

ECONOMIC RESEARCH – JUNE 2025

INVESTMENT INSIGHT

JAPAN



- ✓ Slowdown in consumption and exports in Q1
- ✓ Uncertainty remains high for Q2

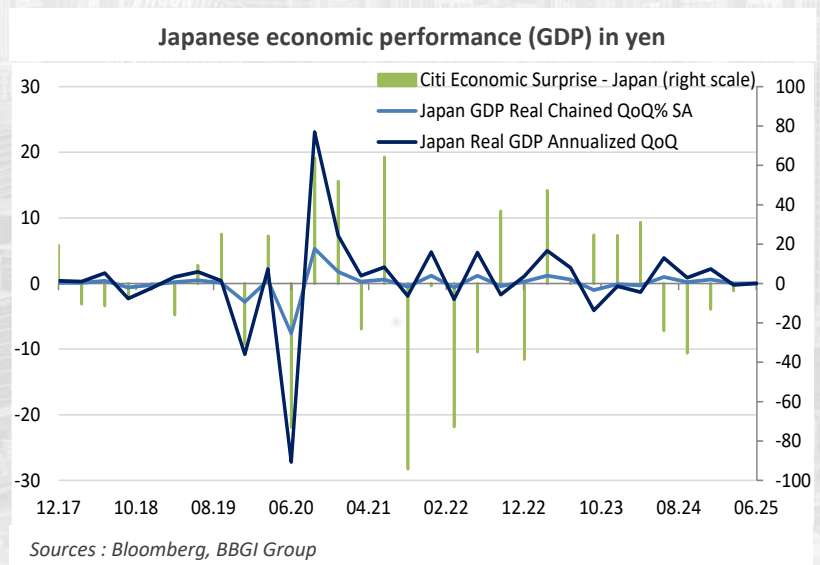
REDUCED OUTLOOK FOR JAPANESE ASSETS

Q1 GDP contraction highlights economic weakness

Japan's GDP experienced an unexpected contraction in Q1 2025, the first decline in a year, which was more severe than anticipated. This downturn, with an annualized contraction of -0.7%, was primarily driven by stagnant private consumption and a significant negative contribution from net exports, highlighting the underlying fragility of the economy.

Persistent inflation erodes consumer spending

Private consumption, which accounts for over half of Japan's economic output, remained largely flat in the first quarter. This stagnation is directly linked to persistent inflation, which is eroding household purchasing power as nominal wages fail to keep pace with rising prices. This has led to a gloomy consumer sentiment and subdued spending, making it difficult for the economy to find a strong domestic growth driver.



Net exports weaken amidst global headwinds

Net exports served as a major drag on GDP growth in Q1, with a quarterly contraction in exports for the first time in a year. This decline was driven by lower services sales and weak demand from major trading partners. The recent appreciation of the yen has also put pressure on export competitiveness. This weakening of exports prior to the full implementation of global tariffs suggests the economy was already susceptible to external pressures.

Uncertain outlook for the second quarter

The surprise contraction in Q1 raises significant doubts about the growth outlook for the second quarter. While employment remains stable, real wages are expected to continue to fall due to rising prices, which will likely keep household spending subdued. This suggests that any potential rebound in consumption in Q2 may be temporary and not indicative of a fundamental improvement in household purchasing power.

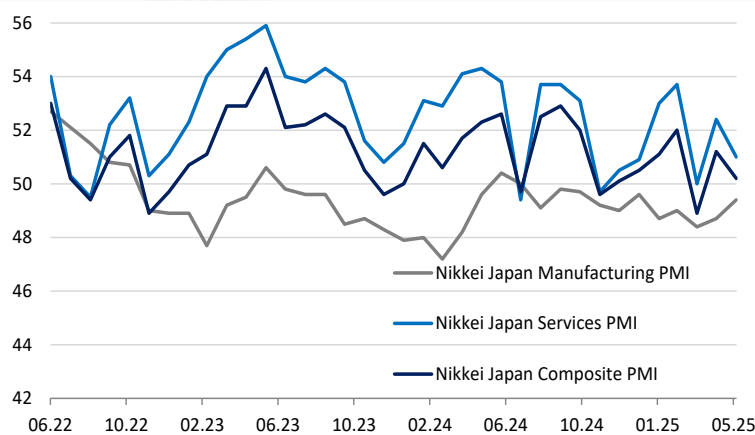
Investment provides a glimmer of hope

In contrast to consumption and exports, business investment showed resilience and is expected to continue its robust acceleration. This is being driven by ongoing investments in research and development, decarbonization, and digitalization. Public investment is also expected to increase with new infrastructure projects. However, for sustained growth, momentum must be driven by the private sector, as previous fiscal stimulus has shown diminishing returns.

Future trajectory depends on key indicators

The sustainability of Japan's economic recovery hinges on a few key indicators. The trajectory of real wages will be crucial, as will the ability of business investment to compensate for weaknesses in consumption and exports. The economy remains vulnerable to 'sliding into recession' in the short term, with external factors like trade tensions and global demand continuing to weigh on performance. The outlook for the second half of the year remains highly dependent on a stabilization of household purchasing power and a more favorable external environment.

PMI indicators (manufacturing, services, composite)



Sources : Bloomberg, BBGI Group