investment and damage future supply capacity. If confidence in supply capacity deteriorates, JPY depreciation could resume, this time risking a descent into “uncontrollable bad JPY depreciation" without investment to underpin it. The current JPY depreciation is accompanied by investment expansion and is therefore of limited concern because an increase in future supply capacity can be expected, but the situation would fundamentally change if investment lost momentum. It is now a consensus view that, when the JPY appreciated sharply following the 1985 Plaza Accord, the BoJ responded with excessive monetary easing, resulting in the formation of an asset bubble whose collapse marked the starting point of Japan's "lost three decades". If responding to JPY appreciation with monetary easing was a mistake, responding to JPY depreciation with monetary tightening would likewise be a mistake in our view, and excessive monetary tightening in the current phase of JPY depreciation would pose a major risk. The Takaichi administration is aiming for a virtuous cycle of "expansion of strategic public-private investment → higher productivity → higher real wages → structural correction of JPY depreciation". If this scenario materialises, we think JPY depreciation would correct itself autonomously without relying on monetary tightening.

Fig 1. Japan net domestic fund demand



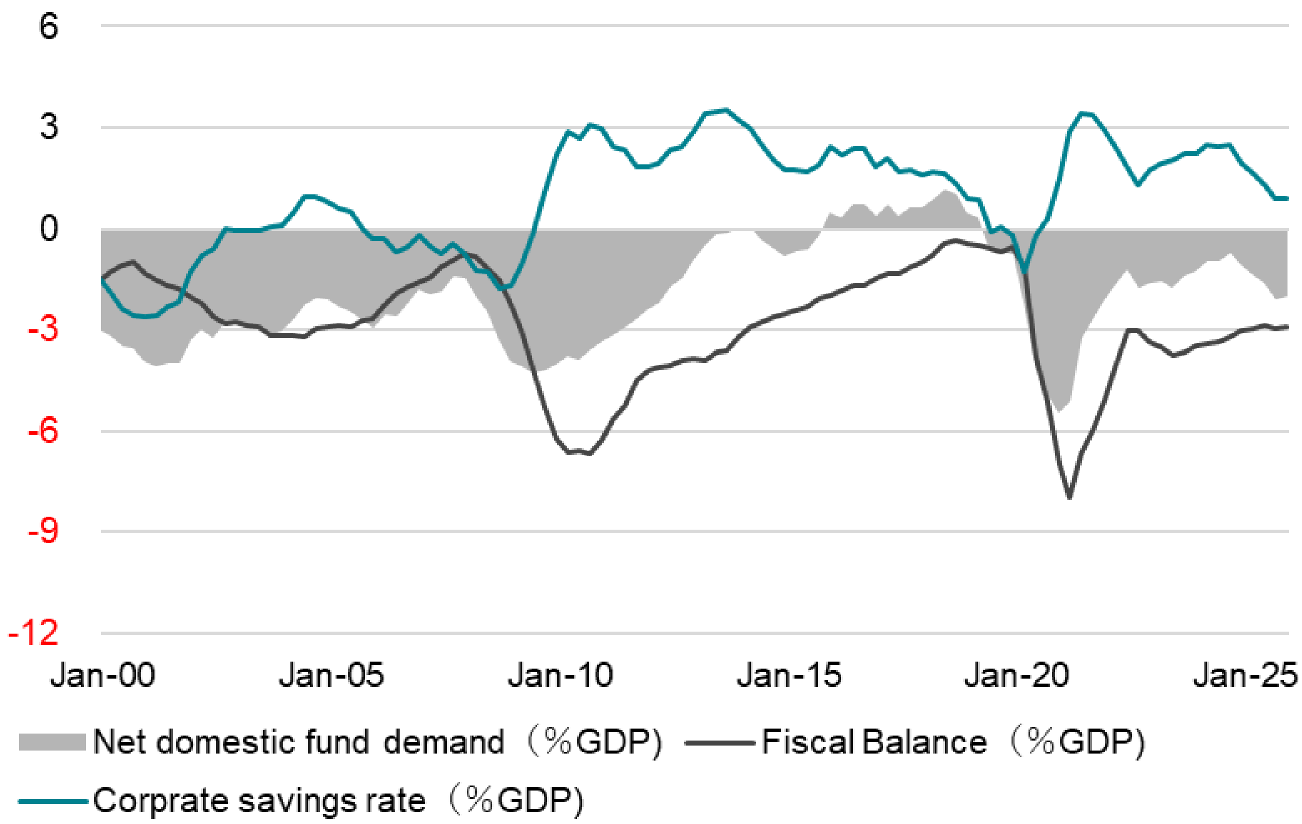
Source: Cabinet Office, BoJ, Crédit Agricole CIB

Fig 2. US net domestic fund demand



Source: BEA, FRB, Crédit Agricole CIB

Fig 3. Eurozone net domestic fund demand



Source: Eurostat, Crédit Agricole CIB

Note: The content is a personal opinion and does not necessarily reflect the government's view.

