

ECONOMIC RESEARCH – MARCH 2025

INVESTMENT INSIGHT

JAPAN



- ✓ Leading indicators supported by services
- ✓ Consumption resilient but still cautious
- ✓ Inflation rebounds to +4% again
- ✓ BoJ to raise key rates again in March

YIELD DIFFERENTIAL IN FAVOR OF THE YEN

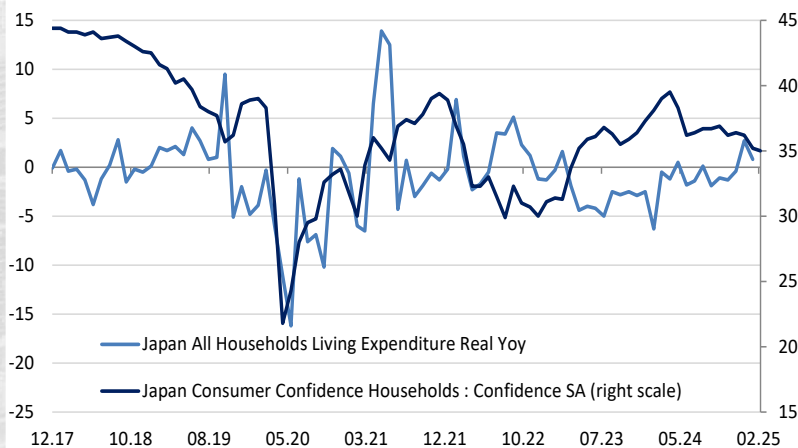
Divergent trends in leading economic indicators

Leading indicators present a mixed but overall positive picture, primarily driven by the services sector. The Manufacturing PMI remained weak at 48.9, marking its eighth month of contraction. Conversely, the services sector showed strong expansion with a robust January reading of 53.1. The Composite PMI, largely underpinned by services, stands at an encouraging 51.6, signaling continued economic growth.

Industrial production and supply chain dynamics

Industrial production experienced a temporary dip of -1.1% in January, which appears to be an isolated event. This decline is largely attributed to a post-holiday drop in demand for consumer electronics, particularly smartphones, following a strong close to the previous year. However, forward-looking indicators suggest a potential rebound in February. This is supported by an anticipated surge in demand for AI-related equipment and a broader recovery in the global semiconductor cycle, which is expected to bolster chip-related production and export activity.

Household confidence



Sources : Bloomberg, BBGI Group

Consumer sentiment and retail sales performance

Despite some improvements in spending, consumer confidence remains a key challenge. The household confidence index declined further to a low of 35.2 in January, extending a gloomy trend observed since Q2 2024. This persistent caution is influenced by a combination of uncertain international conditions and the continued pressure of rising costs of living. However, there are some positive signs in spending behavior. Retail sales have shown a clear improvement, increasing to +3.9% year-on-year, a notable acceleration from the +0.7% low point recorded in September 2024. The month-on-month increase of +0.5% in January further suggests a cautious but upward trajectory for consumer spending.

Strong wage growth supports future consumption

While inflation has weighed on consumer sentiment, wage growth provides a solid foundation for future confidence and spending. Nominal wage growth reached its strongest performance since 1997, with a significant increase of +4.8%. This marks the second consecutive month of real wage growth in December, a critical development for household purchasing power. With upcoming wage negotiations pointing to potential increases of up to +5% for large companies and even higher for small businesses, this robust wage trend is expected to provide a much-needed boost to household confidence and stimulate future consumption.

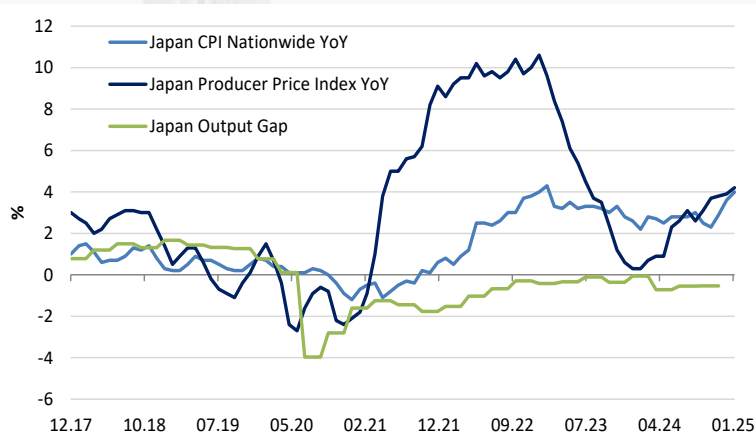
Inflationary pressures re-emerge

Inflation, after a period of moderation, has rebounded sharply, reaching +4% in January 2025. This acceleration brings it close to its recent peak and makes it the highest inflation rate among G7 countries. The primary driver of this renewed pressure is a significant rise in food prices, which increased by +3.2%, with a particularly strong +70% surge in rice prices. While core inflation (excluding food and energy) is expected to remain below +3%, the overall inflationary environment continues to strain household finances and impede a full recovery in consumer confidence, despite the recent wage increases.

Bank of Japan's likely monetary policy path

The recent surge in inflation and a resilient services sector have significantly increased the probability of another Bank of Japan (BoJ) rate hike. The central bank has consistently signaled its intention to continue raising rates in response to sustained price increases. Having already raised rates on three occasions in the past ten months, bringing the policy rate to 0.5% in January, the BoJ is widely anticipated to implement another rate hike at its upcoming March meeting. This monetary policy tightening is considered a reasonable response to the current economic environment. However, a rate increase could have a significant impact on foreign exchange markets and global asset classes, particularly by affecting carry trade strategies financed by the yen.

Output gap and inflation (CPI & PPI)



Sources : Bloomberg, BBGI Group