Japan in the World

Outlook for the Japanese Economy
(1) Things Accomplished in 2025
(2) Things Not Accomplished in 2025 (and Left to Do in 2026)
(3) The Takaichi Administration's First Cabinet Decision on an Economic Policy Package

See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts. Any authors named on this report are research analysts unless otherwise indicated.

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The Japanese economy: Heading into 2026

1. Things accomplished in 2025

① The three hikes: Price hikes, wage hikes, and rate hikes all in play now.

② Changes in the nature of capex: Increased investments in software and other capital goods that lessen the dependence on people for labor.

③ Establishment of a genuine wage market: The emergence of market-set wage rates due to greater labor market liquidity.

④ Synchronized wage hikes: Wage hikes now made with an eye to industry peers rather than on a company-by-company basis (a stag hunt in game theory).

2. Things not accomplished in 2025 (and left to do in 2026)

① Mutually reinforcing price hikes and wage hikes (establishment of a virtuous circle).

② 2% inflation led by services.

3. The Takaichi administration's first Cabinet decision on an economic policy package

① Why assemble a stimulus package when Japan's output gap is currently near zero (no demand shortage)?

② Does pushing non-financial corporations from a savings glut into a savings shortage constitute growth in the economy? (American non-financial corporations are also usually excess savers)

Japan's economy:

Recovery will slow without falling into a recession; core CPI to fall under 2% in 2026

BOJ's outlook (as of October 2025)
Real GDP: +0.7 in FY25, +0.7% in FY26, +1.0% in FY27