Expansion of public-private strategic investment as a driver of JPY appreciation – Minister Kiuchi's assessment is correct (13 Aug 2026)

On 10 August, Minister of State for Economic and Fiscal Policy Minoru Kiuchi directly pushed back against market concerns over the Takaichi administration's "responsible proactive public finance" in an interview with Bloomberg. Minister Kiuchi argued that the Takaichi administration's economic policies would strengthen supply capacity and productivity, thereby increasing investment in Japan and demand for JPY-denominated assets and allowing the depreciation of the JPY to correct itself autonomously. "I do not expect the depreciation of JPY to continue. Rather, it could put upward pressure on JPY," he said. On fiscal policy, he also stressed that the government "places great importance on sustainability and is not expansionary", explaining the transition to a new fiscal management framework centred on reducing the debt-to-GDP ratio. Regarding the rise in long-term interest rates to a 30-year high and the depreciation of JPY following what was dubbed the "Honebuto shock", Minister Kiuchi countered: "It is not appropriate to draw a simple causal link between a single policy document and market movements. Markets reflect a combination of factors, including overseas interest-rate developments and government bond supply and demand".

An important perspective for understanding the government's explanation is the "structural factors" behind the depreciation of the JPY. The conventional view attributes the depreciation of the JPY primarily to the Japan-US interest rate differential, but a more fundamental factor is the asymmetry in investment capacity. In the US, with AI-related investment adding further momentum, net domestic fund demand – the spending power of the government and corporate sectors, defined as the corporate saving rate plus the fiscal balance – has reached around -10% of GDP. In the Eurozone, it is also around -3%. This means that investment expansion is already strong and expectations of higher interest rates are also strong. By contrast, Sanaenomics' strategic investment programme has yet to get fully under way in Japan, and net domestic fund demand has effectively disappeared. This structural disparity attracts capital to the US and, through the logic of the Mundell-Fleming model, generates persistent downward pressure on JPY. Japan's delayed start is attracting attention as recognition spreads globally that the world has entered an era of intense competition in public-private strategic investment and industrial policy.

The BoJ's prescription that "raising interest rates alone would stop the depreciation of JPY" misdiagnoses the fundamental problem. The Honebuto, decided in July 2026, effectively neutralised the primary balance surplus target and established a new investment framework. It also set out a roadmap for more than JPY370trn of cumulative public-private investment in 17 strategic fields through FY40, with strategic investment set to begin in earnest with the execution of the FY27 budget. Only when this expansion in investment materialises would the gap in investment capacity between Japan and the US narrow and the structural correction of JPY depreciation begin. The virtuous cycle envisaged by the Takaichi administration is "expansion of public-private strategic investment → higher productivity → higher real wages → structural correction of JPY depreciation". If this scenario materialises, the depreciation of the JPY would correct itself autonomously. The "integrated achievement of a strong economy and fiscal stability" emphasised by Minister Kiuchi is precisely the essence of "responsible proactive public finance", and its success or failure would determine the course of the Japanese economy.

Foreign exchange rates are market prices determined by trading based on the relative economic conditions and policies of two countries. The current strength of the USD and weakness of the JPY do not reflect an erosion of confidence in the JPY. Rather, they reflect the fact that the US has expanded fiscal spending, including long-term investment, by relatively more, thereby raising its economic growth rate and prompting increases in its policy rate. Movements in USD/JPY can be explained by the difference in changes in the fiscal balances of Japan and the US, demonstrating that the effect described by the Mundell-Fleming model – under which fiscal expansion in a floating exchange-rate regime raises interest rates and leads to currency appreciation – is at work. It is natural for capital to flow towards the US economy, where domestic demand is stronger, investment opportunities are more abundant and interest rates are higher, resulting in a trend of USD appreciation and JPY depreciation.

