Special Report

Japan Economy: Gradual Recovery Amid Global Headwinds

November 2025

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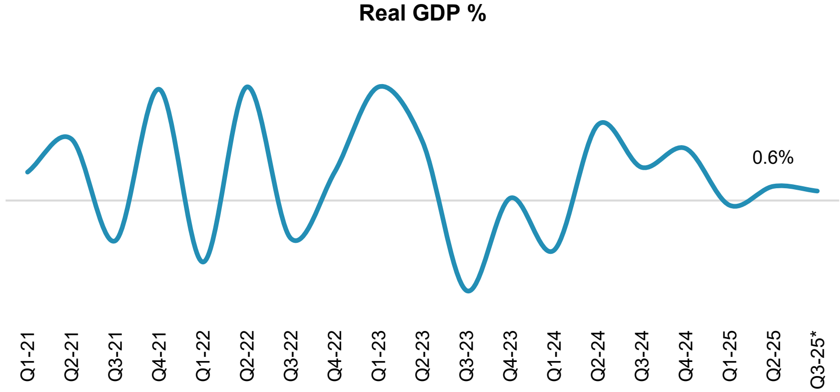
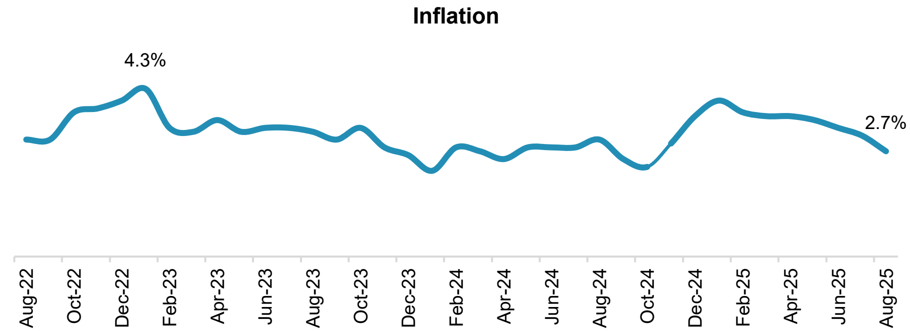
Japan's economy continued a gradual recovery, supported by domestic demand amid persistent inflation, yen volatility, and ongoing fiscal and trade risks

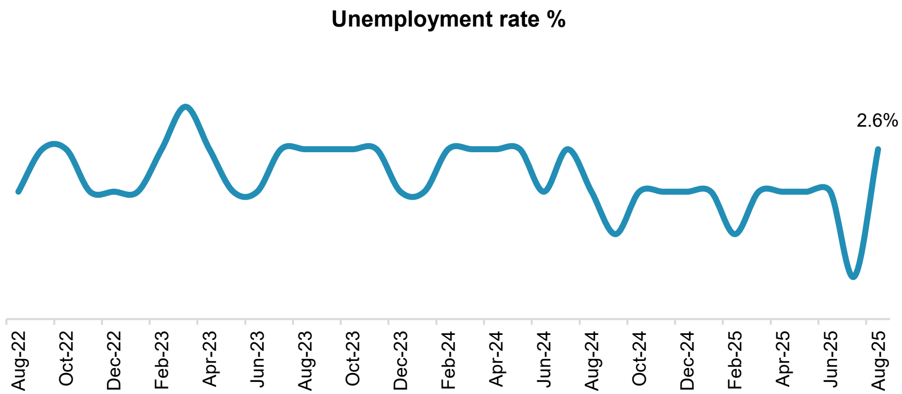
Japan's economy is expected to remain stable in Q3 2025 with 0.4% GDP growth after a contraction in Q1, driven by stronger domestic demand.



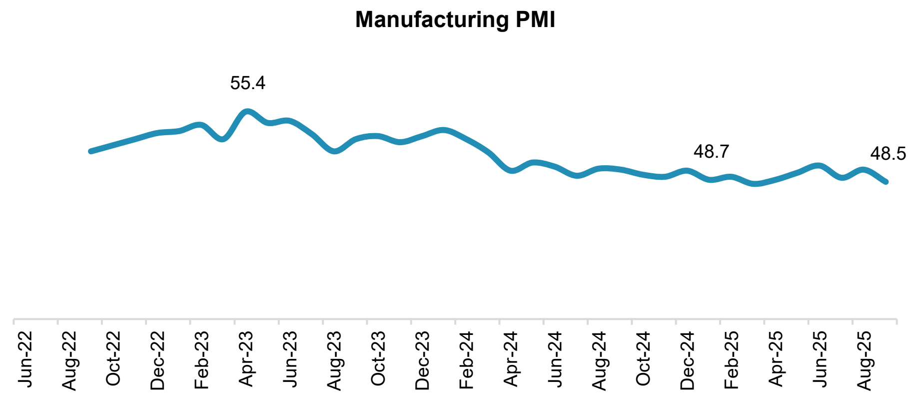
Headline inflation eased to 2.7% in August, reflecting faster price moderation but remains still above the central bank's target.