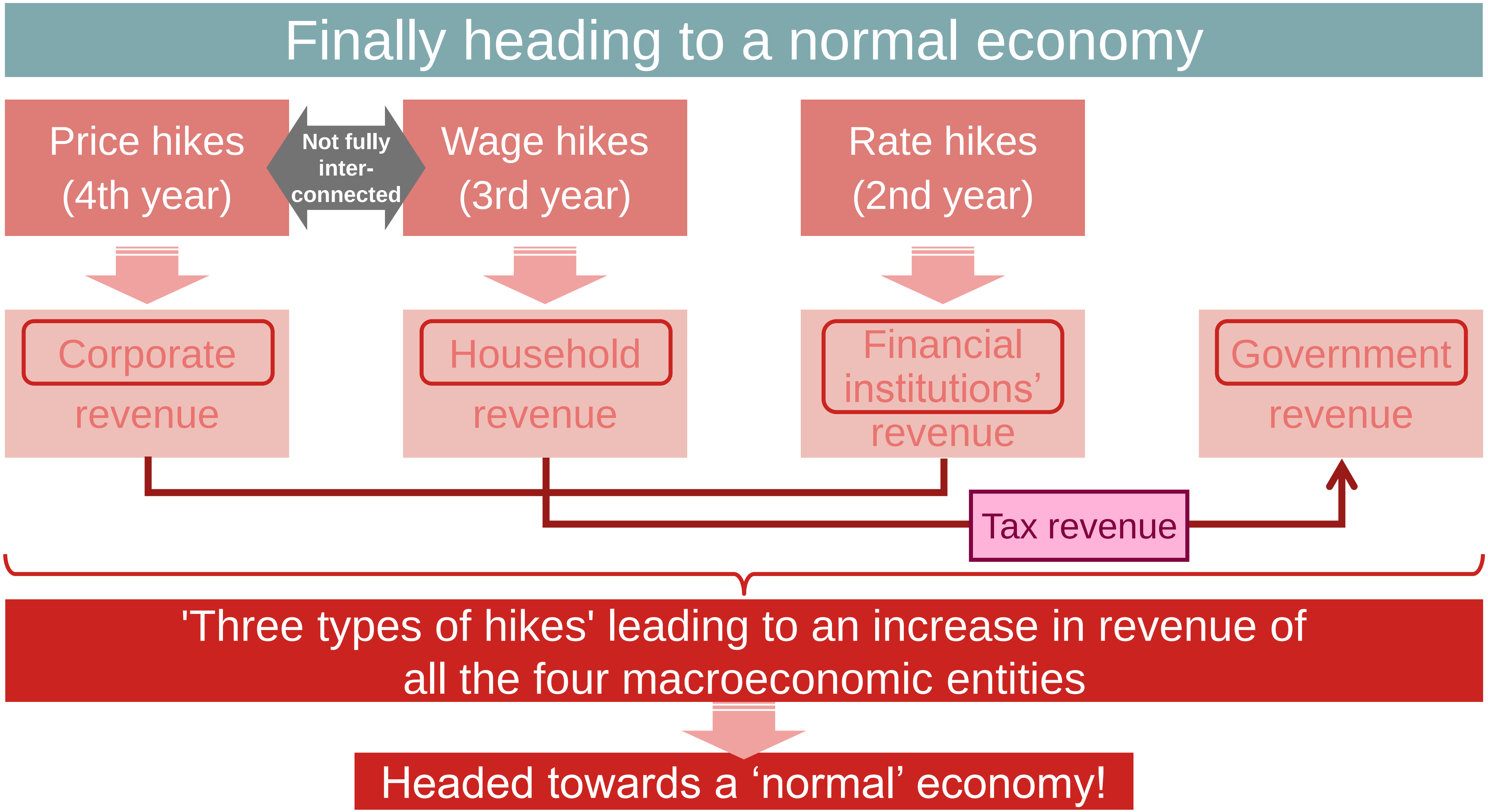
We expect Japan to slow in 2025 H2

	2025				2026				2027				FY (Apr-Mar)				CY (Jan-Dec)			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2024	2025	2026	2027	2024	2025	2026	2027
				F	F	F	F	F	F	F	F	F		F	F	F		F	F	F
(% q-o-q annualized)																				
Real GDP	0.9	2.3	-1.8	0.8	1.1	1.2	0.6	0.8	0.7	0.9	0.6	0.6								
(% q-o-q)													(% y-o-y)				(% y-o-y)			
Real GDP	0.2	0.6	-0.4	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.6	1.0	0.8	0.7	-0.2	1.3	0.7	0.8
Domestic demand*	(0.9)	(0.3)	(-0.2)	(0.3)	(0.3)	(0.3)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.1)	(1.1)	(1.1)	(0.9)	(0.8)	(-0.1)	(1.5)	(0.9)	(0.8)
Private consumption	0.3	0.4	0.1	0.1	0.4	0.1	0.2	0.2	0.2	0.2	0.2	0.1	0.7	1.0	0.9	0.7	-0.2	1.2	1.0	0.8
Private housing investment	1.3	0.3	-9.4	2.0	1.2	-0.2	-0.3	-0.6	-0.9	-0.8	-0.8	-0.8	-0.6	-4.5	-1.5	-3.0	-2.3	-2.1	-2.5	-2.7
Capex	0.9	0.8	1.0	0.1	0.3	0.5	0.4	0.4	0.4	0.4	0.4	0.4	1.9	2.7	1.7	1.5	0.7	2.8	1.9	1.6
Change in private inventories*	(0.6)	(0.0)	(-0.2)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)	(0.2)	(-0.1)	(0.0)	(-0.1)	(0.3)	(-0.1)	(0.0)
Public investment	0.5	-0.1	0.1	0.0	-1.3	2.4	-0.7	-0.3	0.1	1.1	-0.3	-0.6	0.6	-0.2	0.7	0.4	-1.6	0.7	-0.0	0.6
Government consumption	-0.4	0.1	0.5	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	1.2	0.4	0.8	0.9	0.8	0.4	0.8	0.9
Net exports*	(-0.7)	(0.2)	(-0.2)	(-0.1)	(-0.0)	(0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(0.0)	(-0.5)	(-0.1)	(-0.2)	(-0.0)	(-0.1)	(-0.2)	(-0.2)	(-0.1)
Exports	-0.4	2.3	-1.2	-0.5	0.2	0.6	0.5	0.6	0.5	0.6	0.6	0.5	1.5	2.5	1.0	2.2	0.7	3.3	0.7	2.2
Imports	2.5	1.3	-0.1	0.1	0.3	0.5	0.8	0.7	0.6	0.6	0.6	0.4	3.5	2.9	1.9	2.4	1.0	4.1	1.6	2.5
Nominal GDP	0.9	1.6	0.1	0.9	0.3	0.9	0.2	1.2	0.6	0.8	0.5	0.7	3.7	3.8	2.6	2.9	2.9	4.4	2.6	3.0
GDP deflator	0.7	1.0	0.6	0.7	0.0	0.6	0.1	1.0	0.5	0.6	0.4	0.5	3.1	2.8	1.8	2.2	3.1	3.0	1.8	2.2
(% y-o-y)																				
Real GDP	1.8	2.0	1.1	0.6	0.6	0.3	0.9	0.9	0.8	0.8	0.8	0.7								
Nominal GDP	5.1	4.8	3.9	3.5	3.0	2.2	2.4	2.6	3.0	2.9	3.2	2.7								
GDP deflator	3.3	2.9	2.8	3.0	2.3	1.9	1.4	1.7	2.2	2.2	2.5	2.0								
CPI (% y-o-y)																				
Core CPI	3.1	3.5	2.9	2.7	1.9	1.4	1.6	1.6	2.1	2.0	1.9	2.0	2.7	2.7	1.7	2.0	2.5	3.1	1.6	2.0
Core core CPI (A)	2.7	3.2	3.2	3.0	2.9	2.4	2.2	2.1	2.0	2.2	2.2	2.2	2.3	3.1	2.2	2.2	2.4	3.0	2.4	2.1
Core core CPI (B)	1.5	1.6	1.5	1.7	1.8	1.7	1.8	1.8	1.8	2.0	2.0	2.0	1.7	1.6	1.8	2.0	1.9	1.6	1.8	2.0

BOJ's outlook (as of October 2025)
Core CPI: +2.7% in FY25, +1.8% in FY26, +2.0% in FY27
Core core CPI (A): +2.8% in FY25, +2.0% in FY26, +2.0% in FY27

Notes: 1. Forecasts are as of 17 November 2025.
2. Numbers in parentheses for demand components with asterisks (*) are QoQ contributions (ppt).
3. Quarters are on a calendar-year basis. (Q1 is the January-March quarter).
4. The core CPI excludes fresh food. Core Core CPI (A) excludes fresh food and energy.
Core core CPI (B) excludes food, non-alcoholic beverages and energy.
Source: Actual data are from the Cabinet Office and MIC. Forecasts are by Nomura

Japan’s economy: 'Three types of hikes' leading to an increase in revenue of all the four macroeconomic entities



注:The labels "4th year", "3rd year", and "2nd year" under the price hiles, wage hikes, and rate hikes items refer to evaluations as of 2025.
Source: Nomura

