

Daiwa's Economic View

Second-round price pass-through and upside risks to underlying inflation: New phase for prices seen in April BOJ MPM minutes

- Second-round pass-through mechanism discussed in April has already begun to materialize earlier than expected
- Inflation expectations are rising adaptively and remain unanchored, pushing up underlying inflation
- Fed's hawkish shift is amplifying domestic price pressures through yen depreciation and price pass-through

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Second-round price pass-through structure emerging amid US-Iran developments

On 19 June, the minutes of the April 2026 BOJ Monetary Policy Meeting (MPM) were released. The meeting made clear that, with regard to prices, members were strongly conscious of second-round effects through firms' price-setting behavior and wage trends, going beyond merely temporary cost-push factors.

In other words, in addition to the conventional channel whereby supply shocks (such as higher crude oil prices) feed through to the corporate sector via import prices and then to consumer prices through pass-through to selling prices, members shared the view that, in recent years, the speed and scope of such pass-through have expanded against the backdrop of progress in wage hikes and changes in firms' price-setting behavior.

Indeed, in the minutes, several members pointed out that, with firms' behavior shifting more toward raising prices in the past few years, it was highly likely that firms would start passing on to selling prices not only cost increases stemming from the current rise in crude oil prices, but also past increases in personnel costs. These members then expressed the view that, if such actions were taken by an increasing number of firms, it was also highly likely that people's inflation expectations and underlying inflation would rise higher than projected.

This is the core of the discussion on prices in the latest minutes. Cost pass-through by companies is proceeding more rapidly and broadly than before, and it was pointed out that pass-through from energy prices to goods prices, and further to services prices, could generate more persistent upward pressure on prices. Such discussion suggests that the very criteria for judging "whether cost increases are temporary or will translate into underlying inflation" are changing.

The BOJ is paying increasing attention to this matter. At the Diet on the 19th, BOJ Deputy Governor Ryozi Himino expressed the view that [the impact of crude oil prices on prices would "have a certain effect on consumer prices around the summer,"](#) and also stated that [the rise in business-to-business transaction prices was proceeding "somewhat faster than assumed in April."](#) Although the y/y rate of increase in the core CPI in May remained in the 1% range for the fourth consecutive month, it is expected to exceed 2% again from the summer onward and then continue to increase.

In other words, the second-round pass-through mechanism discussed at the April meeting can be interpreted as already beginning to materialize in actual data earlier than expected. Closely linked to this discussion of second-round pass-through is the upside risk to underlying inflation.

In particular, the minutes contained multiple observations that, given the prolonged high crude oil prices and accelerating price pass-throughs, there was a possibility that underlying inflation could overshoot forecasts, bringing forward the timing for reaching the 2% target.

Indeed, one member pointed out that, given that inflation expectations in Japan tended to be formed in an adaptive manner, the price rises in FY26 reflecting the situation in the Middle East could lead to underlying CPI inflation deviating upward from the baseline scenario. A different member stated that a further rise in domestic distribution costs due to the surge in fuel costs could not be avoided, and this could bring forward the timing for underlying CPI inflation to reach 2%.

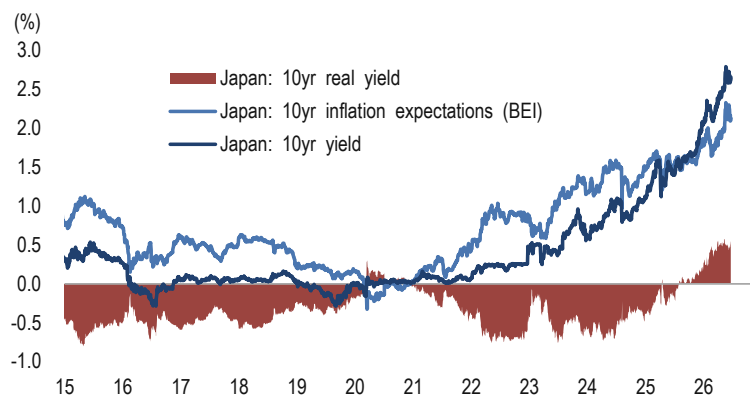
What is particularly important is that this upside risk is being recognized not merely as a short-term price increase, but as a source of persistent inflationary pressure. This is because, in an environment where firms' wage-hiking behavior is spreading and price increases are becoming easier to accept, cost increases are more likely to be transformed into lasting price increases.

Mutual reinforcement between upside risks to underlying inflation and inflation expectations

This structure is inseparable from developments in inflation expectations. In the minutes, while there was recognition that inflation expectations had risen to around 2%, it was also pointed out that they still could not be said to be sufficiently anchored, and that the risk of upward deviation remained.

