November 2026

Nordic Outlook Update – Japan



Policymakers are walking a tightrope as bond yields trade at multi-decade highs and the yen remains undervalued. The government must ease market concerns about public debt dynamics. Meanwhile, the Bank of Japan intends to normalise monetary policy as underlying inflation is close to the 2 per cent target. Japan's economy has proven resilient, with domestic demand supported by high wage growth, fiscal stimulus, AI-demand supporting exports and a solid investment cycle. Growth is constrained by global risks and uncertainty over energy supply.

Key data

Year-on-year percentage change

	2025	2026	2027	2028
GDP	1.1	0.8	0.7	0.7
Unemployment *	2.5	2.5	2.5	2.5
CPI	3.2	1.8	2.3	2.2
Government balance **	-0.7	-1.4	-2.1	-2.7
Government debt **	205	199	196	194
Policy rate, % ***	0.75	1.50	1.75	1.75

* % of labour force, ** % of GDP, *** at year-end. Source: Macrobond, SEB

- Japan's government debt in relation to GDP, which is exceptionally high by international standards, will continue to decline in the coming years as nominal growth strengthens. Moreover, the debt is financed by domestic savings and central bank holdings, making it less dependent on foreign financing. However, debt dynamics are a bit worrisome. The duration of the public debt is around 9 years. When borrowing costs rise, and remain above long-term potential growth, domestic investors may demand compensation for increasing credit risks.

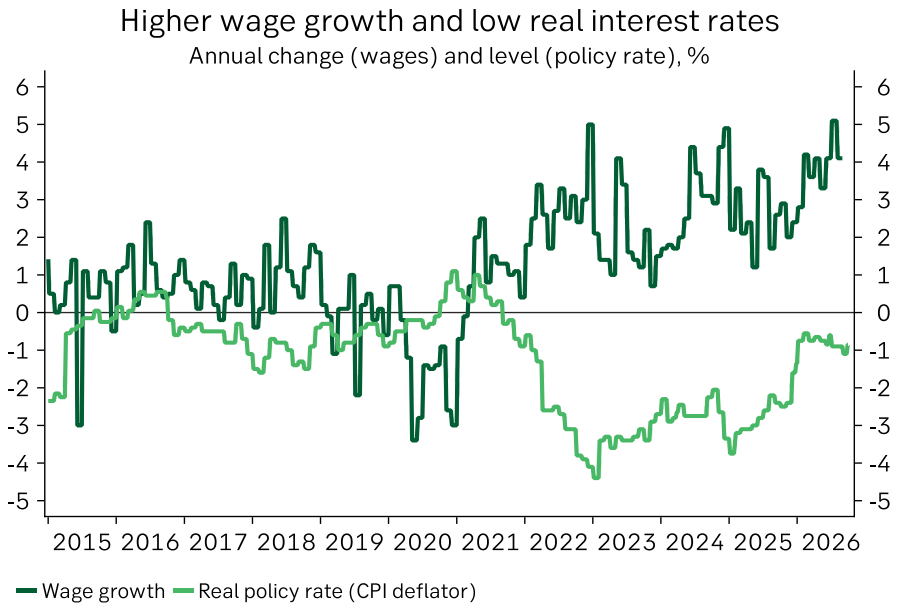
- The Takaichi government's focus on expansionary economic policy (including a supportive monetary policy) – and signs that Japan has permanently left deflation behind – is testing markets. Risks to growth remain skewed to the downside over the forecast horizon.

- Domestic investment to support growth has long been insufficient. To raise potential growth, Japan is promoting investment in strategic sectors through close cooperation between the public and private sectors. High corporate profits, together with expectations of stronger productivity growth, should continue to support the domestic investment cycle.

- To reduce the burden on low- and middle-income workers, the government will introduce benefits tailored to income levels on a full scale from FY2029. Japan will implement a two-year VAT reduction on food and beverages (from 8 to 2 per cent, starting in April 2027). Tokyo says that these measures will be financed without relying on deficit-financing bonds. Japanese policymakers are walking a tightrope as bond yields trade at multi-decade highs.

