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WEEKLY ANALYSIS

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STAGFLATION RESHUFFLES THE DECKS FOR JAPANESE ASSETS

GDP falls in Q3. Timid recovery possible in Q4. Consumers remain concerned. The 3% rebound in the CPI is worrying. The stagflation scenario is taking hold. The BoJ will favor the status quo. Rates are tightening. The yen remains weak. Nikkei in danger.

Key points

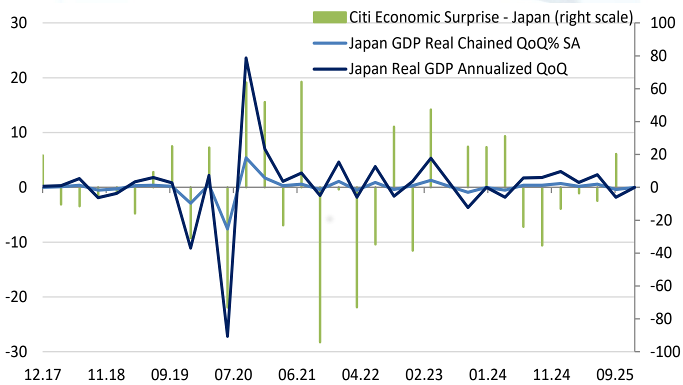
- Exports stall, GDP falls by -0.4% in Q3
- Possible GDP recovery in Q4, but on a knife edge
- Exacerbated dichotomy in sectoral PMIs
- Consumer confidence remains hesitant
- Inflation remains well above the BoJ's target
- Bank of Japan caught between forced normalization and recession risk
- Specter of stagflation pushes up yield curve
- Without rate hike, yen remains under pressure
- Stagflation risks threaten Nikkei

Exports stall, GDP falls by -0.4% in Q3

The Japanese economy stalled in Q3 2025, ending a streak of growth that had lasted several consecutive quarters. While domestic demand showed unexpected signs of resilience on the corporate side, the sharp drop in exports weighed heavily on the balance sheet, leading to a contraction in activity. Gross domestic product (GDP) fell by 0.4% compared with the previous quarter, slightly better than analysts' fears of a sharper decline of 0.6%. On an annualized basis, the decline was 1.8%, marking a sharp reversal after the upwardly revised performance of 2.3% in Q2. This contraction, the first since early 2024, reflects a notable change in the archipelago's growth dynamics, with traditional drivers running out of steam in the face of a hostile international environment. The main factor behind this poor performance was the negative contribution of foreign trade (-0.2 percentage points). Unlike the previous quarter, when exports surged, this time they fell by –1.2%. This sharp reversal is a direct consequence of the entry into force of new US tariffs in September, which significantly slowed shipments of manufactured goods and automobiles to the United States.

Imports also declined, but to a lesser extent (-0.1%), signaling subdued domestic demand. Household consumption, the real driver of the previous quarter's surprise, slowed significantly. It posted an anemic increase of +0.1%, compared with +0.4% in Q2. The positive effect of government measures seems to have dissipated in the face of persistent inflation, particularly in rice and energy prices, which continue to erode the purchasing power of the Japanese. Consumers are once again exercising caution. Conversely, and this is the real positive surprise in this report, business investment (Capex) defied forecasts. After being the weak spot in the previous quarter, non-residential investment jumped by +1.0% (against an expectation of +0.8%). This strength suggests that, despite trade uncertainties, Japanese companies are continuing to invest in automation and modernization of production facilities to compensate for the structural labor shortage. Public spending also supported activity (+0.5%), driven by the acceleration of certain public works projects. However, this was not enough to offset the external shock. These figures confirm Japan's vulnerability to trade tensions. Prime Minister Sanae Takaichi's administration is expected to accelerate the implementation of its new stimulus plan, and the Bank of Japan (BoJ) is expected to maintain its monetary status quo at its next meeting, preferring to wait and see if consumption can rebound in the fourth quarter before considering any further rate hikes.

Japanese economic performance (GDP) in yen



Sources: Bloomberg, BBGI Group SA