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Japan: summary of Japan's economic and policy outlook (the shift from reflationary policy to expanding strategic public-private investment)


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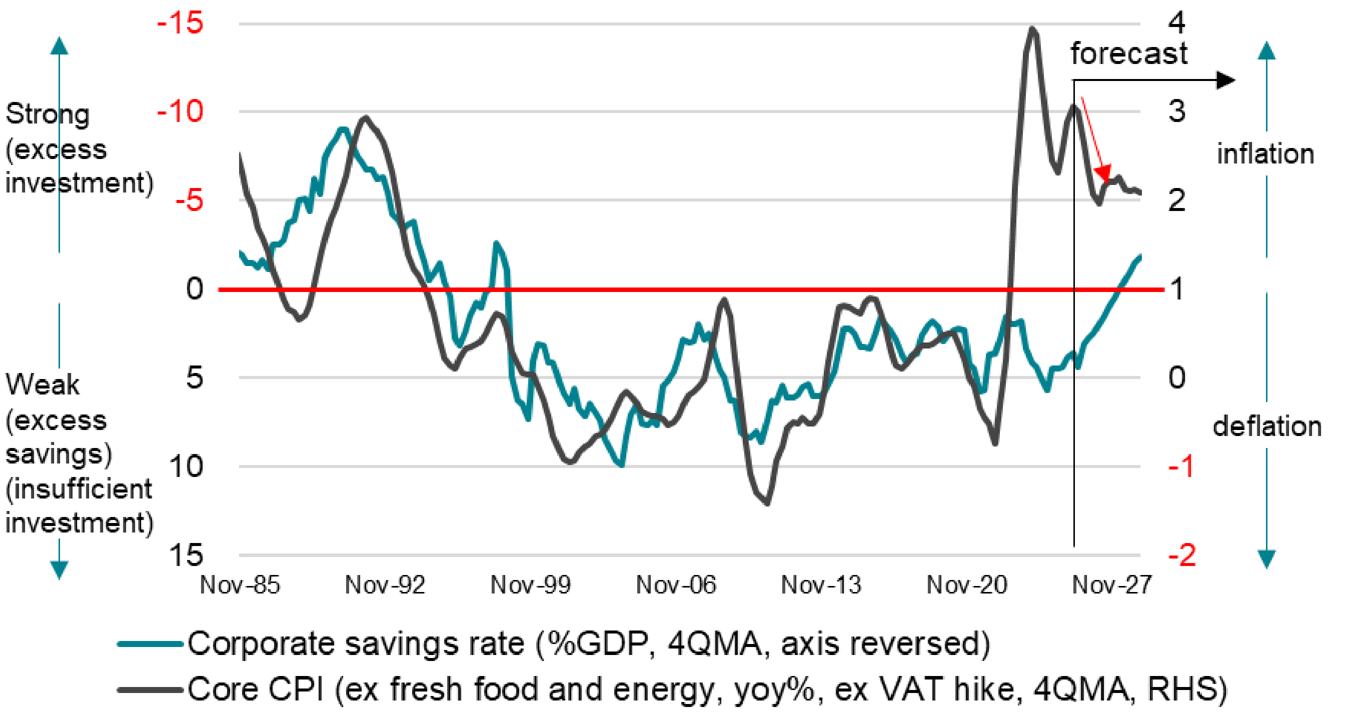
- **Main points – Economy: Takaichi administration's strategic investments through public-private partnerships help overcome structural economic stagnation**
- **Main points – Policy: The axis of economic policy would shift from reflation to strategic public-private investment under the Takaichi administration**
- **Japan's economic growth and inflation outlook: moves toward a full escape from structural stagnation through the expansion of strategic public-private investment**
- **Japan's economic policy outlook: government and the BoJ work together to achieve both strong economic growth and stable prices**
- **2024-29 economic scenario: the path towards a complete exit from structural stagnation**

Main points – Economy: Takaichi administration's strategic investments through public-private partnerships help overcome structural economic stagnation

1. Net domestic fund demand (corporate savings rate + fiscal balance) recovered and, through reflationary forces, expanded nominal GDP. The phase of reflationary policy is now over, and investment to expand supply capacity has become necessary. Expansionary fiscal policy through public-private strategic investment and consumption tax cuts would restore domestic demand, while a global cyclical recovery driven by receding geopolitical risks is also anticipated. As corporate domestic spending increases, the corporate savings rate would begin to decline, and combined with expansionary fiscal policy, net domestic fund demand – which has all but disappeared – would recover once again, moving the economy toward a full escape from structural stagnation.

