MACRO RESEARCH INSIGHT

CROSS-ASSET ANALYSIS — *JAPAN ASSETS*

August 2026

THE RISE OF THE YEN THREATENS THE NIKKEI – Part 2

- ✓ Shift in leading indicators
- ✓ Household confidence stabilizing
- ✓ Inflation caught between buffers and input pressures
- ✓ The BoJ's dilemma and trade-offs in the face of the currency shock

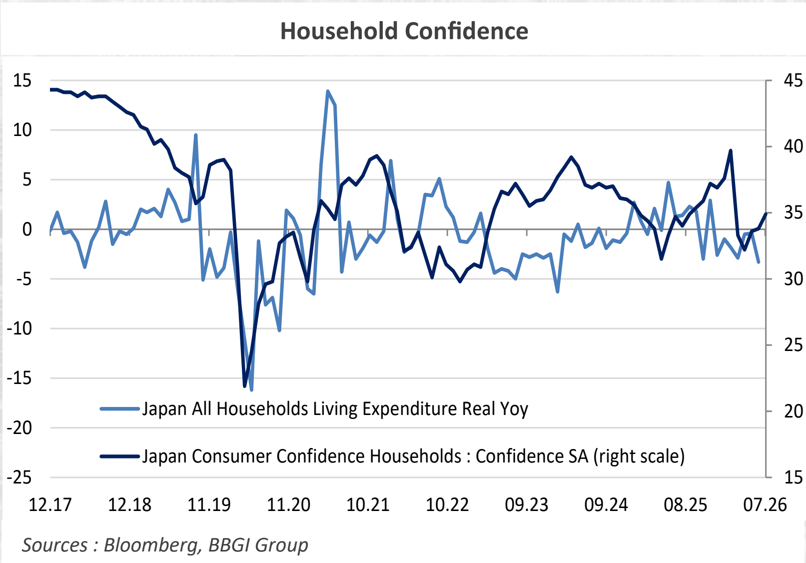
THE RISE OF THE YEN THREATENS THE NIKKEI – Part 2

Q3 Rebound Signals Technical Recovery

The Composite Leading Indicator reached a multi-year high of 116.5, signaling an acceleration in quarterly GDP growth to +0.2% – +0.4% (+0.8% – +1.2% annualized). Strong Asian tech demand and tourism drove high sentiment in the Tankan survey and Services PMI. This technical rebound confirms the domestic economy successfully emerged from its late-spring slowdown. The pickup in service momentum provides a solid buffer against ongoing volatility in external industrial cycles.

Energy Subsidies and Shunto Wages Stabilize Households

Consumer confidence recovered to 34.9 in July from May's low of 33.6 as real purchasing power briefly turned positive. Temporary summer electricity and gas subsidies cushioned the impact of imported inflation, giving service sector spending room to recover. However, households remain cautious, maintaining high precautionary savings and limiting demand for durable goods. This ongoing consumer hesitation reflects persistent anxiety over long-term cost-of-living pressures once price caps expire. Consequently, private consumption is expected to post only a modest, gradual recovery over the remainder of the year.



Sources : Bloomberg, BBGI Group

Core Inflation Persists Beyond Price Caps

While state subsidies temporarily capped consumer price surges, core CPI stabilized at +1.8% year-over-year in July, and service producer prices (PPI) jumped +3.6%. Industrial input costs, delayed pass-through expenses, and high freight rates replaced energy as the primary driver of production costs. This sticky cost-push environment confirms inflation is settling firmly near the central bank's 2% target. Firms are increasingly shifting from broad price hikes to selective adjustments across key domestic supply chains. This underlying price stickiness reinforces market expectations that elevated inflation will endure well into the second half of the year.

Joint FX Intervention Tempered Import Cost Pressure

A historic, coordinated intervention in late July/early August by the Japanese Ministry of Finance, U.S. Treasury, and the Fed halted the yen’s sharp slide toward 164 JPY/USD. This multilateral effort provided immediate tactical relief to industrial supply chains. The resulting slowdown in the Import Price Index temporarily checked the automatic pass-through of global input prices. By stemming rapid currency depreciation, authorities managed to buy crucial time for domestic real wages to catch up. However, central bankers recognize that currency market interventions only offer short-term respite without fundamental interest rate alignment.

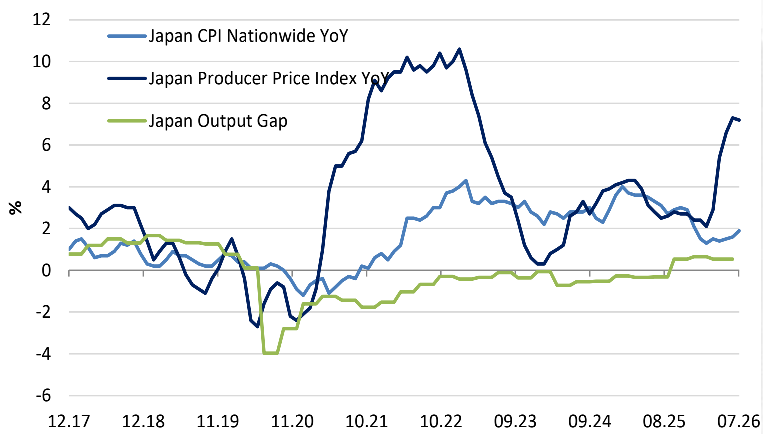
BoJ Faces Urgent Pressure for Aggressive Monetary Action

As speculative pressure quickly pushed the yen back toward the critical 160 JPY/USD threshold, verbal intervention and isolated FX sales proved insufficient. To defend real wage gains and stop imported inflation, Governor Ueda faces mounting necessity to narrow international yield spreads. A decisive shift toward rate hikes is required to transform the temporary FX lull into lasting currency stability. Prolonging policy inaction risks rekindling severe import-driven price pressures on household budgets. The central bank must balance this currency defense against the risk of over-tightening into a fragile domestic expansion.

September & October Rate Hikes Target Yen Stabilization

To anchor inflation expectations and mitigate currency depreciation, the BoJ is expected to execute a cumulative 0.50% interest rate hike. This strategy anticipates two consecutive 0.25% increases in September and October, alongside a reduced pace of JGB purchases. While higher borrowing costs may moderate future Capex growth, long-term stabilization remains achievable as real wage growth firms up. This front-loaded tightening plan aims to establish a higher yield floor before international market volatility resurfaces. Ultimately, narrowing the interest rate differential serves as the primary tool to secure sustainable medium-term growth.

“Output gap” and inflation (CPI & PPI)



Sources : Bloomberg, BBGI Group

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