Unemployment reached highest level in past 13 months to 2.6% indicating slight softening in the labor market.



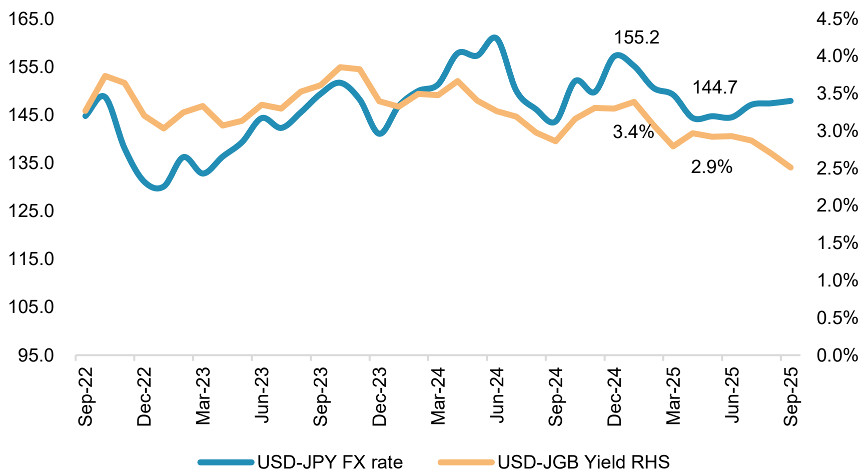
The manufacturing sector reported contraction for three straight months signaling weaker factory activity due to falling new orders

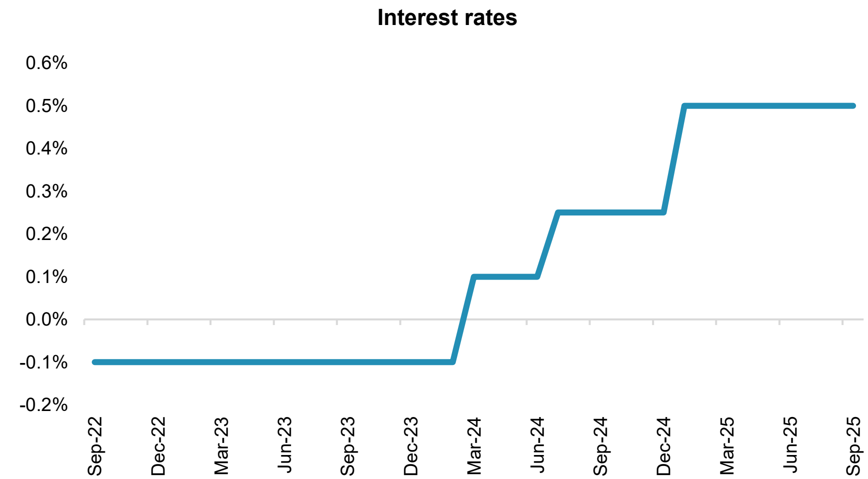


Source: *Government of Japan, Ycharts, Aranca Research. Note: Q3-25 data for Real GDP % is estimated*

Currency & Monetary Policy: Yen Volatility and BOJ Caution Amid Trade Tensions

The yen averaged 150.50 against the USD in Q3 2025, pressured by US tariffs and cautious BOJ policy. Wage gains supported inflation, but external risks limited tightening options.



