

ECONOMIC RESEARCH – SEPTEMBER 2025

INVESTMENT INSIGHT

JAPAN



- ✓ Composite PMI supported by services PMI
- ✓ Resilient consumption supported by wages
- ✓ Inflation weakens slightly but remains too high
- ✓ No BoJ rate hike before 2026

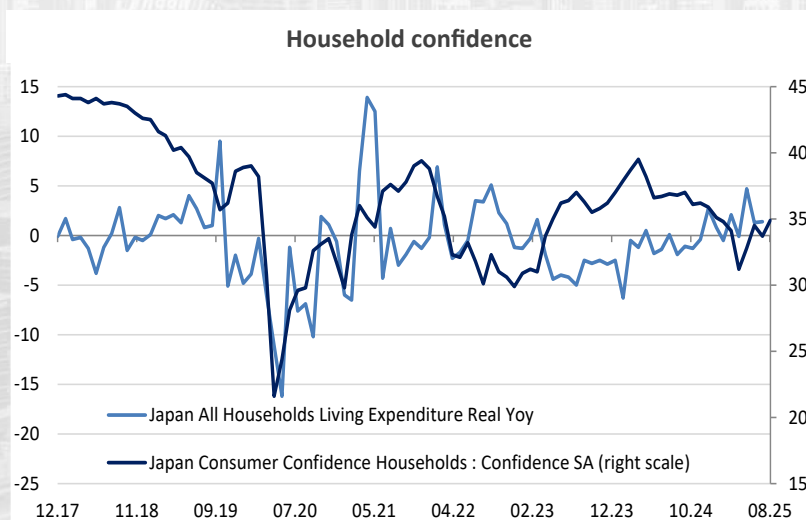
POSSIBLE TURNING POINT FOR THE NIKKEI

Leading indicators signal a two-speed economy

The latest PMI leading indicators reveal a two-speed economy with uncertain momentum. While the composite PMI remains in expansionary territory, this performance is driven by the solid services sector, which acts as the main engine of activity. In contrast, the manufacturing sector remains in contraction territory, a weakness corroborated by a persistent decline in industrial production. This highlights the precariousness of the current recovery, which relies on a single pillar of strength.

Consumption's resilience amidst fragile confidence

Private consumption is showing a degree of resilience, although household confidence remains stubbornly fragile. The consumer confidence index has fallen slightly, marking a pause after several months of improvement. While this level is an improvement from the lows of last year, it remains well below its historical pre-pandemic average. Despite this mixed sentiment, real household spending continued to grow, a divergence largely explained by the recent positive growth in real wages, which is supporting purchasing power. This is a critical dynamic that will determine the longevity of the current economic momentum.



Sources : Bloomberg, BBGI Group

Inflation eases, but core pressures persist

Inflation is undergoing a crucial transitional phase, marked by a moderation in overall figures but with persistent underlying pressures. The national price index (CPI) posted a +2.7% year-on-year increase in July, a decrease from earlier peaks but still above the Bank of Japan's (BoJ) 2% target. The core index (excluding fresh food) rose by a more modest +2.0% year-on-year, but it was the core-core index (excluding fresh food and energy) that showed the greatest rigidity, with a persistent increase of +2.9%.

Producer prices confirm an upstream trend

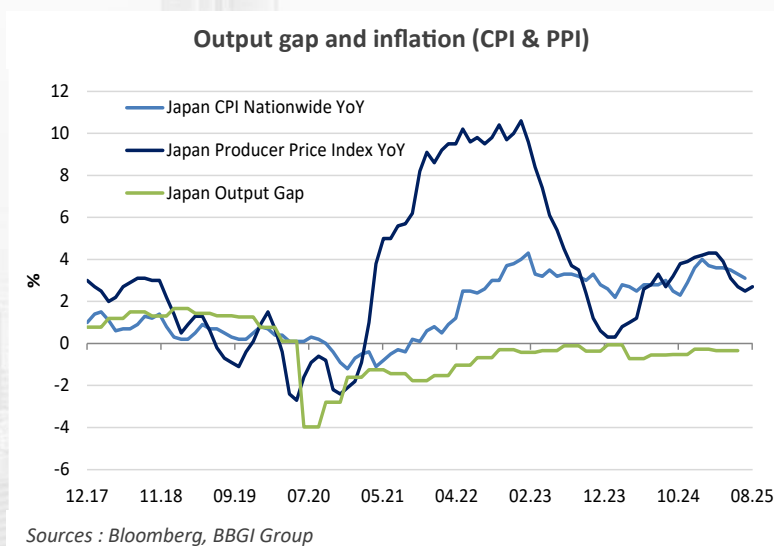
The persistence of underlying inflation is particularly notable in the services sector, where historic wage increases are beginning to be passed through to prices in labor-intensive areas such as catering and hospitality. This dynamic is confirmed upstream by producer prices, as measured by the Corporate Goods Price Index (CGPI), which slowed sharply, rising only +0.8% year-on-year in July. The external inflationary pressure that was fueling the PPI has largely dissipated, and Japan is now facing more domestically-driven inflation. This upstream trend is an encouraging sign that consumer price pressures may continue to ease in the coming months.

The bank of Japan's cautious stance

Faced with this complex and nuanced economic environment, the BoJ is pursuing an extremely cautious and gradual policy of monetary normalization after decades of ultra-accommodative measures. In March 2025, the BoJ took a historic step by ending its negative interest rate policy (NIRP) and yield curve control (YCC). Despite these changes, the BoJ has repeatedly insisted that financial conditions would remain "accommodative," continuing its bond purchases to ensure market stability.

A gradual path to policy normalization

The future direction of the BoJ's policy will depend on a delicate balancing act between conflicting economic signals. The most likely scenario is not a cycle of aggressive rate hikes, but rather modest adjustments, spaced out over time. The decision-making process is complicated by factors such as colossal public debt, fragile growth, and global economic uncertainty. Any abrupt move could trigger a currency shock or an unwanted tightening of financial conditions. The consensus among economists is that any further rate hikes are unlikely before the first or second quarter of 2026, as the central bank prioritizes supporting the economy.



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