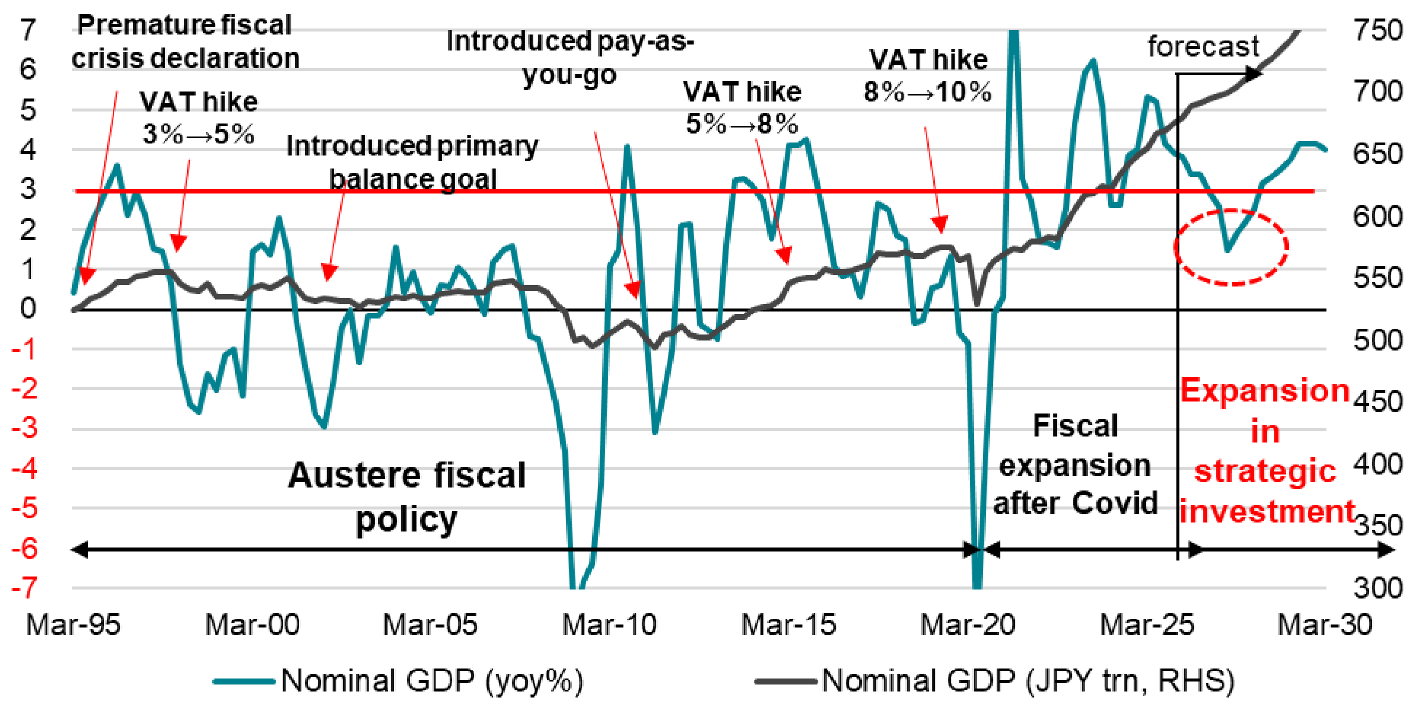
Corporate savings rate and core CPI



Source: BoJ, Cabinet Office, MIAC, Crédit Agricole CIB

2. The reflationary force driven by expansionary fiscal policy and continued accommodative monetary policy has significantly expanded nominal GDP. The premature rate hikes by the BoJ and the deterioration in the terms of trade would temporarily slow the expansion of nominal GDP. The driving force behind growth will shift from reflationary policy to investment expansion.