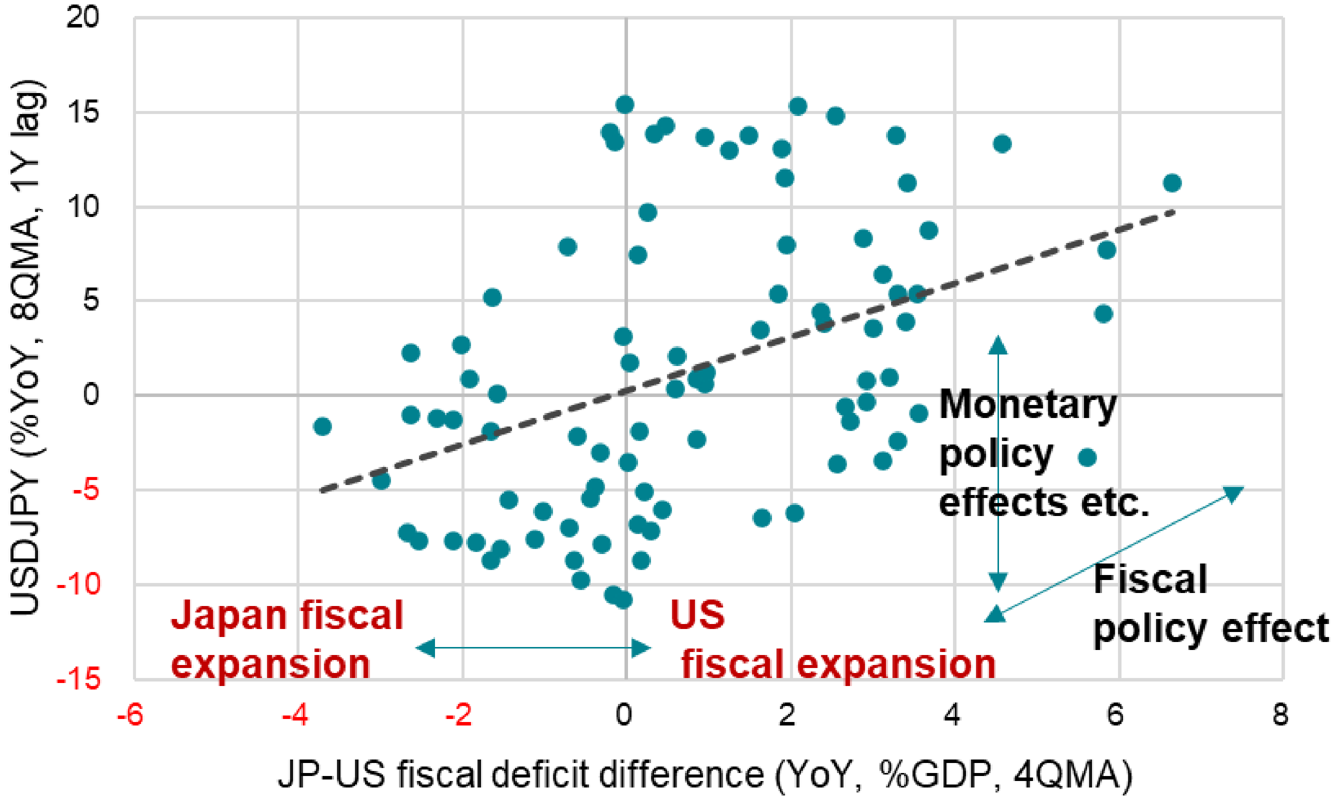
Foreign exchange intervention is generally regarded as having only a “limited” effect, but its significance as a deterrent is substantial. It would take time for the benefits of investment expansion to reach households in the form of higher real wages. If the JPY depreciates excessively during this transition period, higher import prices could derail domestic demand. The tolerable level of JPY depreciation is considered to be around the JPY150 range against the USD, with intervention designed to restrain depreciation beyond that level. However, the government’s objective is not to actively engineer JPY appreciation, but merely to curb excessive depreciation. Direct relief for households would be provided through proactive public finance, including income tax and VAT cuts.

The granting of a “dual mandate” to the BoJ, aimed at achieving both stable inflation and strong economic growth, has been criticised as political pressure to restrain rate hikes. However, this falls within the framework of coordination with the government under Article 4 of the Bank of Japan Act. It represents an attempt to shift from an ECB-style framework focused solely on price stability towards an FRB-style dual mandate and does not undermine the BoJ’s independence. In the Honebuto, the government clearly defined a “strong economy” as one in which, “under the achievement of the 2% price stability target, economic growth exceeding 1% in real terms and 3% in nominal terms is established as soon as possible and subsequently raised further”. In the BoJ’s Outlook Report, real GDP growth is projected at +0.6%, +0.8% and +0.8% for FY26, FY27 and FY28, respectively, indicating that economic growth remains weak. Meanwhile, inflation is projected to remain in the 2% range, broadly consistent with the price stability target.