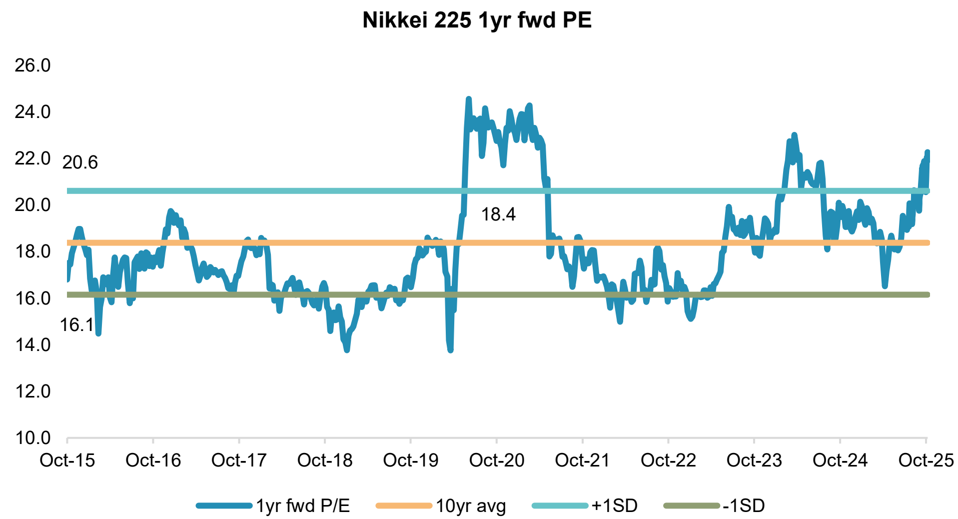


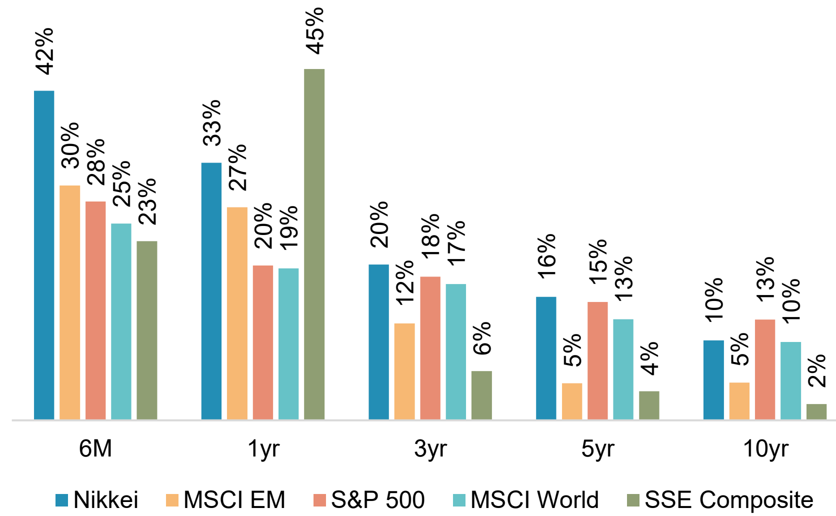
- The yen saw pronounced swings in Q3 2025, with **USD/JPY averaging 150.50** (+4.7% q/q, +12.3% y/y) amid **US tariff escalations, safe-haven outflows, and revived carry trades.** It briefly touched 153 in early October before stabilizing near 150 as Bank of Japan (BOJ) guidance tempered expectations.
- **10-year Japanese Government Bond (JGB) yields rose to 1.55%,** reflecting growing bets on **BOJ normalization,** though **US trade measures and China's weak growth weighed on Japan's export outlook and yen stability**, highlighting the tension between domestic policy and external risks.
- The **BOJ kept rates at 0.50%**, extending its pause from June, while **tapering JGB purchases** to ¥3T quarterly **and advancing its ETF unwind**. BOJ reaffirmed a data-driven stance, with only some expecting a 25 basis points hike to 0.75% in late 2025, and most seeing a move in 2026.
- **Core inflation moderated to 2.7%,** staying above target on 3.2% wage gains, but tariff-related costs could reheat prices. The **BOJ remains constrained**, balancing solid wage momentum with softer external demand and ongoing trade uncertainty.

Source: *YCharts, Aranca Research*

Japan Equities Rebound Amid Tariff Concerns and Governance Reforms

Japan's equities rebounded in Q3 after tariff-driven declines, supported by governance reforms and NISA inflows. FY25 earnings are projected to rise 8% despite external headwinds.



