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ECONOMIC RESEARCH – MARCH 2026

INVESTMENT INSIGHT JAPAN

- A difficult recovery in Q4
- A first quarter marked by tensions between resilience and external shocks

STAGFLATION RESHUFFLES THE DECKS FOR JAPANESE ASSETS

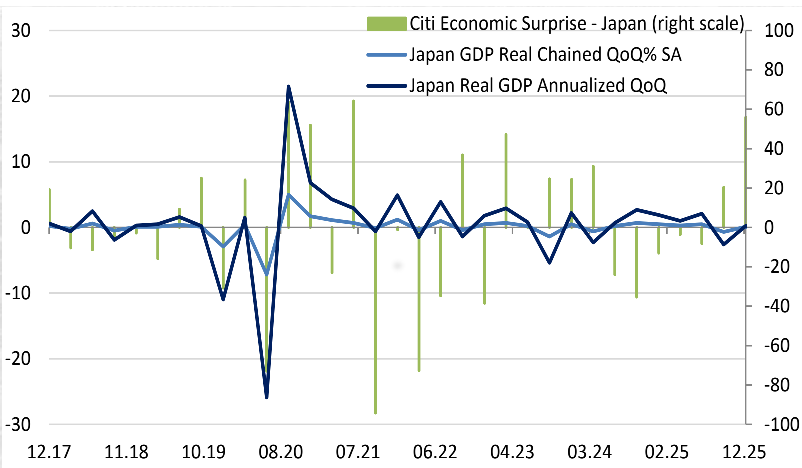
Precarious recovery and technical GDP rebound

The Japanese economy concluded 2025 in a precarious balance, narrowly avoiding a technical recession. February 2026 data confirms a marginal GDP rebound of +0.1%, reversing the previous quarter's -0.4% contraction. Despite this return to growth, the recovery remains fragile and uneven, suppressed by persistent domestic inflation and external trade barriers that have significantly hindered broader economic momentum.

Stagnant consumption and real wage erosion

Household consumption remains the primary drag on the domestic economy, growing at an anemic +0.1% for the seventh consecutive quarter. Although the mobile phone and tourism sectors provided some support, spending on essential food and automobiles has declined sharply. Government stimulus measures have largely been neutralized by persistent energy and food inflation, which reached +3.4% on the GDP deflator. Consequently, real wages remained in negative territory for the 12th consecutive month in December, forcing consumers to adopt a highly defensive posture that limits the potential for an autonomous, consumption-led recovery.

Japanese economic performance (GDP) in yen



Sources : Bloomberg, BBGI Group

Structural transformation through corporate capex

In contrast to sluggish consumption, corporate non-residential investment (Capex) has emerged as a robust growth pillar. Non-residential investment rose by +0.8% in Q4, following a +1% increase in Q3, consistently exceeding market expectations. This trend appears structural rather than cyclical; Japanese firms are aggressively investing in automation, software, and artificial intelligence to mitigate chronic labor shortages. This technology-driven transformation suggests that while the broader economy struggles, the corporate sector is proactively repositioning itself to maintain productivity within a shrinking demographic landscape.

External trade volatility and tariff disruptions

The contribution of foreign trade was largely negligible in late 2025, as the benefits of a weak yen were offset by aggressive US customs tariffs. Export volumes fell by 0.3%, driven by a significant 11.1% collapse in shipments to the United States, particularly within the automotive and machine tool sectors. While the trade deficit was partially mitigated by resilient semiconductor exports to Europe and broader Asia, the volatility of external demand remains a critical risk. The shift in trade dynamics underscores Japan's vulnerability to global protectionist trends and the necessity of diversifying its export markets.

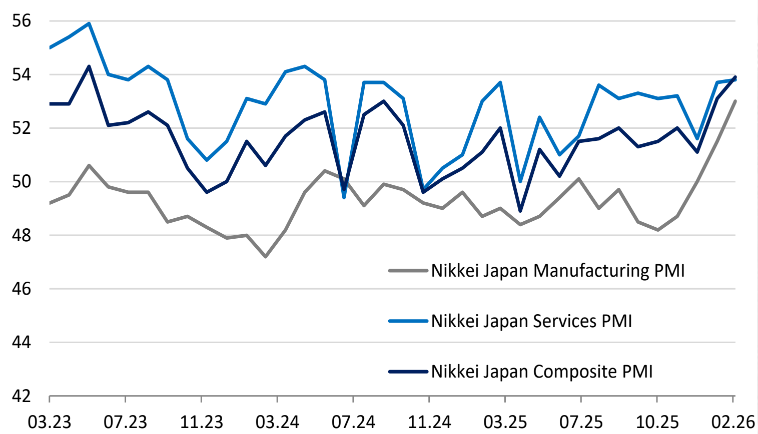
Fiscal normalization and infrastructure postponements

Public sector contribution turned negative in Q4, subtracting 0.1 percentage points from GDP growth. This decline is attributed to "budgetary normalization" and the tapering of 2024 emergency subsidies. Furthermore, an explosion in the cost of construction materials—such as steel and cement—combined with severe labor shortages, has led to the widespread postponement of local infrastructure projects. Despite approved budgets, companies are increasingly unable to operate within initial financial envelopes, leading to a contraction in public investment and a reduction in the state's role as an economic stabilizer.

Geopolitical escalation and imported inflation risks

The sudden military escalation in the Middle East and the closure of the Strait of Hormuz present an existential threat to Japan’s 2026 outlook. With 95% of crude oil imported from the region, Japan is acutely exposed to "imported inflation." A sustained rise in Brent crude prices threatens to wipe out anticipated wage gains even before the Shunto negotiations conclude. This leaves the Bank of Japan in an impossible dilemma: raising rates to defend a yen weakened by energy costs risks stifling the nascent Capex recovery, while maintaining the status quo allows inflation to take root, further eroding domestic purchasing power.

PMI indicators (manufacturing, services, composite)



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