As long as market expectations do not price in rapid rate hikes, the BoJ cannot be said to be behind the curve. The greatest risk is a scenario in which the BoJ attempts to force JPY appreciation through rapid rate hikes. If monetary tightening depresses domestic investment and damages supply capacity, Japan could fall into an “uncontrollable, harmful depreciation of JPY” amid concerns over increasing dependence on overseas supply. There is a consensus that, following the 1985 Plaza Accord, the BoJ responded to the rapid appreciation of the JPY with excessive monetary easing, contributing to the formation of the bubble and marking the starting point of Japan’s “lost three decades”. If it was a mistake to respond to JPY appreciation with monetary easing, it is self-evident in our view that responding to JPY depreciation with monetary tightening would likewise be a mistake.

Coordination between the government and the BoJ represents a normal form of economic policymaking. By contrast, changes in monetary policy in response to external pressure resembling interference in domestic affairs would undermine central bank independence, and the currency of a country whose central bank is vulnerable to such pressure would not become stronger. Kyodo News reported that the unusual, coordinated JPY-buying intervention by the Japanese and US governments – the first in 28 years – was ultimately made possible by BoJ Governor Kazuo Ueda strongly signalling that the policy rate could be raised as early as September. Multiple Japanese government officials said this was because “the US was concerned that delays in rate hikes were causing excessive JPY depreciation, leading to further inflation and increases in long-term interest rates that could spill over into global financial markets”. One senior official was quoted as saying, “Ueda’s remarks played very well with the US side. On the other hand, the BoJ has now been left with no option other than a rate hike [at its next Monetary Policy Meeting on 17–18 September].” After the Japanese and US finance ministers issued a joint statement on foreign exchange intervention last September, it was also reported – although not officially confirmed – that the US had privately asked the Japanese government to encourage the BoJ to raise interest rates. US Treasury Secretary Scott Bessent was reportedly concerned that a rise in Japanese long-term interest rates could pull US interest rates higher and potentially cool the US economy. If the BoJ were indeed to raise interest rates as a result of intervention by a foreign government, the independence of the BoJ’s monetary policy could be regarded as having been compromised. If future rate hikes were also perceived in this way, they would not contribute to a correction towards JPY appreciation; rather, the resulting erosion of independence could itself become a further risk factor for JPY depreciation.

Fig 4. Mundell-Fleming effect



Source: Cabinet Office, BoJ, Crédit Agricole CIB

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Japan economics forecast table