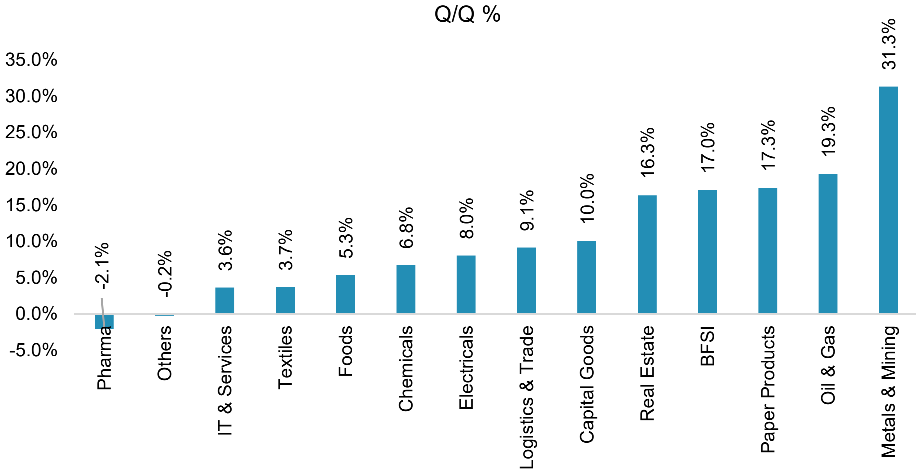


- Japan's equities faced sharp swings in Q3 2025 as **US tariff threats and yen volatility rattled sentiment**. The **Nikkei 225 fell over 15% in late July**, dropping below 40,000, before **rebounding 12% by quarter-end** after a US–Japan deal capped auto and chip tariffs at 15%, easing fears of a deeper selloff. The **TOPIX** followed similar trends, down 10% initially before recovering 8%, with **circuit breakers briefly triggered in August** as exporters bore the brunt of the turmoil.
- **TSE's P/B >1x mandate** spurred stronger shareholder returns, **driving a 20% jump in buybacks and a 15% reduction in cross-shareholdings**, boosting capital efficiency and attracting ¥5 trillion in domestic inflows through expanded Nippon Individual Savings Accounts.
- Despite the turbulence, sentiment turned **constructive**, with **TOPIX firms guiding for 8% FY25 earnings growth**, signaling a fifth consecutive year of record profits supported by a moderate yen and firm services demand, though US policy uncertainty and auto sector softness remain key risks.

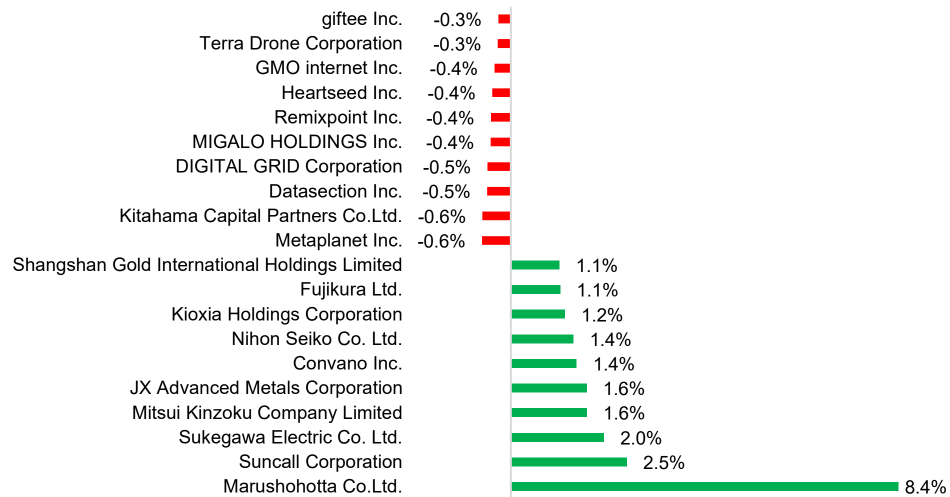
Source: *Bloomberg, Aranca Research*

Equity: Sectoral Performance

12 out of 14 sectors increased Q/Q in 3Q 2025 with sharpest increases in Metals & Mining, followed by Oil & Gas



Propensity of the top gainers was significantly higher than that of the top losers over the past three months