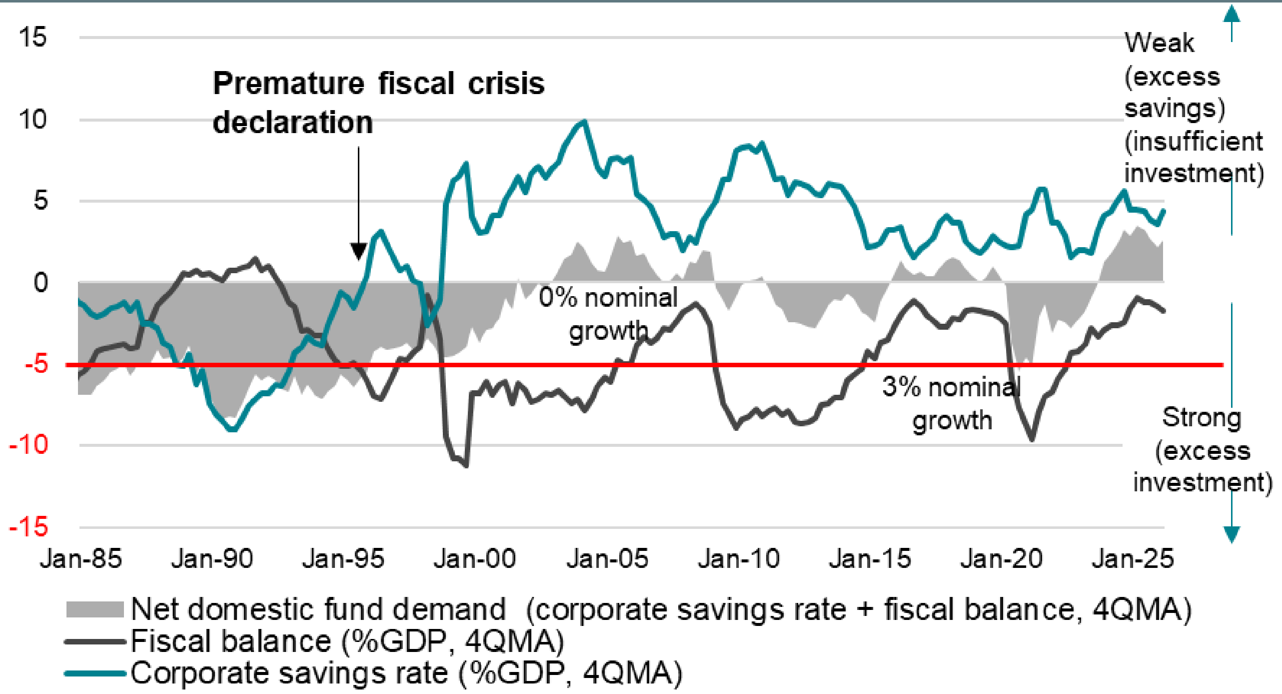
Nominal GDP



Source: Cabinet Office, Crédit Agricole CIB

3. Net domestic fund demand (corporate saving rate + fiscal balance) has recovered, and reflation has driven nominal GDP growth. Under the Takaichi administration, proactive public finance – through strategic public-private investment and a temporary VAT cut – is expected to restore domestic demand, alongside a cyclical global recovery following receding geopolitical risks. As corporate domestic spending increases, the corporate saving rate would begin to decline. Together with continued proactive public finance, this will revive net funding demand, which had effectively disappeared, and provide momentum for a full exit from structural economic stagnation.

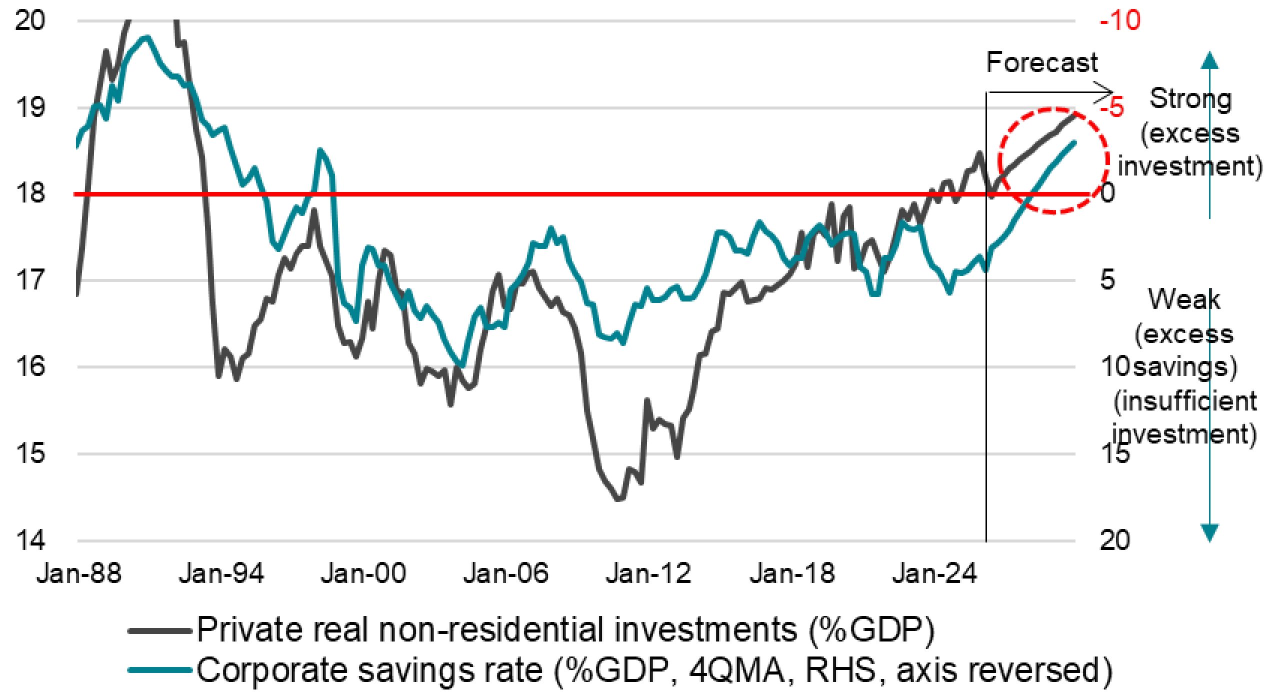
Net domestic fund demand (corporate savings rate + fiscal balance)



Source: Cabinet Office, BoJ, Crédit Agricole CIB

4. An upswing in the capex cycle will help return the corporate saving rate to a normal negative level. As long as the capex cycle remains on an upward trend, expectations of future supply capacity expansion would limit further strong depreciation pressure on the JPY. As the decline in the corporate saving rate catches up with the capex cycle, real wage growth will strengthen. The focus of the economy, policy, corporates and markets will shift from external demand to domestic demand.

Corporate savings rate and private capex



Source: Cabinet Office, BoJ, Crédit Agricole CIB

Main points – Policy: The axis of economic policy would shift from reflation to strategic public-private investment under the Takaichi administration

1. Driven by a phase of global cyclical economic recovery and the expansion of domestic demand through the Takaichi administration's PPP strategic investment initiatives, a rising capex cycle would take the lead, putting downward pressure on the corporate savings rate. The 2026 Honebuto would mark the beginning of a shift toward proactive fiscal policy focused on strategic investment, particularly through new investment frameworks. Core inflation (ex fresh food and energy) temporarily decelerates due to slow recovery in domestic demand, but then re-accelerates towards the 2% target. By 2027, domestic demand expands, supported by an upside in capex cycle and rising real wages. By 2028, expansion in domestic demand is expected to accelerate, the corporate savings rate to return to its normal negative territory and potential growth to exceed its trend – marking a complete escape from structural economic stagnation.