Inflation:
Japan's CPI has a higher weighting towards food

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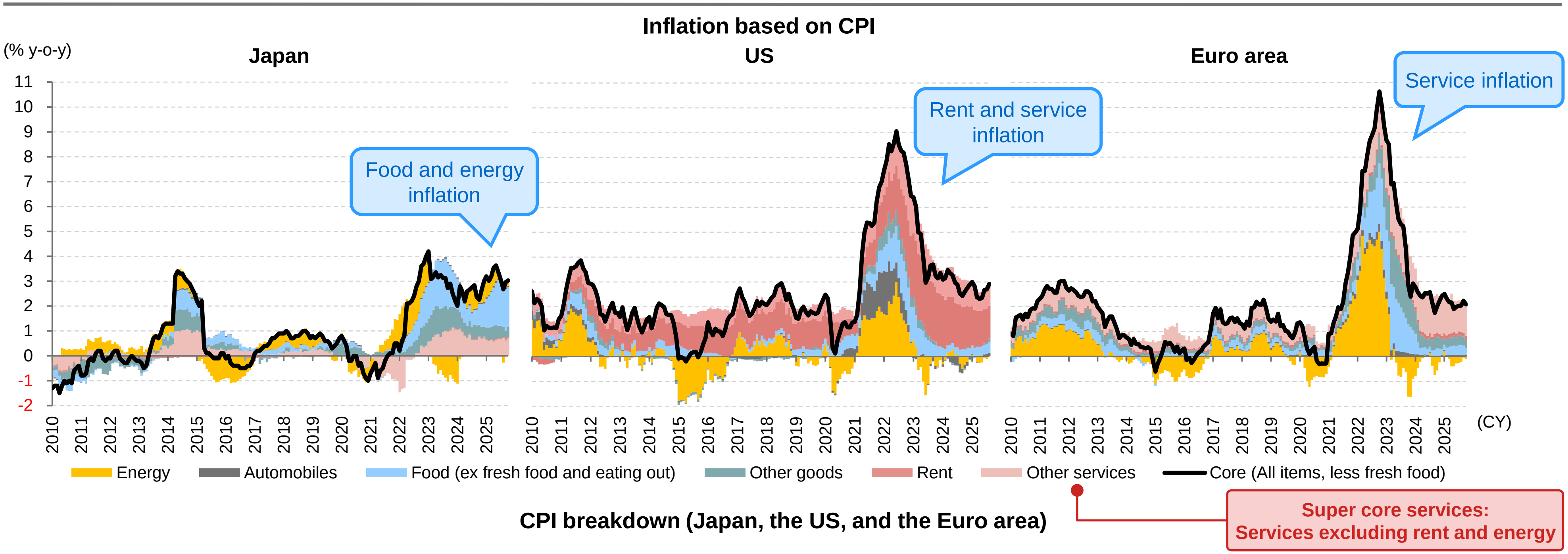
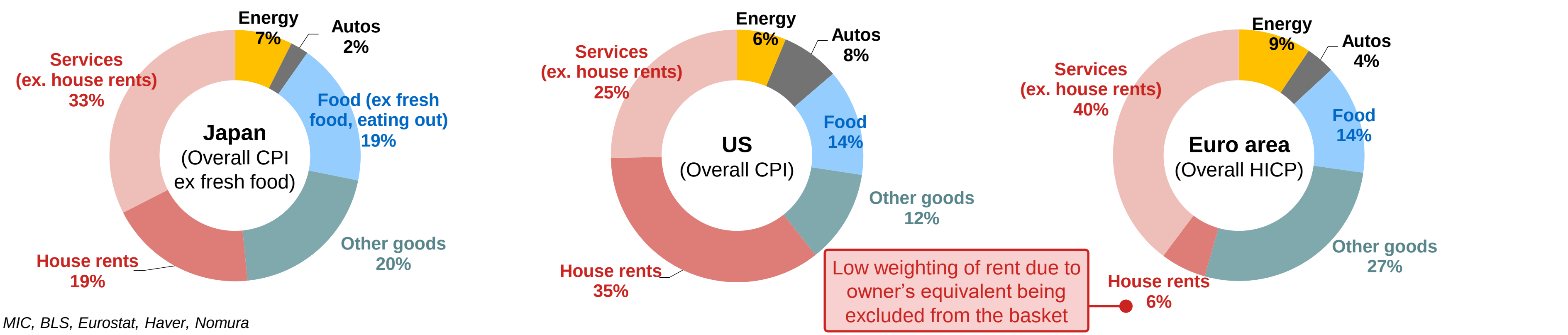
Drivers of Japan's inflation are food and energy, while rent and services are the drivers for the US and services are the drivers for the Euro area





Source: MIC, BLS, Eurostat, Haver, Nomura

Capex: Reduced labor dependence leading to improved labor productivity

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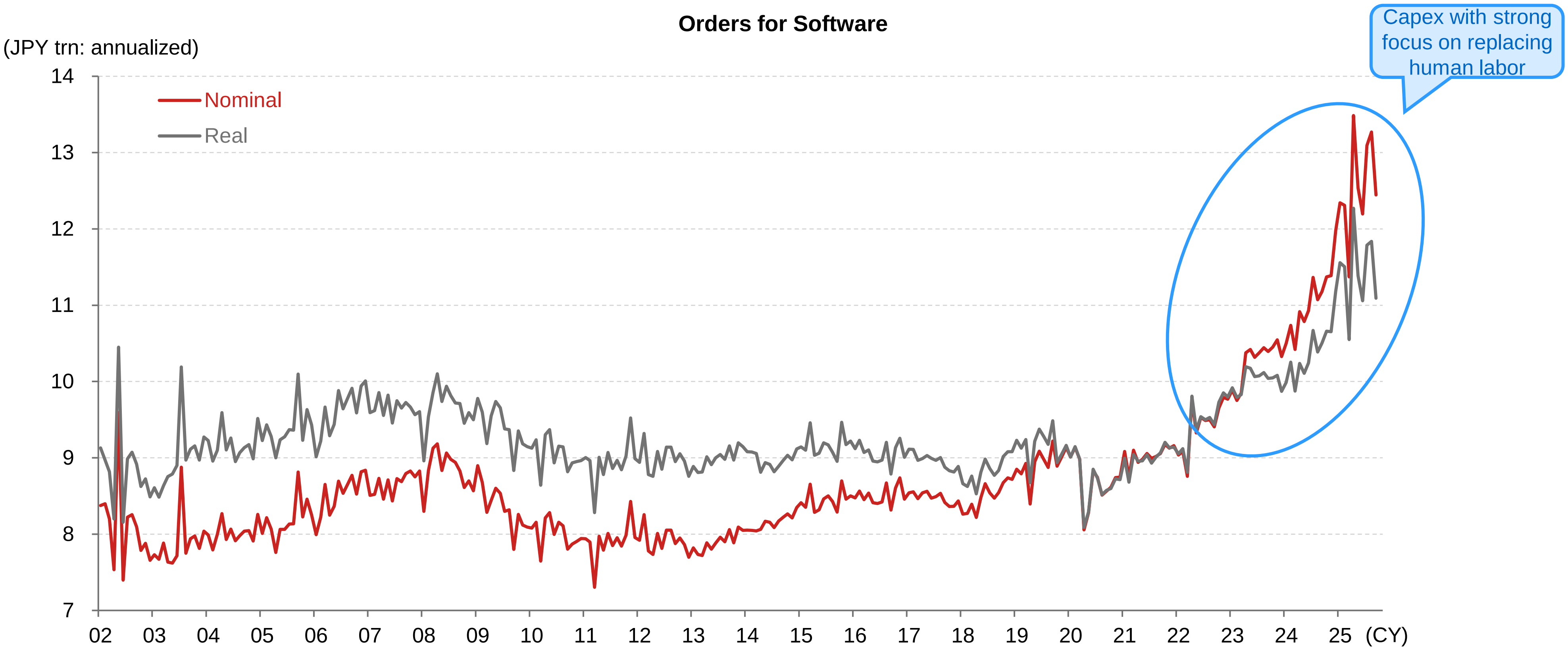
- **While capex in machinery and construction faces constraints on the supply side (shortages of labor, parts, and materials, and a resulting rise in costs), software orders have been rising rapidly.**

