

ECONOMIC RESEARCH – MARCH 2026

INVESTMENT INSIGHT

JAPAN



- ✓ Positive leading indicators before the energy crisis
- ✓ Further decline in consumer confidence likely
- ✓ Probable and temporary rebound in inflation
- ✓ The equation has become more complex for the BoJ

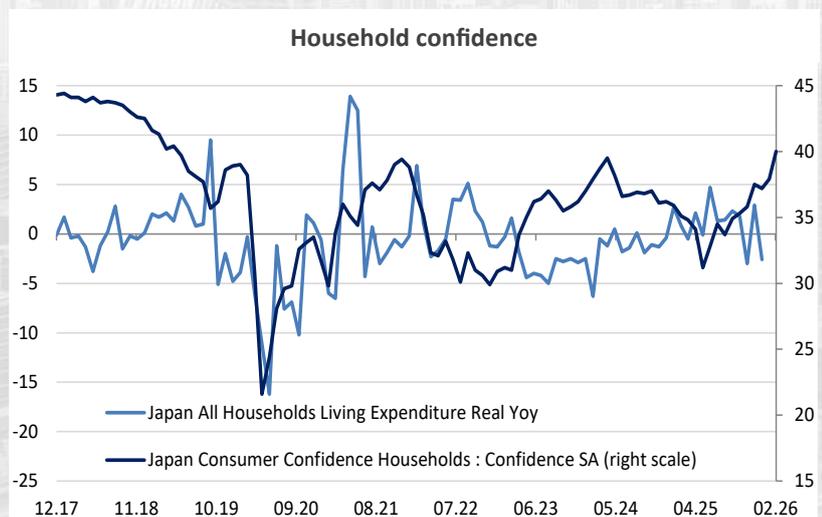
STAGFLATION RESHUFFLES THE DECKS FOR JAPANESE ASSETS

Positive leading indicators preceding the energy crisis

Leading indicators through February 2026 signaled a strengthening recovery, with manufacturing at 53 and services at 53.8. While industrial production in January supported this resilient outlook, these surveys predated the Middle East escalation. The significant uncertainties from the current energy shock are not yet reflected and will likely weigh heavily on the March reporting cycle.

Reversal of consumer confidence and retail momentum

After nearly a year of stagnation, retail sales showed a robust +1.8% rebound in early 2026, suggesting a long-awaited recovery in household demand. However, this momentum is being undermined by the geopolitical crisis and soaring energy costs. While nominal wages have seen upward adjustments, the combination of a weak yen and high oil prices is driving "imported inflation," which threatens to erode purchasing power gains. Consequently, we anticipate a pivot toward precautionary savings as households brace for supply chain disruptions and a renewed inflationary spike.



Sources : Bloomberg, BBGI Group

Probable and temporary inflationary rebound

The downward trajectory of Japanese inflation, which had successfully receded to 1.5% at the end of January, is now under threat from global commodity volatility. Persistent yen weakness at 157 JPY/USD effectively prevents the mitigation of rising crude oil costs, likely triggering an immediate upturn in the Producer Price Index (PPI). While the Bank of Japan had hoped for a stabilization below the 2% target, the economy now faces a renewed wave of external price shocks that could derail the transition toward a purely domestic, demand-driven inflationary model.

Systemic risks and the BoJ policy trap

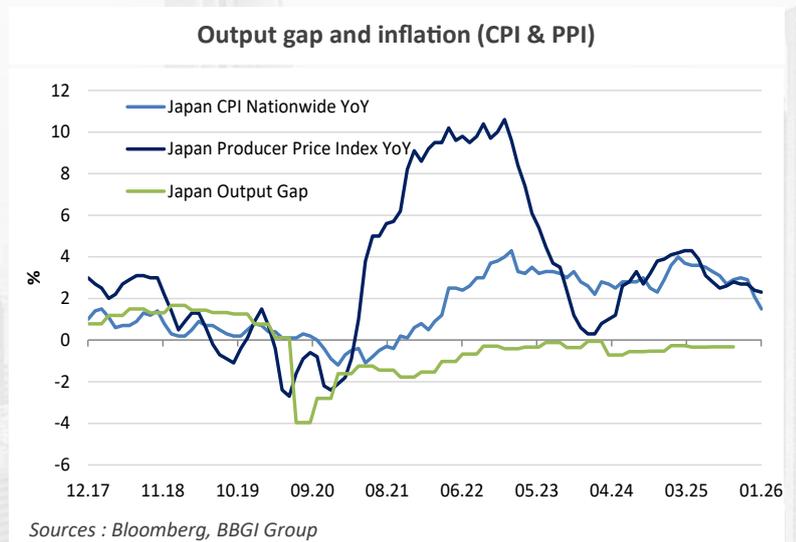
The Bank of Japan (BoJ) currently faces a historic dilemma as the risk of stagflation—stagnant growth combined with rising imported prices—becomes a systemic threat. With oil exceeding \$80 per barrel and tensions mounting in the Strait of Hormuz, the narrative of "transitory" inflation is collapsing. The yen's depreciation further amplifies the cost of vital imports. While orthodox monetary logic suggests an immediate rate hike to 1% to defend the currency, the BoJ is trapped by the fragility of domestic demand and the risk of stifling the only resilient growth driver: business investment.

Monetary normalization on a geopolitical hold

The BoJ appears to have transitioned into a "crisis management" mode, prioritizing the protection of fragile growth over aggressive currency defense. Despite previous expectations of a rate hike in March or April, recent communications from Deputy Governor Himino suggest a tactical shift toward the status quo. The central bank is likely waiting for the final results of the Shunto wage negotiations to determine if income growth can absorb the energy shock. Tightening credit while energy costs are already squeezing consumers could inadvertently trigger a recession for the remainder of 2026.

Strategic outlook and the Shunto pivot

The immediate future of Japanese monetary policy depends on the endurance of the Middle East conflict and the strength of domestic wage growth. The BoJ is likely to tolerate temporarily higher inflation to avoid sacrificing a recovery that has become increasingly precarious. If the wage-price spiral fails to materialize alongside these external shocks, the central bank may be forced to maintain its accommodative stance indefinitely. The normalization process is officially on hold as the archipelago navigates an unstable equilibrium dictated by energy security and global geopolitical volatility.



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