Japan		Q125	Q225	Q325	Q425	Q126	Q226	Q326f	Q426f	Q127f	Q227f	Q327f	Q427f	CY25	CY26f	CY27f	CY28f
Real GDP	qoq%	0.5	0.2	-0.4	0.2	0.5	0.3	0.1	0.1	-0.1	0.5	0.3	0.4				
	qoq ann.%	2.1	0.7	-1.8	1.0	1.9	1.1	0.4	0.4	-0.2	2.2	1.4	1.6				
	yoy%	1.6	1.9	0.7	0.5	0.4	0.5	1.1	0.9	0.4	0.7	0.9	1.2	1.2	0.8	0.8	1.6
Private consumption	qoq%	0.6	0.1	0.5	0.1	0.5	-0.0	-0.4	0.1	-0.4	0.4	0.2	0.3	1.3	0.7	-0.1	1.2
Residential investments	qoq%	-0.5	0.5	-8.0	5.0	0.9	-0.5	-0.5	-0.5	-1.0	0.0	0.3	0.4	-1.8	-0.2	-1.5	1.4
Non-residential investments	qoq%	1.1	1.4	-0.3	1.3	-1.0	-1.2	1.5	0.6	0.6	0.7	0.7	0.7	2.5	0.2	2.6	2.8
Public investments	qoq%	-0.7	0.7	-1.1	-0.4	1.5	-0.1	0.3	0.2	0.5	0.9	0.9	0.9	-0.3	0.9	2.1	3.5
Net trade	pp	-0.5	-0.0	-0.1	0.1	0.3	0.4	-0.3	-0.2	-0.1	-0.0	-0.0	-0.0	-0.2	0.3	-0.4	-0.1
Exports	qoq%	-0.7	1.6	-1.4	0.1	1.7	0.5	0.2	0.2	0.2	0.4	0.4	0.4	2.5	2.1	1.1	1.4
Imports	qoq%	2.0	1.8	-0.6	-0.1	0.3	-1.5	2.0	1.5	0.8	0.5	0.5	0.5	3.8	0.5	3.4	2.1
Nominal GDP	yoy%	5.3	5.3	4.2	3.9	3.8	3.1	2.7	2.2	1.7	0.9	1.7	2.2	4.7	2.9	1.6	3.2
Core CPI (ex fresh food)	yoy%	3.1	3.5	2.9	2.8	1.8	1.5	1.7	1.9	2.1	0.6	0.4	0.1	3.1	1.7	0.8	1.7
Core-core CPI (ex fresh food and energy	yoy%	2.7	3.2	3.2	3.0	2.5	1.8	1.8	1.7	1.7	0.7	0.6	0.6	3.0	2.0	0.9	1.8
Unemployment rate	%													2.5	2.6	2.5	2.5
Nominal agg. compensation	yoy%													3.7	3.6	3.6	4.3
Corporate savings rate	%GDP													3.5	2.5	0.5	-1.5
Household savings rate	%GDP													1.5	2.0	4.0	5.0
Fiscal balance	%GDP													-1.0	-1.5	-2.5	-1.5
Current account balance	%GDP													4.0	3.0	2.0	2.0
BoJ policy rate（current account intere	%（end)	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.25	1.25	1.50	1.50	0.50	1.00	1.50	2.00
10Y JGB yield	%（end)	1.35	1.40	1.65	1.80	2.20	2.60	2.90	2.90	2.95	2.95	3.00	3.00	1.80	2.90	3.00	3.00

As of Aug 17 2026
*IS balance items based on flow of funds data

CACIB	Real GDP	CPI (ex fresh food)	CPI (ex fresh food and energy)
FY26	+0.7 (+0.8)	+1.8 (+1.7)	+1.8 (+2.0)
FY27	+1.1 (+0.8)	+0.4 (+0.8)	+0.7 (+0.9)
FY28	+1.6 (+1.6)	+2.1 (+1.7)	+2.1 (+1.8)

*parenthesis denote CY forecast; Units: yoy%

Source: BoJ, Cabinet Office, MIAC, Crédit Agricole CIB

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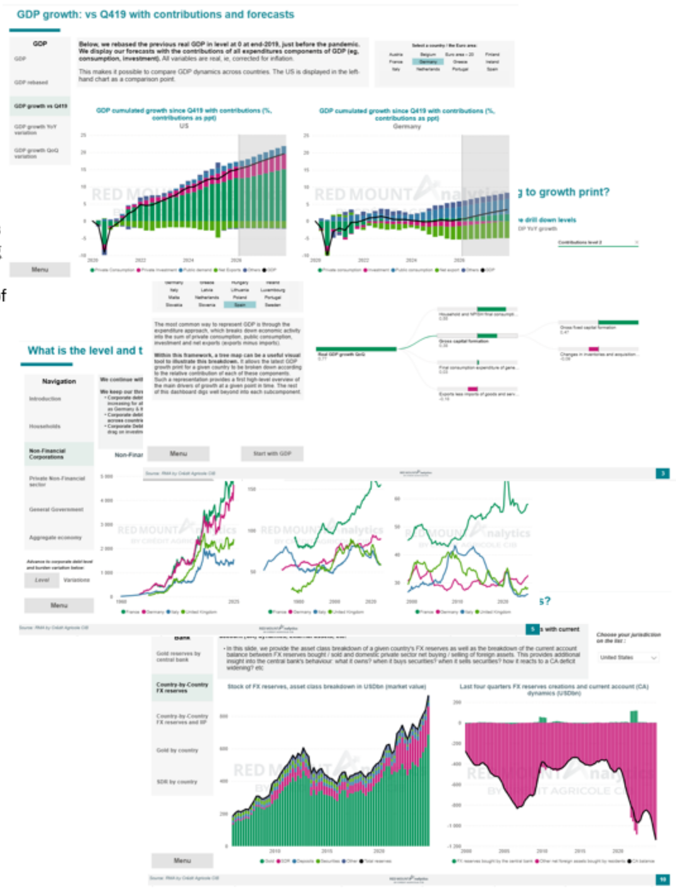

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