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ECONOMIC RESEARCH – NOVEMBER 2025

INVESTMENT INSIGHT JAPAN

- ✓ **Exports stall, GDP falls by -0.4% in Q3**
- ✓ **Possible GDP recovery in Q4, but on a knife edge**

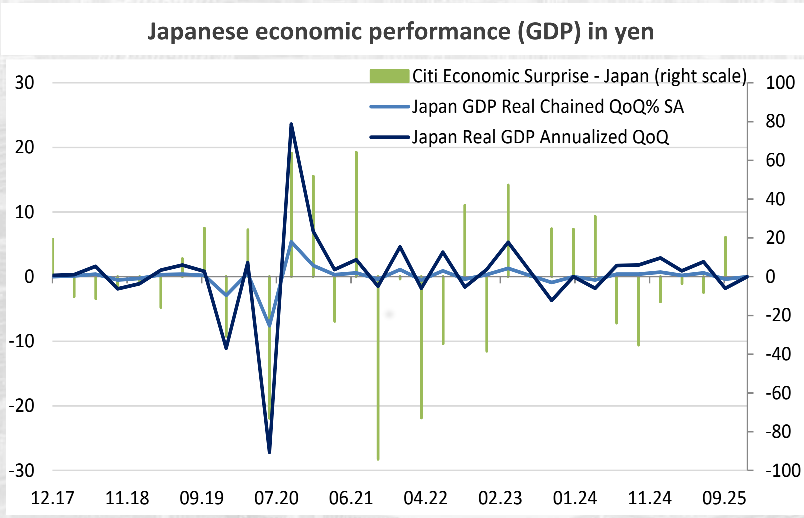
STAGFLATION RESHUFFLES THE DECKS FOR JAPANESE ASSETS

Q3 GDP contraction: Export-driven reversal

The Japanese economy stalled abruptly in Q3 2025, ending a streak of consecutive growth quarters with a GDP contraction of -0.4% (-1.8% annualized). This performance, while slightly better than the feared -0.6% decline, marks the first contraction since early 2024 and signals a definitive shift in growth dynamics. The primary driver was a negative contribution from foreign trade, specifically a sharp -1.2% drop in exports. This reversal is directly attributable to the implementation of new US tariffs in September, which severely impacted shipments of automobiles and manufactured goods.

Domestic stagnation vs. capex resilience

Domestic demand revealed a complex picture. Household consumption, the engine of Q2's growth, decelerated significantly to an anemic +0.1% as the effects of government measures faded and inflation—particularly in rice and energy—eroded purchasing power. Conversely, a major positive surprise emerged in non-residential business investment (Capex), which defied forecasts with a +1.0% jump. This resilience indicates that Japanese firms are prioritizing automation and modernization to counter structural labor shortages, even amidst trade uncertainty.



Sources : Bloomberg, BBGI Group

Policy response: Fiscal acceleration & BoJ pause

The confirmed vulnerability to external trade tensions has immediate policy implications. Prime Minister Sanae Takaichi's administration is expected to accelerate the rollout of its new economic stimulus plan to buffer the external shock. Simultaneously, the Bank of Japan (BoJ) is virtually certain to maintain the monetary status quo at its next meeting. The central bank will likely adopt a "wait-and-see" stance, needing confirmation of a consumption rebound in Q4 before risking further rate hikes.

Q4 outlook: Precarious consumption-led recovery

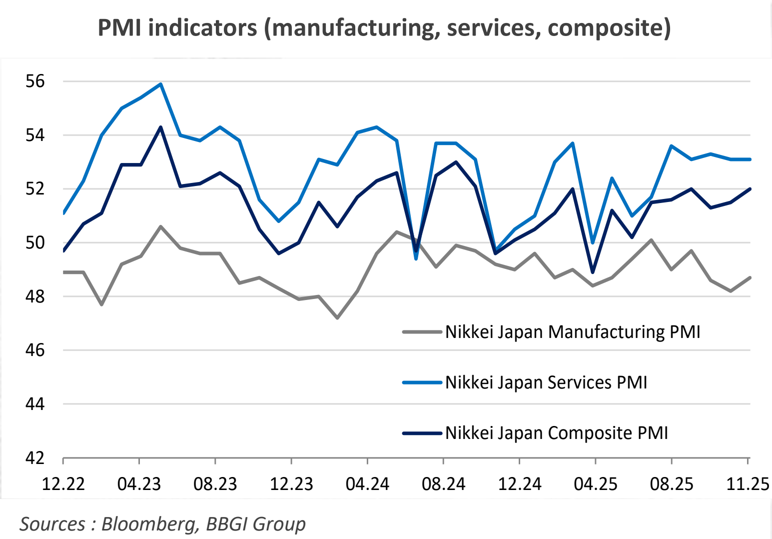
While the Q3 contraction validates our cautious "moderation" scenario, a technical recession is likely to be avoided via a rebound in Q4. The fundamentals for a domestic recovery remain valid: the "virtuous spiral" of wage growth is set to accelerate, bolstered by significant winter bonuses in large corporations and stabilizing energy prices. This restoration of real disposable income should fuel a resurgence in private consumption, pushing GDP back into positive territory to close the year.

Sectoral divergence and inventory headwinds

A widening dichotomy characterizes the current landscape: a resilient service-oriented domestic economy versus a manufacturing sector besieged by international headwinds. Export order books remain depressed due to weak demand from China and the US. Critically, manufacturers are shifting from inventory accumulation to a destocking phase. This inventory adjustment will actively weigh on growth through Q4 and Q1 2026, forcing a likely pause in investment until the geopolitical horizon clears.

2026 critical pivot: Shunto & fiscal transition

The economic trajectory for 2026 hinges on a successful "passing of the baton" from private consumption to government stimulus. As consumption may fade post-holidays, the stimulus plan currently in the Diet must bridge the gap. The ultimate litmus test for the BoJ’s normalization path remains the 2026 Shunto (wage negotiations). While large firms signal readiness to sustain wage hikes to retain talent, cost-constrained SMEs are hesitant. Without broad-based wage growth, the BoJ’s ability to hike rates will be severely constrained, leaving the economy in a fragile equilibrium.



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