Rapid increase in orders for software (or software investment)



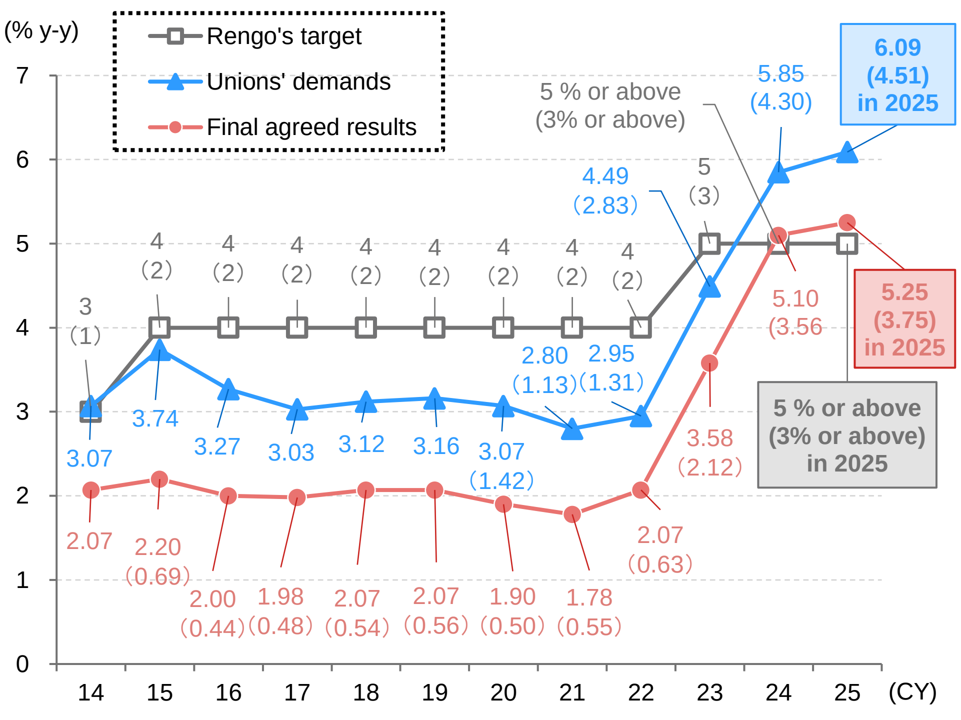
Note: 'Real' orders for software are deflated using prices of custom software (except embedded software) on an SPPI (Service Producer Price Index) basis.
Source: METI, Nomura

Wages (1):
Synchronized wage hikes are emerging as a trend

- **The way companies determine wage hikes is starting to evolve, as they are increasingly letting their decisions be informed by what their peers are doing, leading to a greater level of intra-company synchronization. As a result, the Nash equilibrium of the stag hunt game is shifting from a wage-decline state (the equilibrium under a maximin strategy) to a wage-growth state (the equilibrium under a payoff dominant strategy).**
- **Wage hikes are becoming more synchronized among companies, leading to a change in the corporate 'norm' about wage hikes.**

