Mizuho Brief: FOMC, BoJ, BoE

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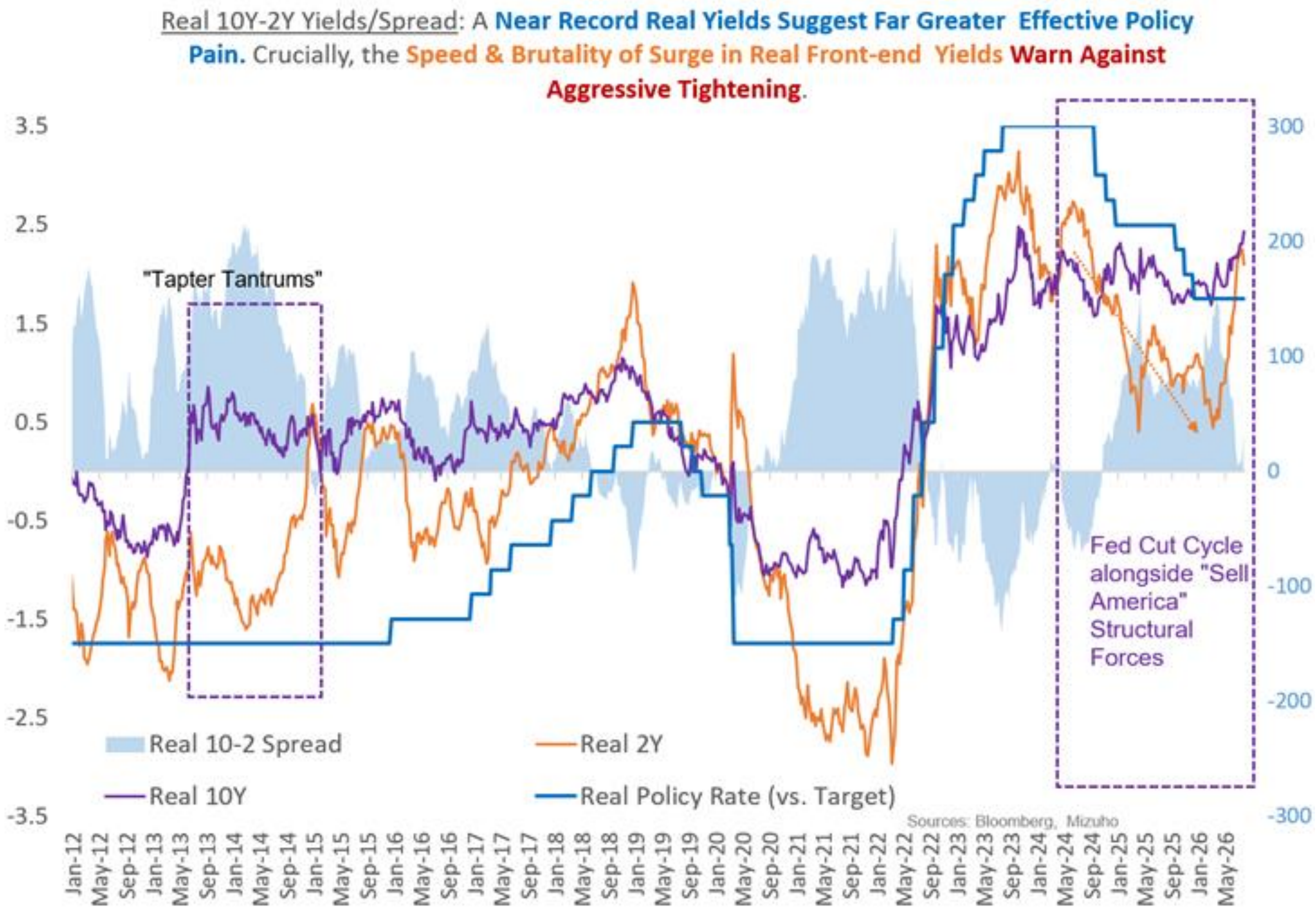
Vishnu Varathan | Head Macro Research, Asia ex-Japan