Real GDP and CPI forecasts by BoJ and CACIB

BoJ	Real GDP	CPI (ex fresh food)	CPI (ex fresh food and energy)
FY26	+0.6	+2.5	+2.5
FY27	+0.8	+2.4	+2.6
FY28	+0.8	+2.0	+2.2

Units: yoy%

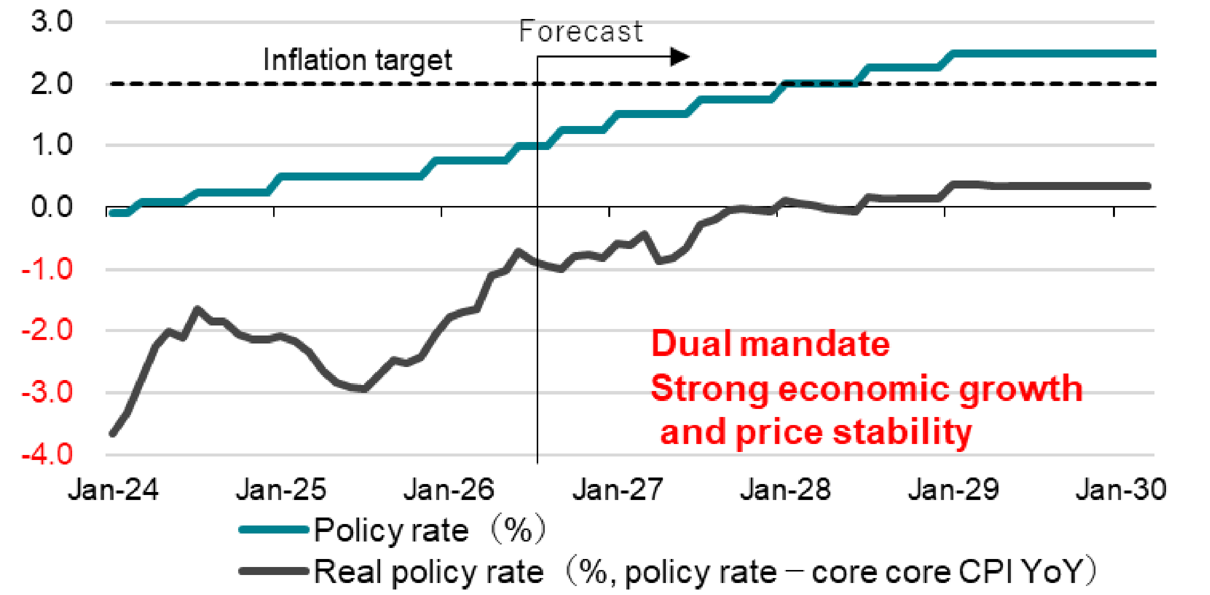
CACIB	Real GDP	CPI (ex fresh food)	CPI (ex fresh food and energy)
FY26	+0.8 (+0.8)	+2.0 (+1.8)	+2.0 (+2.1)
FY27	+0.8 (+0.6)	+0.7 (+1.1)	+0.7 (+1.1)
FY28	+1.5 (+1.3)	+2.1 (+1.7)	+2.1 (+1.7)

*parenthesis denote CY forecast; Units: yoy%

Source: BoJ, Crédit Agricole CIB

2. The Honebuto clarified Takaichi administration's direction toward expanding strategic investment and pursuing a high-pressure economy. The BoJ would be assigned a dual mandate of "strong economic growth" and "stable price increases". The pace of rate hikes would temporarily accelerate to roughly once per quarter due to the impact of rising oil prices, before returning to a more gradual pace of approximately once every six months. Maintaining low real interest rates would promote economic activity, centred on capital investment. By 2028, corporate savings rate would return to negative territory, and the real policy rate would move out of negative territory relative to the inflation target. The terminal rate of 2.5% would be reached in 2029.