Rengo's target appears likely to be exceeded in the 2026 shunto

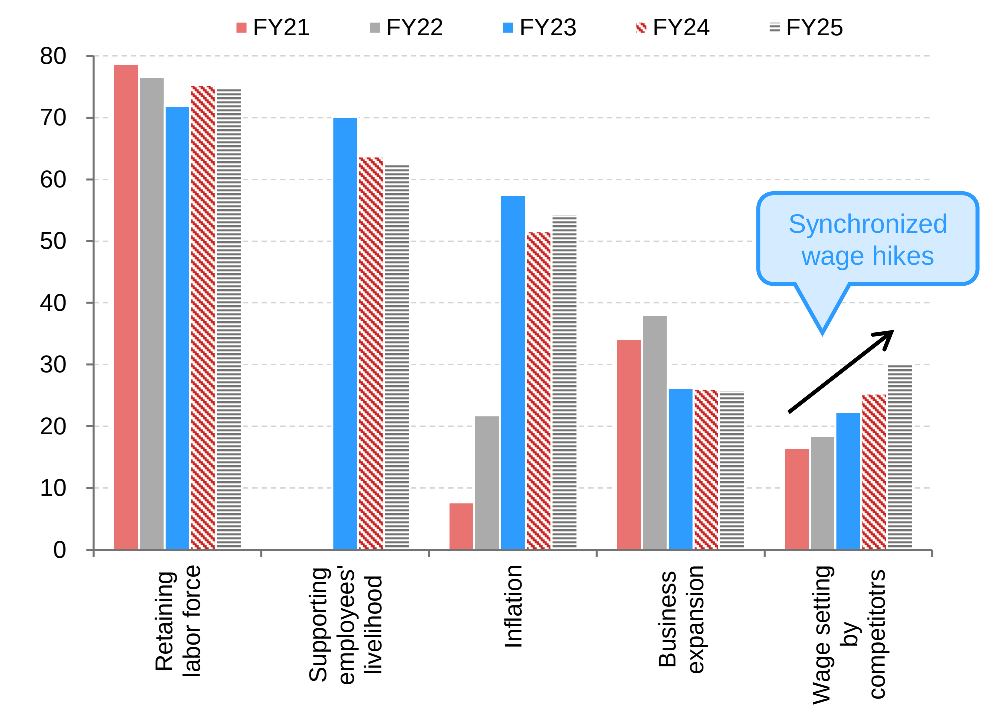
Spring wage negotiations (target, demands and results)



Note: (1) Wage increase is total increase in base pay and seniority-based pay. Base pay increase shown in brackets. Except for 2014, the results are averages for unions that have published a figure for base pay increase.
(2) Figures are based on the final set of results of each year's shunto.
Source: Nomura, based on Japanese Trade Union Confederation (Rengo) data

More synchronized wage hikes, suggesting a change in the corporate 'norm' of wage hikes

Reasons for wage hikes (multiple answers)



Note: The survey period for FY25 was 20-31 January 2025. The survey sample included 26,765 companies, of which 11,014 responded.
Source: Teikoku Databank, Nomura

Wages (2):
Key events to watch ahead of 2026 shunto

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- **Final months of 2025: Labor unions indicate their position.**
- **Early-to-mid January 2026: Management-side organizations indicate their position.**
- **Mid-March 2026: Climax of shunto negotiations (when most major companies issue their response).**

Key events to watch ahead of 2026 shunto

Year	Date	Events	Timeline for 2025 spring wage negotiations	
2025	10/23	Rengo publishes Basic Concept for 2026 spring wage negotiation (sets wage hike target)	24/10/18	Mainly reflects stance of labor unions
	11/6	UA Zensen sets wage hike target	24/11/6	
	11/18	Japanese Association of Metal, Machinery, and Manufacturing Workers sets wage hike target	24/12/4	
	11/20	Rengo publishes policy for spring wage negotiations	24/11/28	
	11/25	Three-way meeting of government, labor, and corporate management representatives	24/11/26	
	11/26	Japan Council of Metalworkers' Unions sets wage hike target	24/12/3	
	12/4	Japan Federation of Industry Workers' Unions sets wage hike target	24/12/5	
	12/12	Confederation of Japan Automobile Workers' Unions sets wage hike target	24/12/11	
	12/15	Outline of December BOJ Tankan survey released	24/12/13	
	Late Dec	Labor unions at major automakers set wage hike demands	Around 20 Dec 2024	
2026	Early Jan	New Year's meetings at three business organizations (announcement of stance on wage hikes)	25/1/7	Mainly reflects stance of management
	Early–mid Jan	BOJ branch manager meeting and Regional Economic Report (Sakura Report)	25/1/9	
	Mid–late Jan	Keidanren publishes policy paper setting out basic stance on 2026 spring wage negotiations	25/1/21	
	Within Feb	Workers at each company decide on demands, begin negotiations with management	In Feb 2025	
	Early Mar	Rengo publishes overall wage hike demands	25/3/6	
	3/17–19	Peak for company responses	25/3/11-13	
	3/23	Rengo publishes first set of negotiation results	25/3/14	
	Late Mar	Rengo publishes second set of negotiation results	25/3/21	
	Early Apr	Rengo publishes third set of negotiation results	25/4/3	
	Mid–Apr	Rengo publishes fourth set of negotiation results	25/4/17	
	Early May	Rengo publishes fifth set of negotiation results	25/5/8	
	Early Jun	Rengo publishes sixth set of negotiation results	25/6/5	
	Early Jul	Rengo publishes seventh (final) set of negotiation results	25/7/3	

Note: Forward-looking dates are Nomura assumptions
Source: Japanese Trade Union Confederation (Rengo), BOJ, media reports, Nomura