MIZUHO

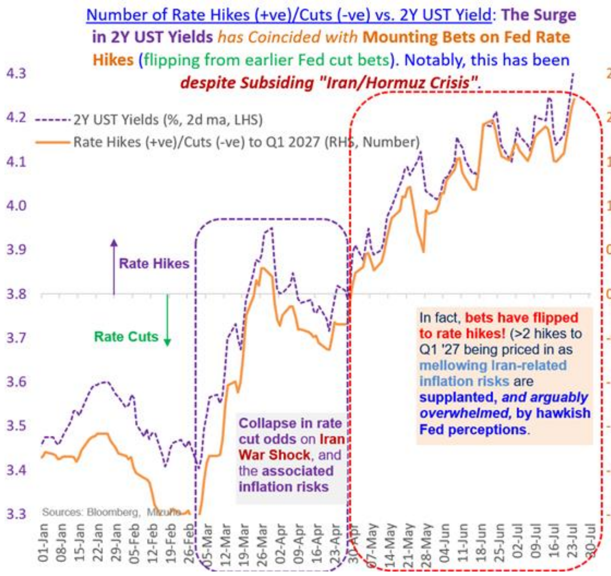
Central Bank Watch: The Advantage of Options (Over Action)

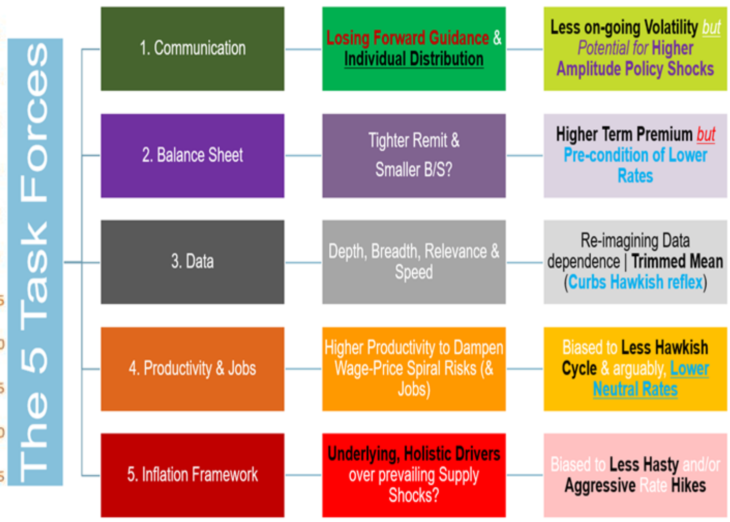
"In a dark place we find ourselves, and a little more knowledge lights our way." – **Master Yoda**

- On the heels of the **ECB inaction last week** (and the **BoC maintaining the status quo** the week before), we expect a **raft of policy hold this week**.
- Specifically, for the **Fed** (Wed), **BoE** (Thu) and **BoJ** (Fri) **to all sit on their hands**.
- *Albeit with* all, and especially *active hawkish, options retained.*
- Point being, this is **not merely passive policy space exploited**, but **strategic policy posture engineered**.
- Crucially, **retaining (hawkish) policy options** ***rather than hastening to pull the trigger***, may **arguably be more advantageous**.
- Binary Risks…: Above all because **a hawkish hold better hedges for acute binary risks** – given the tendency **to lurch between opposing risks of** *inflation flare-up* and *demand destruction.* – accentuated by fresh tariff assaults and two-way AI capex-earnings risks.
- … Amid Embedded (Policy) Restriction: Especially given **policy restriction already in place** (Fed at an elevated 3.50-3.75% and the BoE at 3.75%) and *recent hikes* (ECB and BoJ both by 25bp in June) **buying** *time* and space.
- Aligning with Conflict Cycle: Moreover, a hawkish hold **better aligns with Trump also preferring to keep** *all options on the table, with a preference for diplomatic solutions*.
- Oil's Exceptional Two-Way Volatility: Especially **as Oil prices show exceptional two-way volatility**. And notably, *liable to slump on prospects of truce.*
- Surging Yields Fill "Talk-Walk" Gap: What's more **global yields have soared**, *filling the gaps between hawkish talk and walk*, which buys time to avert hasty missteps.
- Given More Acute *Real* Pain: More so the **surge in** 2Y/10Y **UST yields**, (up 33/24bp to 4.33%/4.43%) in nominal terms is ***profoundly more acute*** (up ~70/40bp) ***in real terms*** – *warning of amplified policy pain.*
- All said, the **extreme uncertainty** amid **appreciable restraint** – *imposed collectively by policy and markets* – set the stage for a **considered hold augmented by hawkish vigilance**.