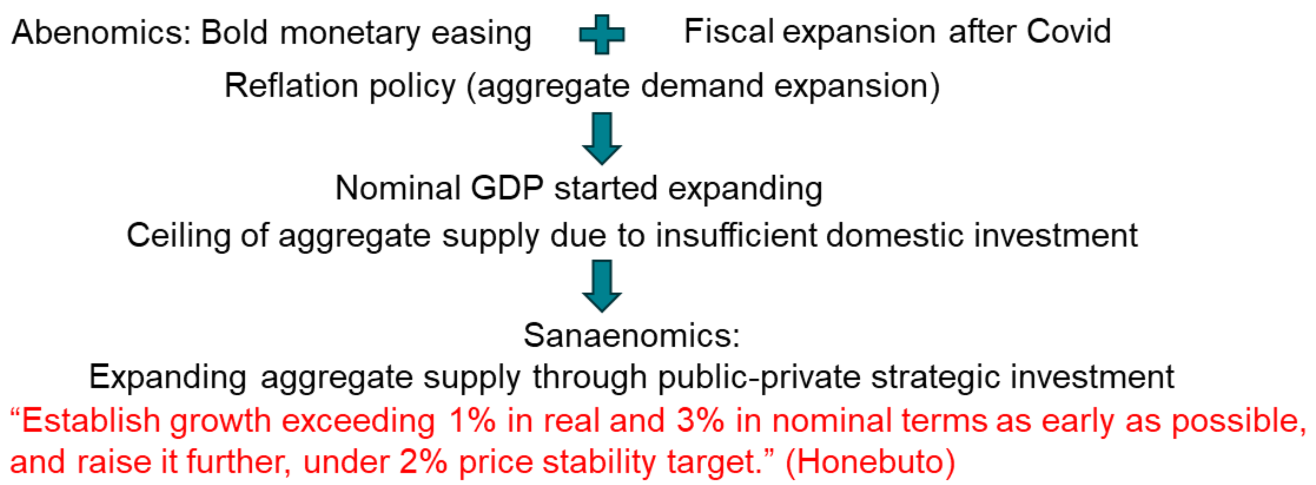
BoJ policy rate



Source: MIAC, BoJ, Crédit Agricole CIB

3. Backed by a landslide victory in the Lower House election, the Takaichi administration broke free from the constraints of austerity-minded thinking through the Honebuto, pivoting to expansionary fiscal policy. Rather than reflationary policy, the administration commits to the sustained expansion of supply capacity and economic scale through the expansion of strategic public-private investment. The approach is one of a "high-pressure economy", in which the expansion of investment demand widens the output gap sufficiently. As corporate domestic spending increases, the corporate savings rate would begin to decline, and combined with the move toward expansionary fiscal policy, net domestic fund demand – which has all but disappeared – would recover once again, moving the economy toward a full escape from structural stagnation. The burden on households until real wages rise strongly would be alleviated through fiscal measures supporting households, such as VAT cuts.

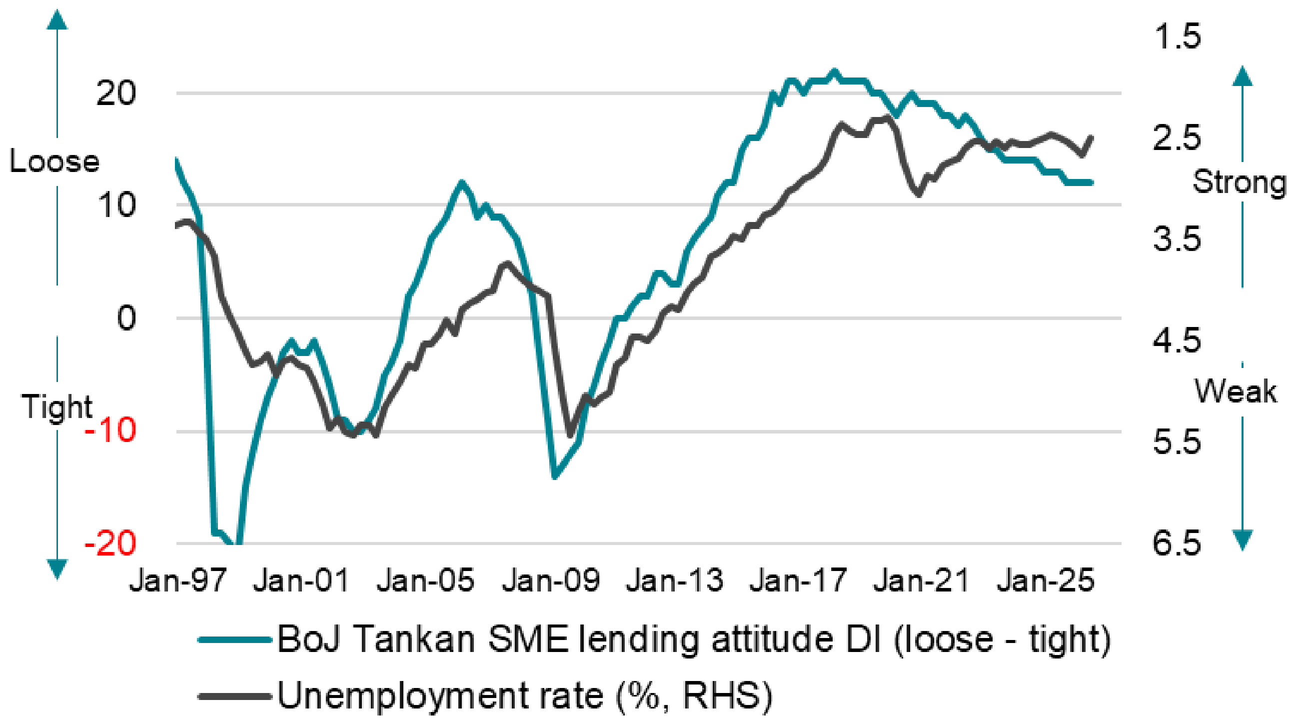
Transition from reflation to Sanaenomics



Source: Crédit Agricole CIB

4. Against a backdrop of global slowdown and heightened geopolitical risks, insufficient policy support and a breakdown in the credit & capital expenditure cycles would weaken domestic demand, push the corporate savings rate higher and risk a return to structural stagnation. Premature rate hikes by the BoJ could further delay the recovery in employment, wages and consumption. A collapse in the capital expenditure cycle would knock Japan out of the global strategic investment race, eroding future productive capacity and leaving JPY depreciation and rising interest rates unchecked. Sustaining the capital expenditure cycle while cushioning JPY weakness through currency intervention and stimulus measures is therefore essential.