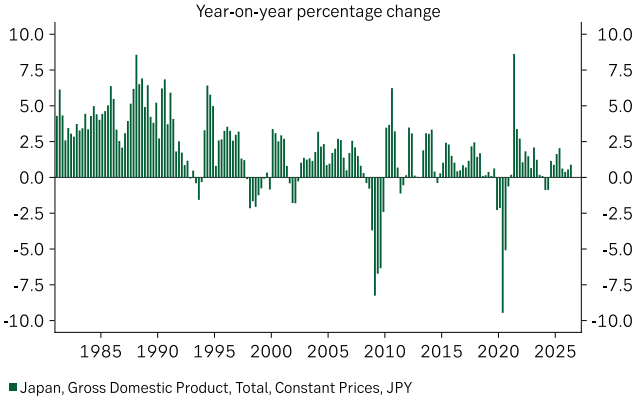
- Nominal and real interest rates are expected to remain well below those in, for example, the US. Although rates remain low, they are higher than before, creating some headwinds for economic growth. The real policy rate will remain negative throughout the forecast period.

- Still, the yen is expected to receive support from (1) narrowing policy rate differentials with the US and the euro area, and (2) domestic financial investors who now find Japanese bond yields more attractive (hence limiting Japan's export of capital to other countries). Over the forecast horizon, the current account surplus is expected to amount to USD 585bn.



Resilient growth in H1 2026

Year-on-year percentage change

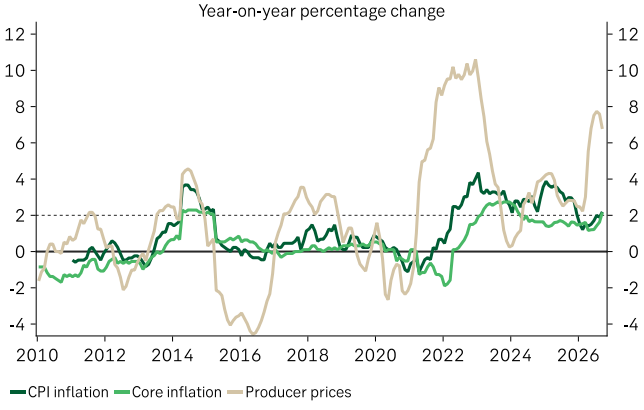


Source: Japanese Cabinet Office (CAO), Macrobond, SEB

The economy remained resilient in the first half of 2026 despite major global challenges. Chip exports and fiscal expansion are supporting Japan's GDP growth.

Core inflation moving closer to 2% target

Year-on-year percentage change

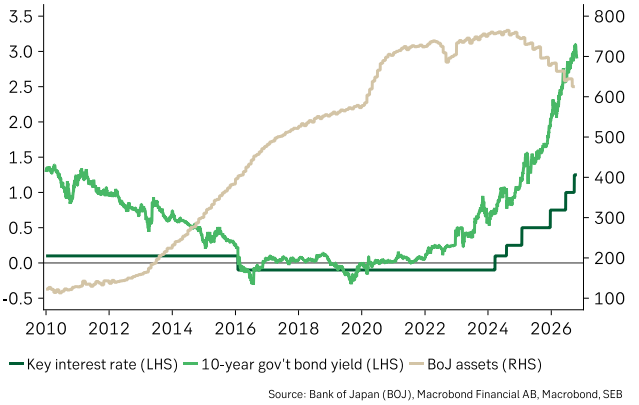


Source: Japanese Statistics Bureau, Ministry of Internal Affairs & Communications, Bank of Japan (BOJ), Macrobond, SEB

Continued high wage agreements, and the yen weakness, contribute to an inflation that is now at the Bank of Japan's 2 per cent target.