FOMC: Rising, Not Realized, Hawkish Bets





- At this week's **FOMC** (29th July, Wed), **hawkish talk may turn even more emphatic** but will probably ***not*** be expressed in **action** (or the lack thereof).
- Point being, **Brent's resurgence to ~$100** amid *an intensifying escalation of the US-Iran conflict*, despite **flagging pipeline inflation risks**, **does not unambiguously necessitate imminent rate tightening**.

- For one, **a great deal of uncertainty about the Middle East crisis situation remains**, *arguably requiring greater consideration* (of rapidly evolving evidence).
- Especially given that the Fed's ***prevailing policy rate*** at 3.50-3.75% constitutes ***a good degree of restraint*** (being above estimated "neutral rates"). *More so, considering prolonged elevation in rates.*
- Meanwhile, the **surge in front-end (2Y) UST yields** *past 4.35%* constitute **sufficient interim tightening in effective rates and financial conditions**.
- All else equal, this should ***at least buy time*** with respect **to the (market) presumed hike**(s) ahead.
- What's more, *tamer-than-expected inflation prints* – both headline and sequential – *suggest* that the Fed has *even more policy latitude for policy "patience"*.
- In addition, the **5 Task Forces** that Fed Chair Warsh has set out, with a projected finding before year-end **arguably provide hawkish cover** *for a prolonged interim pause.*
- Finally, **further hawkish cover** is derived from the Fed's **purposeful brevity*** and **strategic reticence on forward guidance** when ***coupled with credibility-enhancing commitments to*** attaining the 2***% inflation target***.
- As a result, the *Greenback and UST yields may remain underpinned* as future hawkish expectations remain priced in (even if only from an absence than of guidance).

*Confined to factual assertions in the statement

BoJ Watch – Flex, Not (Futile) Fight

- At this week's (31st July, Fri) policy meeting, the **BoJ is likely to indulge in more hawkish flex, *but*** we argue it may **refrain from hikes that risk being a futile fight against chronic JPY pressures**.
- **Sharp** (~2%) **JPY depreciation** *since the last BoJ meeting* in mid-June, **has arguably invoked more hawkish inclinations** from the BoJ.
- What's more, this 2% drop in the JPY will *compound some 25-30% surge in crude oil* during the corresponding period.
- Which is **likely to dial-up allusions to vigilance against imported price pressures** – which some may argue is *code for policy backstop for JPY* (including hikes).
- Furthermore, hawks could argue that the **nefarious adverse loop** between *JPY weakness* and *intensifying imported inflation pressures* **warrant hikes to nip in the bud**.
- But while understandable, that is misguided as the **BoJ will likely struggle to adequately impress with rate hikes** – *certainly not sufficiently to snap pressures from "carry" funding position.*
- **Especially as adverse energy, shipping** and **insurance shocks further underpin JPY** from a **flows** and **C/A shifts**.

- And so, **hastily squandering** (relatively limited) **capacity for further hikes** comes across as a **myopic** move with short-lived JPY support benefits.
- Whereas what's preferable *sustained hawkish flex complemented by credible, MoF intervention threats* (<u>in coordination with Fed/US Treasury</u>).
- Unfortunately, for the BoJ, it remains the case that *(bearish) JPY is a BoJ problem with a (dovish) Fed solution.*