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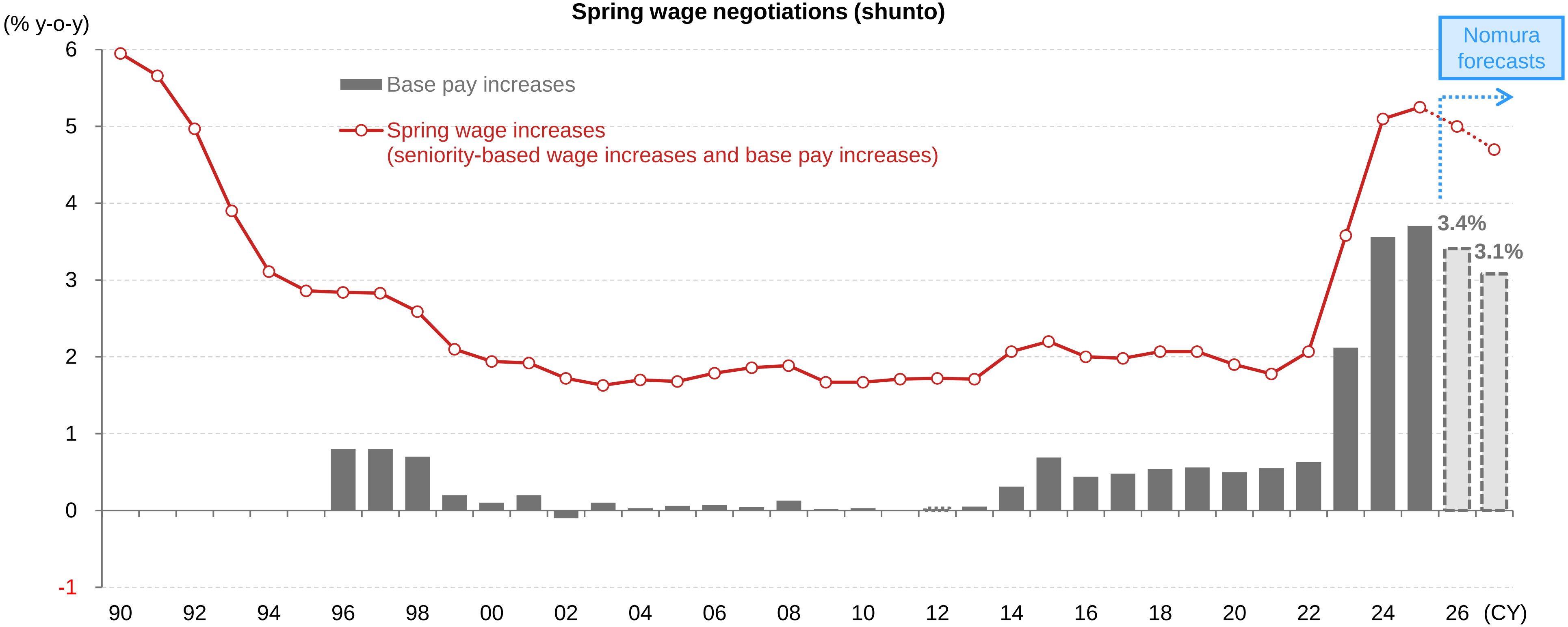
Wages (3):
Base pay growth likely to be above 3% in 2026 and 2027

- **In the 2024 *shunto*, wage hikes (including seniority) were 5.10% with base pay growth of 3.56%.**
- **In the 2025 *shunto*, wage hikes (including seniority) proved to be 5.32% with base pay growth of 3.75%.**
- **In the 2026 *shunto*, we expect wage hikes (including seniority) to be 5.0% with base pay growth of 3.4%.**
- **In the 2027 *shunto*, we expect wage hikes (including seniority) to be 4.7% with base pay growth of 3.1%.**

Base pay growth will likely remain around 3% with some slowing toward 2027

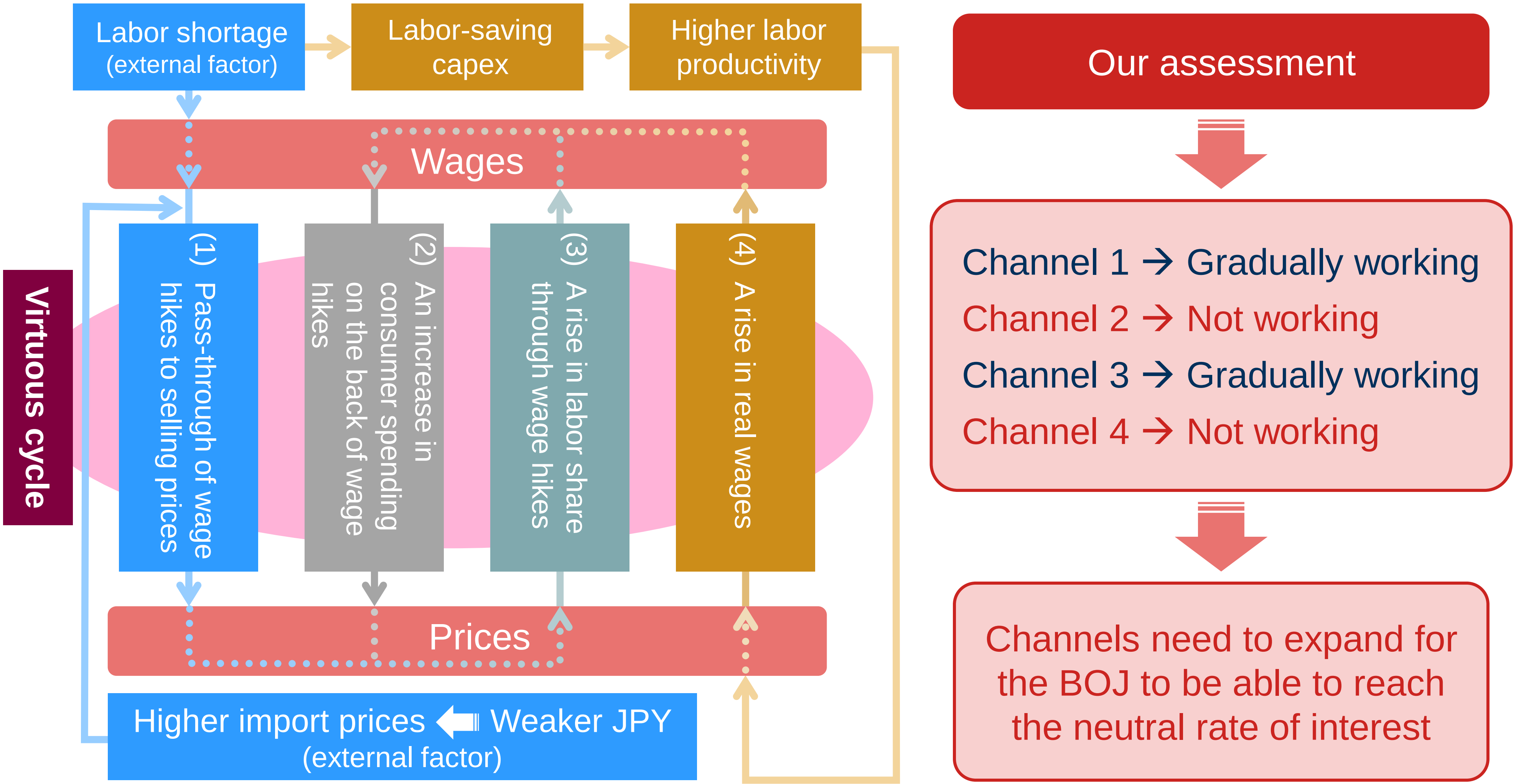
Spring wage negotiations (shunto)