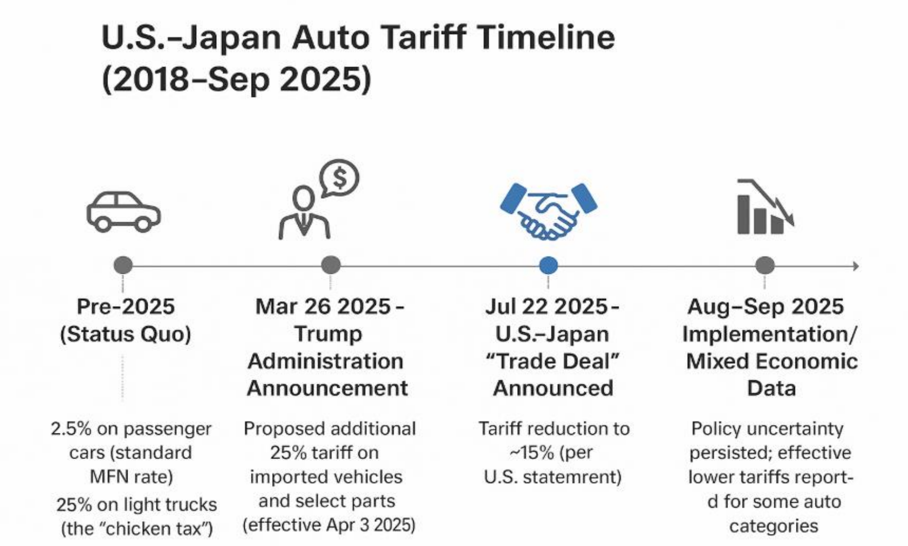


- Broad gains across Japanese sectors in Q3 2025, with 12 of 14 posting positive returns; Metals & Mining (+31%), Oil & Gas (+19%), and Paper Products (+17%) led the advance.
- Pharma (-2%) and IT Services (-0.2%) were the only laggards, reflecting profit-taking and weak overseas demand.
- Among individual names, Marushohotta (+8.4%) and Suncall Corp (+2.5%) topped gainers, while Metaplanet and Kitahama Capital Partners declined about 0.6% each.
- Sector leadership likely to remain cyclical, with commodity-linked and capital-goods names benefiting from yen softness and export resilience.

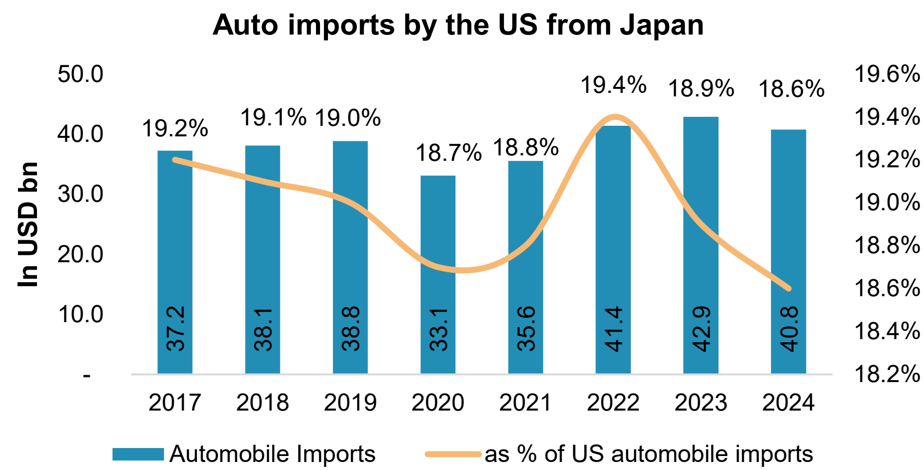
Source: *JPX, Koyfin, Aranca Research*

Auto Imports to the US are a Key Economic Link; Trade Relief Potentially Boosted Export Activity

From standard rates to 2025 trade deal, this is how the US-Japan Auto tariffs have been shaped over the years



In 2024, auto has been largest component of Japanese exports to the US with a share of 18.6% of total auto imports by the US



- The auto imports from Japan to the US remains a major economic link but the recent trade developments, tariffs and shifting consumer sentiment have impacted the volumes and pricing. However, the bilateral trade agreement signed with the US in July has led to reduction of auto import tariffs from 25% earlier to now 15%.
- Over the years, the share of Japan in the US imports has remained relatively stable, generally fluctuating between 18-19.5%.
- Post the signing of trade deal in July 2025, Japanese auto stocks rallied 8-17% on the day of announcement, with major names such as Toyota and Honda witnessing 11-14% gains. Although the announcement supports the margin expansion narrative, overall weak export demand remains an overhang. We believe, the sector's medium-term view is cautiously positive, as the tariff clarity and yen weakness provide the required support, but the structural headwinds such as Electric Vehicle transition, weak global demand temper the recovery potential.

Source: *US import data, Aranca Research*

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