

Weekly Analysis

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REDUCED OUTLOOK FOR JAPANESE ASSETS

Slowdown in growth. Mixed leading indicators. Inflation still too high. Halt to the normalisation of BoJ policy. Lower risks on long-term rates. The yen may appreciate further. The Nikkei is plateauing.

Key points



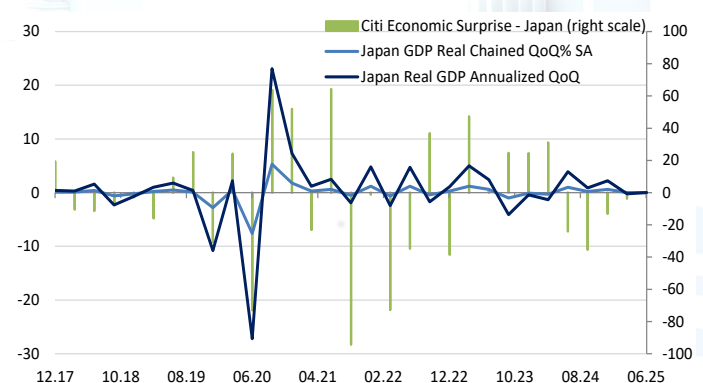
- Slowdown in consumption and exports in Q1
- Uncertainty remains high for Q2
- Leading indicators still mixed
- Consumption resilient but still cautious
- Inflation weakens slightly but remains high
- BoJ unlikely to touch rates in 2025
- 10-year yields stall at 1.5%
- Yen likely to strengthen against the dollar
- The Nikkei's rebound is now likely to run out of steam

Slowdown in consumption and exports in Q1

Japan's Gross Domestic Product (GDP) in the first quarter (Q1) of 2025 experienced an unexpected contraction, marking the first decline in a year. This slowdown was primarily driven by stagnant private consumption, heavily impacted by persistent inflation and erosion of real wages, coupled with a significant negative contribution from net exports, exacerbated by global trade uncertainties and the imposition of US tariffs. Although business investment showed some resilience, it was not enough to offset these broader weaknesses. This decline, the first in four quarters, raises concerns about the underlying resilience of the Japanese economy in the face of internal and external pressures. GDP contracted by -0.7% on an annualised basis in Q1 2025, a steeper decline than the market consensus forecast of -0.2%. This represents a significant reversal from the +2.4% annualised growth recorded in Q4 2024. On a quarterly basis (QoQ), the economy contracted by -0.2% in the January-March period, after adjusting for inflation, following a gain of +0.6% in the previous quarter. Private consumption, which accounts for more than half of Japan's economic output,

remained largely stable or showed only a marginal increase in Q1 2025. This stagnation is explicitly linked to the impact of rising prices and sluggish consumer sentiment, against a backdrop of inflation at its highest level in decades, which is eroding household purchasing power. Nominal wages are not rising at the same pace as inflation, further negatively affecting consumer confidence and spending. Net exports were also one of the main drags on GDP growth, subtracting -0.8% from growth. Exports of goods and services fell by -0.6% quarter-on-quarter, marking the first contraction since Q1 2024 and a sharp decline from the annualised growth of +6.9% in Q4 2024. This decline appears to be due to lower sales of services after an exceptional Q4 and weak demand from major trading partners. Conversely, imports, which negatively affect GDP, rose sharply (+2.9% quarter-on-quarter) after declining in the previous quarter. This contraction prior to the full implementation of tariffs suggests that the economy was already fragile.

Japanese economic performance (GDP) in yen



Sources: Bloomberg, BBGI Group SA

Uncertainty remains high for Q2

The surprise contraction in Q1, at a time when the potential effects of tariff increases are not yet really observable, casts doubt on the growth outlook for the second quarter. Private consumption, although stagnant in Q1, is expected to remain weak despite stable employment and wage growth.