MACRO RESEARCH INSIGHT

CROSS-ASSET ANALYSIS — *JAPAN ASSETS*

August 2026

THE RISE OF THE YEN THREATENS THE NIKKEI – Part 1

- ✓ Slowing momentum for Q2 GDP
- ✓ Q3: Between domestic recovery and external risks

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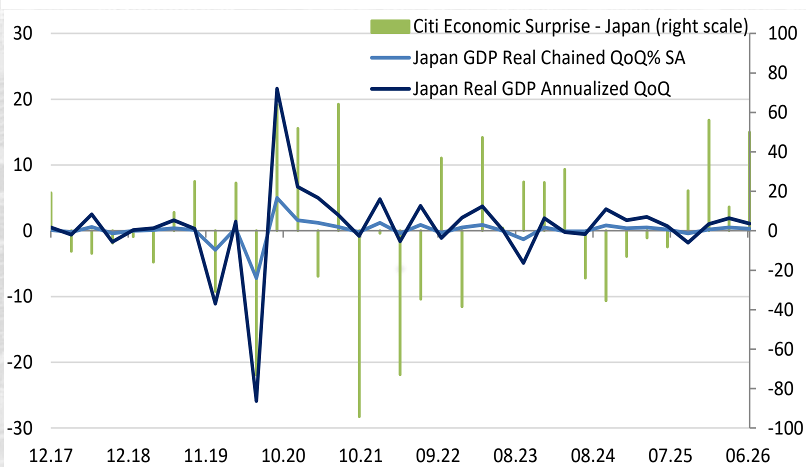
Q2 GDP Momentum Stalls Below Consensus

Japan's economic growth slowed to +0.3% quarter-over-quarter (+1.1% annualized) in Q2 2026, down from +0.5% in Q1 and missing consensus expectations of +0.5%. This deceleration signals a loss of recovery momentum, driven primarily by contractions in private domestic demand and business investment. This underperformance underscores the persistent underlying fragility of Japan's post-pandemic macroeconomic expansion.

Household Consumption Contracts Despite Shunto Wage Hikes

Private consumption unexpectedly dropped -0.02% (against a projected +0.4% gain), breaking Q1's tentative recovery. Despite substantial wage increases negotiated during the Shunto, high energy costs and sticky inflation (+1.8% excluding fresh food) continue to squeeze real wages, prompting precautionary savings and selective spending. Consequently, the anticipated virtuous cycle between rising incomes and expanding domestic retail demand remains stalled. This ongoing consumer hesitation has hit discretionary sectors particularly hard, delaying a broader broad-based economic recovery.

Performance of the Japanese economy (GDP) in yen



Sources : Bloomberg, BBGI Group

Capex Slumps Under BoJ Rate Normalization

Gross fixed capital formation dropped 1.2%, reversing early-year accumulation as companies exercise heightened strategic caution. Corporate capital expenditure is being squeezed by the Bank of Japan's gradual rate hikes, elevated input costs, foreign exchange volatility, and global supply chain disruptions, leading firms to delay modernization projects. This sharp decline in investment signals a growing hesitation among corporate boards to commit to long-term capital deployment. As a result, domestic business expansion is increasingly taking a back seat to risk management in the near term.

Tech Exports Buffer Public and Private Sector Declines

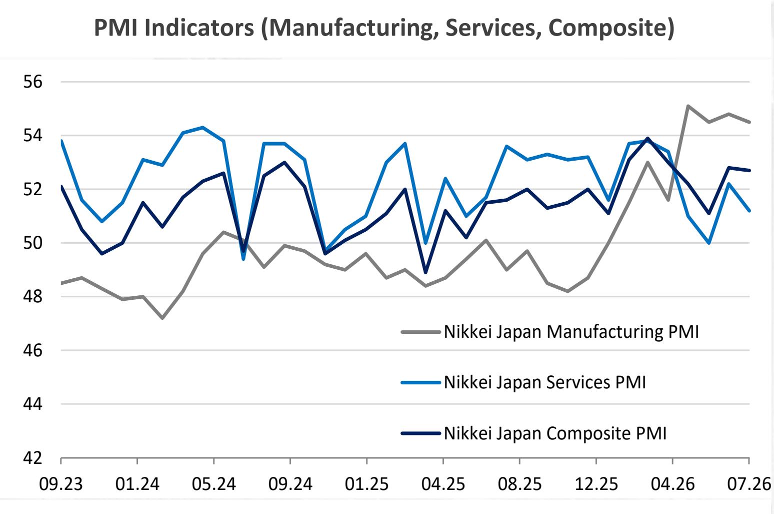
Foreign trade contributed a positive +0.5% to Q2 GDP, offsetting drag from constrained public spending (-0.8%). Robust global demand for electronic components, artificial intelligence equipment, and sustained semiconductor shipments to Asia allowed export-oriented conglomerates to cushion overall domestic weakness. This resilience highlights the structural importance of high-tech manufacturing to Japan's balance of trade. Without this foreign demand, the broader economy would have risked an outright quarterly contraction.

BoJ Trapped in Monetary Policy Dilemma

The Bank of Japan is caught between persistent currency weakness, with the yen hovering under 155 JPY/USD, and a fragile domestic recovery. The central bank is attempting a delicate balance: gradually raising interest rates to anchor long-term inflation expectations and defend the yen without choking off private demand or credit growth. Managing this interest rate differential remains central to preventing imported cost-push inflation from further eroding purchasing power. However, tightening policy too aggressively could easily derail the modest growth momentum that remains.

Q3 Growth Faces External Risks

Projections for Q3 target modest real GDP growth between +0.2% and +0.3%. While stabilizing service prices, purchasing power gains, and automation investments aimed at labor shortages support recovery, ongoing adjustments to export inventories and potential weakness in foreign industrial orders pose continuous downside risks. Ultimately, achieving sustained stabilization will require private spending to take the baton from foreign trade drivers. If regional demand falters before domestic consumption recovers, economic growth in late 2026 could stall completely.



Sources : Bloomberg, BBGI Group

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