Japan: Normalising monetary policy

Interest rates. Per cent. Assets. JPY trillion

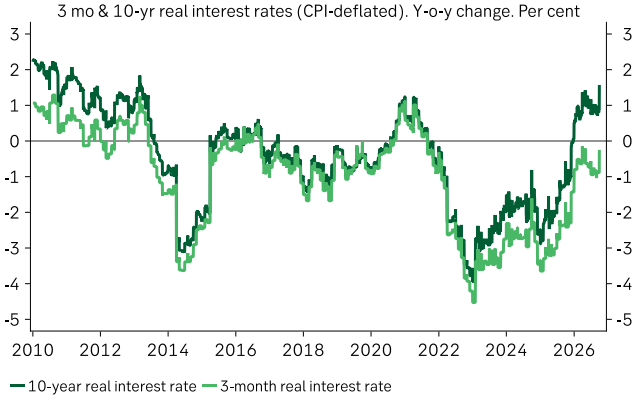


Source: Bank of Japan (BOJ), Macrobond Financial AB, Macrobond, SEB

The Bank of Japan continues to shrink its balance sheet while raising the policy rate. We expect the central bank to raise the rate again before year-end (to 1.50%).

Negative real policy rate - positive 10-year real yield

3 mo & 10-yr real interest rates (CPI-deflated). Y-o-y change. Per cent

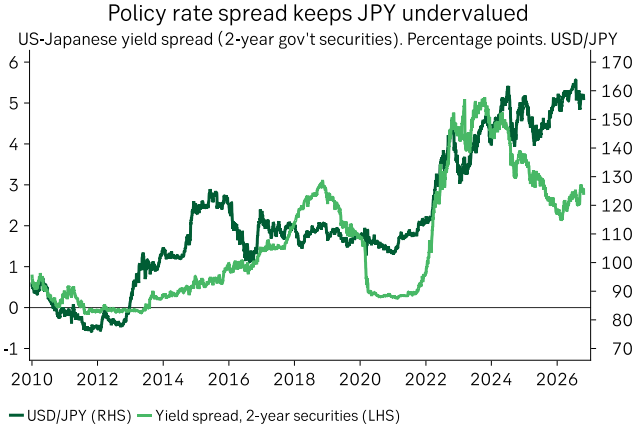


Source: Macrobond Financial AB, Macrobond, SEB

Positive long-term real bond yields make exposure to debt markets more attractive for Japanese domestic investors. Overall, this should provide support to undervalued yen.

Policy rate spread keeps JPY undervalued

US-Japanese yield spread (2-year gov't securities). Percentage points. USD/JPY

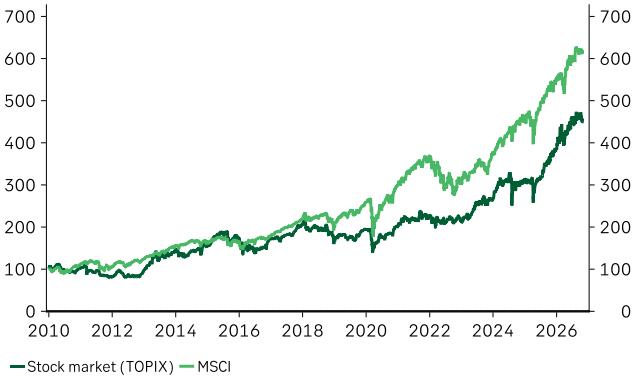


Source: Macrobond Financial AB, U.S. Department of Treasury, Macrobond, SEB

The concerted FX intervention in late July by the US and Japan has provided, as expected, limited support for the yen. A higher policy rate in Japan will strengthen the yen.

Japanese stock market - elevated levels

TOPIX and MSCI. Index 2010 = 100. Level



Source: Tokyo Stock Exchange, MSCI, Macrobond, SEB

A weak yen, high corporate profits and AI exposure make Japanese equities attractive. However, any correction in stock markets due to AI valuations is negative for Japan.

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