Note: 1. Base pay increases are based on surveys by Keidanren (1996-98), Central Labour Relations Commission (1999-2014), and Rengo (2015-25).
2. Nomura forecasts shown for 2026 and 2027.
Source: Nomura, based on Japan Trade Union Confederation (Rengo), Central Labour Relations Commission, Japan Business Federation (Keidanren) data

Wages and prices:
Four channels comprising interconnectivity between wages and prices

Four major channels for a virtuous cycle between wages and prices(the term” virtuous cycle” disappeared the BOJ’s Outlook Report in May 2025 and hasn’t been used since)



Source: Nomura

Inflation (1):

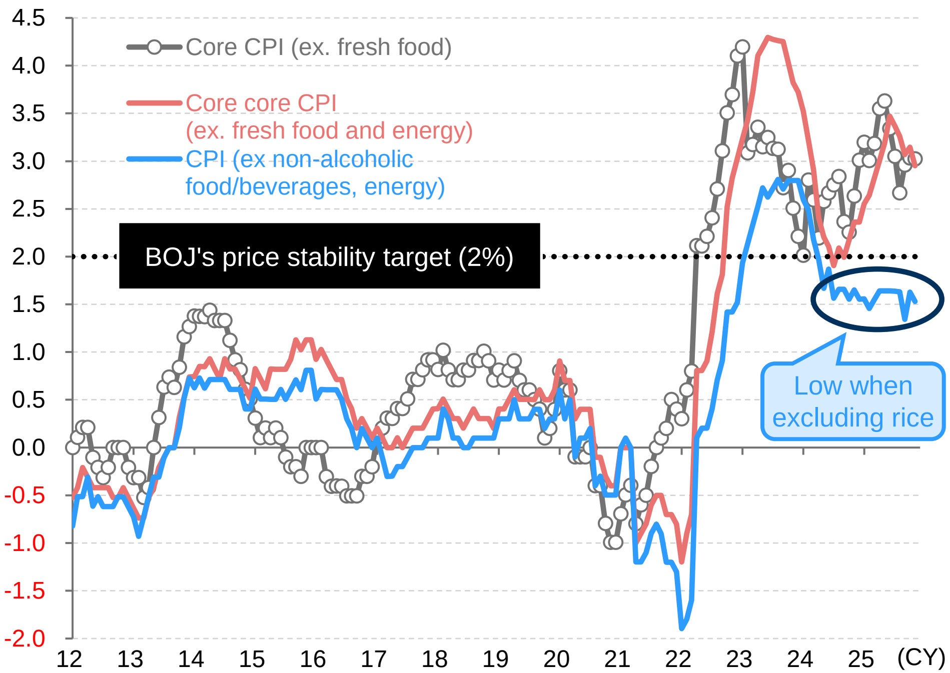
Inflation excluding food and energy not above 2%

- **Both core CPI inflation (excluding fresh food) and core-core CPI inflation (excluding fresh food and energy) are driven upwards by rice and other foods.**
- **When excluding food (ex. alcoholic beverages), the CPI inflation rate remains low.**
  ⇒ Core CPI inflation (year-on-year) has likely already reached a peak.

One of the three doesn't include rice. Which one?

CPI

(% y-o-y)

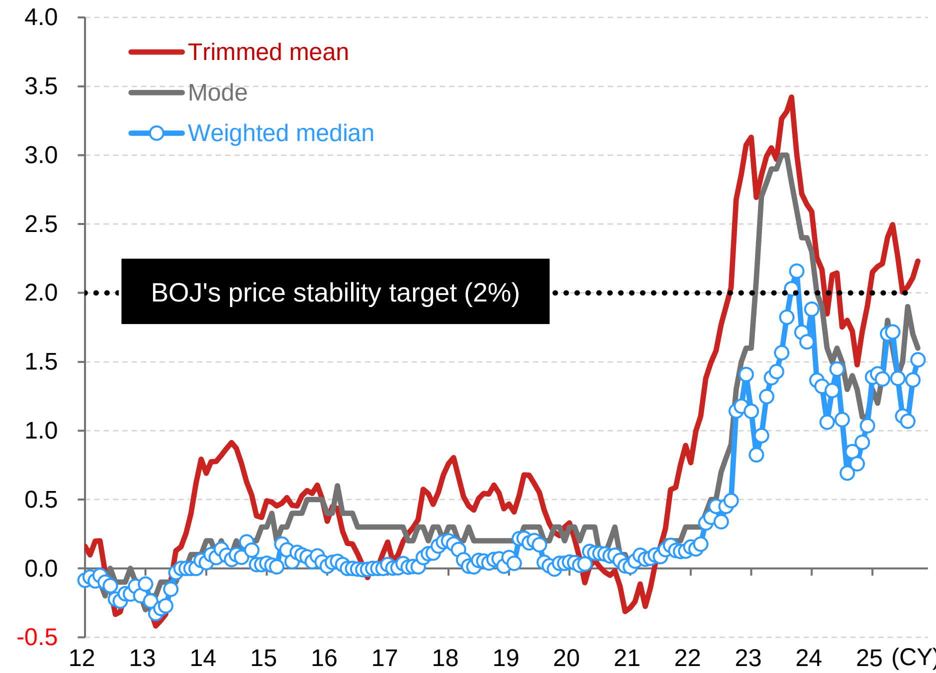


Note: CPI excludes consumption tax.
Source: MIC, Nomura

Underlying inflation numbers don't always fully capture real underlying inflation