On this point, some members noted that **inflation expectations in Japan were not as anchored to the inflation target as in the US and Europe, and they were susceptible to actual price changes. These members continued that, considering this and other factors, there was concern over the risk of medium- to long-term inflation expectations and the underlying inflation rate rising above 2%.**

Japan: 10yr Yield, Real Yield, and BEI



Source: Bloomberg; compiled by Daiwa.

In addition, some members expressed the recognition that, considering the fact that spillovers from price rises to wages had been gaining momentum in recent years with the deflationary norm dispelled, attention was warranted on the risk that the rates of increase in both prices and wages would deviate upward from projections, although this would depend on the extent of the spillovers. A different member noted that, the current financial and fiscal conditions and developments in the pass-through of price and wage increases appeared to be more prone to inducing second-round effects stemming from the rise in crude oil prices.

In other words, the series of processes starting from higher crude oil prices has a structure that can create a chain reaction: higher raw material prices → acceleration of price pass-through → overshoot in underlying inflation → rise in inflation expectations. In this process, an overshoot in inflation expectations functions as an amplifier that further pushes up underlying inflation.

Based on this discussion, one member expressed the view that, given that the underlying CPI inflation was currently approaching 2%, whether the current supply shocks would cause underlying CPI inflation to further deviate upward was an important factor in discussing second-round effects. Taking this point into account, the discussion at the April meeting can be positioned not simply as one concerning short-term price developments, but as an assessment of the possibility that a self-sustaining mechanism of inflation could be formed.

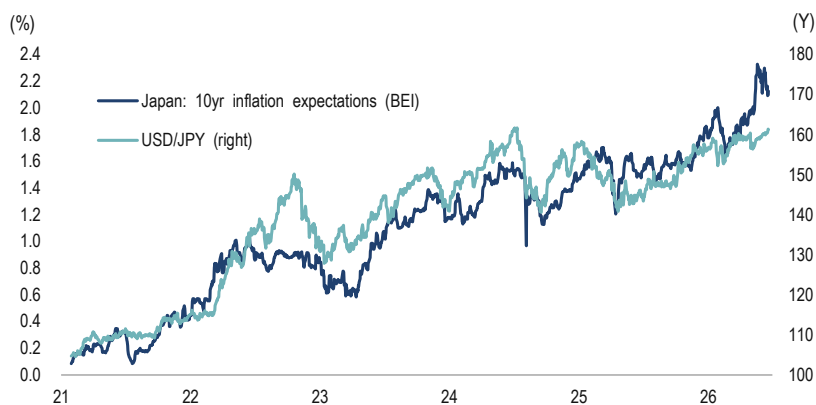
In particular, [following the subsequent provisional agreement between the US and Iran, downside risks to the economy appear to have diminished to some extent](#). This suggests a shift into a phase where upward pressure on prices originating from supply constraints, and the risk of an increase in underlying inflation through its second-round effects, have become relatively more important.

Therefore, the price assessment at the April meeting can be summarized as multifaceted: while there was a strong awareness of upside risks to underlying inflation, significant uncertainty remained regarding the timing and persistence of their materialization. At the same time, in light of subsequent changes in the external environment, policy decisions appear to be shifting to a phase in which greater emphasis should be placed on upside risks to prices and risks related to expectation formation, rather than downside risks to the economy.

In this context, [the resumption of rate hikes at the June MPM](#) would likely be positioned not merely as a response to the recent rise in prices, but as a pre-emptive, risk-management response to persistent inflationary pressure through second-round effects and expectation formation that had already been recognized at the April meeting.

The focus going forward has shifted to how sustainably these inflation expectations will rise. If an upward deviation in expectations is confirmed, an overshoot of underlying inflation could materialize, potentially necessitating an acceleration in the pace of interest rate hikes.

USD/JPY, 10yr BEI in Japan



Source: Bloomberg; compiled by Daiwa.

In particular, the global policy environment, especially the Fed's policy stance, has been changing in a direction that reinforces this mechanism, as expected. In other words, as the Fed has strengthened its hawkish stance and the possibility of rate hikes has increased, upward pressure on import prices is likely to persist through a weaker yen. Such an external environment is supporting domestic price pass-through and wage hikes, while also acting as a factor that tends to push inflation expectations upward.

Considering these domestic and external circumstances, we think that the BOJ needs to respond more proactively and pre-emptively to the risks of an inflation overshoot and rising inflation expectations.

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