Japan's credit cycle and the unemployment rate



Source: BoJ, MIAC, Crédit Agricole CIB

Japan's economic growth and inflation outlook: moves toward a full escape from structural stagnation through the expansion of strategic public-private investment

Growth (2026: 0.8%, 2027: 0.6%, 2028: 1.3%): move towards overcoming structural economic stagnation after a short-term stagnation

In our view, through 2026 to H127, headwinds from the global slowdown, uncertainty surrounding the Trump administration and geopolitical-driven oil prices & supply disruptions, compounded by premature BoJ rate hikes, would constrain economic growth around potential (about 0.6%) and temporarily stall progress toward exiting structural stagnation. From H227 onward, a global cyclical recovery combined with the Takaichi administration's proactive fiscal push through expanded public-private strategic investment and an upswing in the capital expenditure cycle will broaden domestic demand and begin to accelerate the move out of structural stagnation. By 2028, growth overshooting into the 1% range will set the economy on a path toward a high-pressure economy. A consumption tax cut, alongside rising real wages, will drive a recovery in consumer spending. Sustained nominal GDP expansion will prompt a clear shift in corporate behaviour from cost-cutting to investment, pushing the capex-to-GDP ratio well above the long-elusive 18% threshold and, together with expanding consumption, adding momentum to the recovery. Rising corporate expected returns and growth rates will lift potential growth, the corporate savings rate will return to a normal negative level, and structural stagnation will be fully overcome. A pivot to fiscal austerity or an excessively rapid pace of rate hikes by the BoJ would pose the risk of derailing the escape from structural stagnation.

Inflation (2026: 2.1%, 2027: 1.1%, 2028: 1.7%): temporary slowdown to the 1% range due to weak domestic demand and VAT cuts

The YoY rate of CPI (ex fresh food and energy) would temporarily decline to the 1% range in H226, reflecting still-weak domestic demand, VAT cut and a loss of purchasing power due to a sharp increase in energy costs. Corporates are beginning to become wary of the rising price elasticity of demand. Under a global cyclical economic recovery and a recovery in domestic demand, corporate spending, including capital investment and wages, will strengthen, and the positive corporate savings rate, which caused structural economic stagnation as excess savings, would shrink. With the recovery of consumption due to rising real wages and the realisation of a high-pressure economy due to an upward revision of the growth rate, the inflation rate is expected to once again expand towards 2%. By 2028, the corporate savings rate will turn negative, eliminating the pressure of structural economic stagnation, and the stable & sustainable achievement of the price target is expected to be achieved as wage increases accelerate and inflation expectations are anchored at 2%. The prerequisites are that the BoJ's premature rate hikes do not cause domestic demand to falter due to downward pressure on the credit cycle and that there is no rapid appreciation of the JPY.

Japan's economic policy outlook: government and the BoJ work together to achieve both strong economic growth and stable prices

Monetary policy: a dual mandate of achieving both strong economic growth and stable prices

The premature rate hikes that began in 2024 delayed the recovery of domestic demand and squandered the room for rate increases needed to confront a global rising interest rate environment. Greater emphasis is placed on coordination with the Takaichi administration's policy direction of escaping structural stagnation through strategic public-private investment. The government has effectively imposed a dual mandate on the BoJ, requiring it to pursue both strong economic growth and stable price increases simultaneously. The pace of rate hikes, after a temporary acceleration to roughly once per quarter driven by the impact of rising oil prices, would revert to approximately once every six months, remaining gradual. Maintaining low real interest rates promotes economic activity. By 2028, the corporate savings rate would return to negative, corporate demand for funds would recover, and with the escape from structural stagnation, the real policy rate would move out of negative territory relative to the inflation target. A terminal rate of 2.5% would be reached in 2029, which in real terms would be roughly in line with the current level of potential growth. Under geopolitical risks and a global economic slowdown, if the pace of rate hikes becomes excessively rapid and the credit cycle and capital expenditure cycle break down, a slowdown in domestic demand would push the corporate savings rate higher, posing the risk of a return to structural stagnation.

Fiscal policy: pursuing proactive fiscal policy through expanded strategic investment with a focus on boosting domestic demand

A complete break from liberal policies aimed at reducing government involvement is made, with a new approach adopted to resolve the social and economic challenges impeding growth through expansionary fiscal policy and strategic public-private investment. Rather than reflation policy, the commitment is to the sustained expansion of supply capacity and economic scale through the expansion of strategic public-private investment. This is a "high-pressure economy" policy that aims to make the output gap sufficiently large by expanding investment demand. By allowing the public to feel the economic recovery firsthand, the administration seeks to maintain strong popular support through to the 2026 upper house elections. The flawed primary balance surplus target – which had constrained even strategic investment within the bounds of tax revenues – was hollowed out through the Honebuto, and the fiscal target was shifted to a stable decline in the debt-to-GDP ratio, incorporating the growth effects of investment. Budget formulation policy is fundamentally reformed, with a new investment allocation established in the initial budget to enable long-term investment based on growth strategy, while crises are addressed through flexible supplementary budgets. To break free from dependence on external demand, economic policy promotes a trajectory reminiscent of the domestic demand expansion of the late 1980s that followed trade disputes with the US. A complete escape from structural stagnation causes tax revenues to significantly exceed projections, allowing the fiscal balance to exit deficit in 2029. The government's net debt-to-GDP ratio falls well below the 50% level seen during the period when Japan held a AAA rating.

2024-29 economic scenario: the path towards a complete exit from structural stagnation

2024 (result): BoJ's premature rate hike stopped economic growth

The BoJ prematurely ended its negative interest rate policy and implemented additional rate hikes, putting downward pressure on the credit cycle, and coupled with the global economic slowdown, the real GDP growth was near zero. As the pass-through of rising import prices progressed, the persistently high rate of inflation put downward pressure on real wages, causing domestic demand to stagnate.

Despite stagnant domestic demand, long-term yields rose due to the BoJ's continued rate hike stance against the backdrop of rising nominal wages.

2025(result): expectations for growth rose with the arrival of the Takaichi administration

The downward pressure on the economy from the global slowdown and uncertainty surrounding the Trump administration continues. With the BoJ temporarily pausing its rate hikes, the capital expenditure cycle remains firm. Real GDP growth significantly exceeds potential growth. Following the departure of the fiscally austere Ishiba administration, the Takaichi administration's economic policy stance shifts toward expansionary fiscal policy, raising expectations for economic growth.

Long-term and super long-term yields have risen sharply due to the BoJ's rate hike, the Takaichi administration's proactive fiscal policy and rising expectations for growth. The stock market has also seen the Ishiba discount caused by the austerity-oriented Ishiba administration disappear, and continued to rise due to expectations for growth under the Takaichi administration and support from a weak JPY.

2026: temporary stagnation in the transition period between premature BoJ rate hikes and the fiscal policy shift

Amid the headwinds of a global economic slowdown, uncertainty surrounding the Trump administration, and rising oil prices and supply disruptions stemming from geopolitical risks, premature rate hikes by the BoJ cause real GDP growth to decelerate, and the momentum toward escaping structural stagnation temporarily stalls. The Takaichi administration advances expansionary fiscal policy centred on expanded strategic public-private investment through the Honebuto. Rather than reflation policy, the commitment is to the sustained expansion of supply capacity and economic scale through the expansion of investment. The execution of expansionary fiscal government budgets from fiscal year 2027 onward aims for a high-pressure economy. 2026 is a transitional period, with limited driving force.

With stable nominal GDP growth driven by a recovery in net domestic fund demand, risk assets are expected to remain firm. Long-term and super long-term yields, which have already factored in growth expectations, are rising gradually, and the curve is slowly flattening as the market incorporates rate hikes towards neutral from 2027 onward.

2027: the launch of strategic investments through public-private partnerships also restart efforts to overcome structural economic stagnation

Following the stagnation through the H1 driven by a temporary acceleration in the BoJ's pace of rate hikes, the launch of strategic public-private investment accompanying the execution of the expansionary fiscal government budget causes the corporate savings rate to begin declining steadily. Net domestic fund demand also recovers firmly. Corporate competition shifts clearly from cost reduction to investment, and the movement of the capex-to-GDP ratio to well above the long-elusive 18% threshold accelerates. VAT cuts and rising real wages revive consumer spending. The administration tolerates gradual rate hikes accompanying the expansion of investment, with hikes continuing at a pace of roughly once every six months. The real policy rate remains low, supporting the escape from structural economic stagnation.

Negative net domestic fund demand and sustained nominal GDP growth would continue to push risk assets higher, with Nikkei index firmly in the upper 60,000 range. Long-term yields would rise as the policy rate rises, but the widening of the curve would cease as investors begin to price in the terminal rate.

2028: increase in potential growth rate as structural deflationary stagnation ends

Driven by the expansion of domestic demand, real GDP growth accelerates to the mid-1% range. The corporate savings rate turns to a normal negative, corporate funding demand recovers, and the inflation rate reaches the 2% target in a stable and sustained manner. Inflation expectations become anchored, marking a complete escape from structural economic stagnation. The policy rate rises to 2%, and the real policy rate exits negative territory.

As the economy would completely emerge from the structural stagnation, nominal GDP growth would continue and we would expect the Nikkei index to rise toward 70,000 level. Rate hikes would reach a peak and the GDP growth rate would slow somewhat, causing the yield curve to flatten slightly.

2029: sustained high-pressure economy and a positive turn in the fiscal balance

After the BoJ's policy rate reaches 2.50%, stopping the rate hike at a slightly positive real level would lead to a high-pressure economy that is somewhat overheated. While a positive real policy rate and a stronger JPY would weigh down the economy, the high-pressure economy would provide support, and real GDP growth would continue to firmly exceed 1%. The predictability of sustained economic expansion will boost corporate investment, and the expansion of nominal GDP would increase tax revenues, leading to a return to a fiscal deficit.

Despite slower expansion in growth, stable net domestic fund demand and expanding nominal GDP would avoid a bottoming fall out of risk assets and inflation expectations.

Note: The content is a personal opinion and does not necessarily reflect the government's view.

Japan economics forecast table

Japan		Q125	Q225	Q325	Q425	Q126	Q226	Q326f	Q426f	Q127f	Q227f	Q327f	Q427f	CY25	CY26f	CY27f	CY28f
Real GDP	qoq%	0.5	0.1	-0.4	0.3	0.5	0.4	0.0	0.1	0.0	0.3	0.3	0.3				
	qoq ann.%	2.0	0.5	-1.5	1.1	1.9	1.4	0.2	0.2	0.1	1.2	1.0	1.2				
	yoy%	1.6	1.9	0.7	0.5	0.5	0.7	1.1	0.9	0.5	0.4	0.7	0.9	1.2	0.8	0.6	1.3
Private consumption	qoq%	0.6	0.1	0.6	0.2	0.4	0.0	-0.4	0.1	-0.3	0.3	0.1	0.2	1.3	0.7	-0.1	0.9
Residential investments	qoq%	-0.5	0.6	-7.9	5.0	0.9	-0.6	-0.5	-0.5	-0.5	-0.5	0.1	0.3	-1.8	-0.3	-1.5	0.9
Non-residential investments	qoq%	1.2	1.3	-0.2	1.3	-1.0	-0.9	1.0	0.5	0.5	0.5	0.6	0.6	2.5	0.1	2.0	2.5
Public investments	qoq%	-0.8	0.9	-1.1	-0.5	1.4	-0.5	0.3	0.2	0.5	0.6	0.8	0.8	-0.3	0.5	1.7	3.2
Net trade	pp	-0.5	-0.0	-0.1	0.1	0.3	0.4	-0.3	-0.2	-0.1	-0.0	-0.0	-0.0	-0.2	0.3	-0.3	-0.1
Exports	qoq%	-0.7	1.7	-1.4	0.1	1.7	0.4	0.2	0.2	0.2	0.2	0.3	0.3	2.5	2.0	0.9	1.3
Imports	qoq%	2.0	1.8	-0.6	-0.2	0.3	-1.7	2.0	1.5	0.6	0.4	0.5	0.5	3.8	0.4	3.0	1.9
Nominal GDP	yoy%	5.3	5.2	4.2	3.9	3.8	3.4	3.4	2.9	2.6	1.5	1.9	2.2	4.7	3.4	2.0	3.1
Core CPI (ex fresh food)	yoy%	3.1	3.5	2.9	2.8	1.7	1.5	1.8	2.2	2.4	1.0	0.7	0.3	3.1	1.8	1.1	1.7
Core-core CPI (ex fresh food and energy	yoy%	2.7	3.3	3.2	2.9	2.5	1.8	2.0	2.0	2.0	1.0	0.7	0.5	3.0	2.1	1.1	1.7
Unemployment rate	%													2.5	2.6	2.5	2.4
Nominal agg. compensation	yoy%													3.7	3.6	3.6	4.4
Corporate savings rate	%GDP													3.6	2.5	0.5	-1.5
Household savings rate	%GDP													2.6	3.0	5.0	5.0
Fiscal balance	%GDP													-1.5	-1.5	-2.5	-1.5
Current account balance	%GDP													4.8	4.0	3.0	2.0
BoJ policy rate（current account intere	%（end)	0.50	0.50	0.50	0.75	0.75	1.00	1.25	1.25	1.50	1.50	1.75	1.75	0.50	1.25	1.75	2.25
10Y JGB yield	%（end)	1.35	1.40	1.65	1.80	2.20	2.60	2.90	2.90	3.00	3.00	3.10	3.10	1.80	2.90	3.10	3.25

As of Sep 9 2026

*IS balance items based on flow of funds data

Source: Cabinet Office, BoJ, MIAC, Bloomberg, Crédit Agricole CIB

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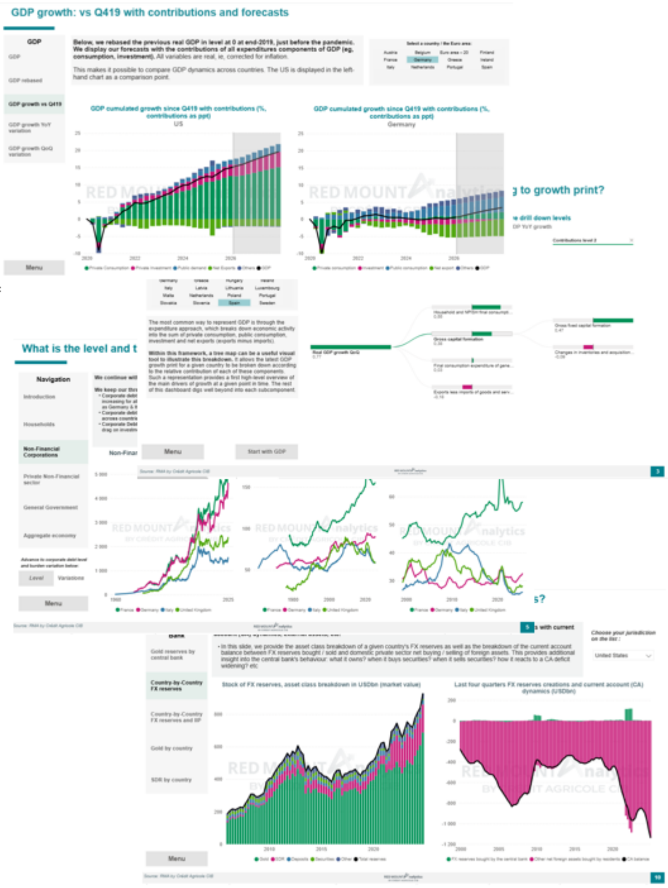

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