Measures of underlying inflation

(% y-o-y)



Notes: 1. 'Trimmed mean' is obtained by excluding upper and lower tails (here, 10 percent tails) of price change distribution adjusted for item's weight in CPI.
2. '"Mode" is the inflation rate with the highest density in the distribution, assuming that inflation rates for Core CPI (ex. fresh food) items fit a normal-inverse Gaussian distribution.
3. "Weighted median" is the average rate of inflation of categories that fall within the 47.5% - 52.5% range (on a weighted basis) in the distribution of their inflation rates
Source: BOJ, Nomura

Inflation (2):
Underlying inflation to edge up

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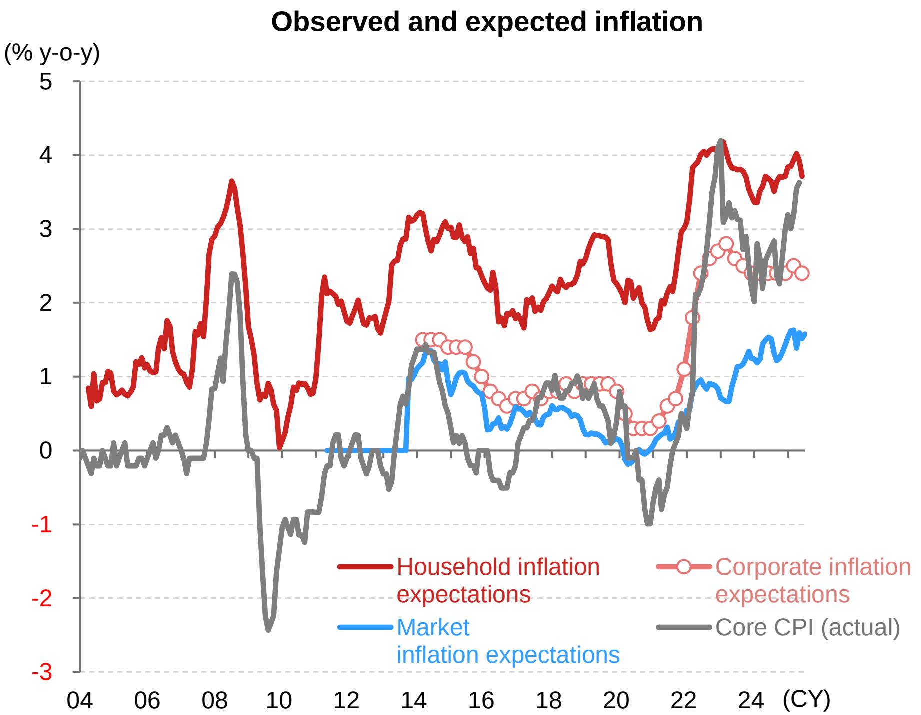
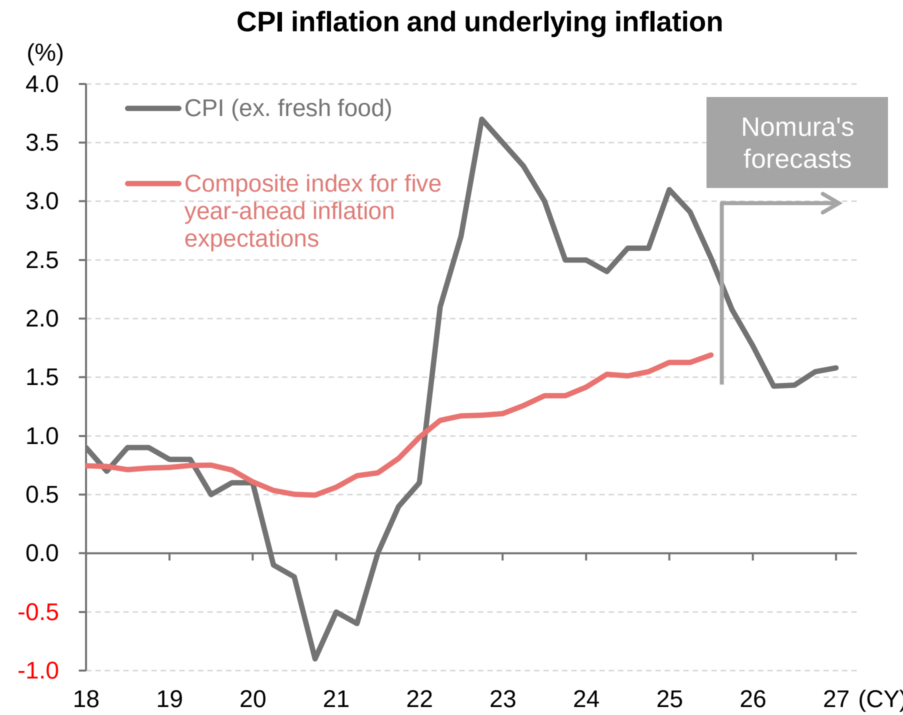
- Market inflation expectations (BEI) are rising, along with corporate and household inflation expectations.
- While the composite index for five year-ahead inflation expectations based on principal component analysis (composite of corporate, household, and expert inflation expectations) is rising, it is not anchored to 2%.

Rising inflation expectations



Note: 1. 'Household inflation expectations' are calculated as weighted average based on distribution of survey responses, using 5% for "5% or higher," 3.5% for "2% to less than 5%" and 1% for "less than 2%".
2. 'Corporate inflation expectations' are based on Tankan survey of 1y-ahead general price (CPI) outlook (surveyed since March 2014).
3. 'Market inflation expectations' are based on 10-year JGBi after Oct 2013 and 10-year inflation swaps prior to that.
Source: MIC, Cabinet Office, BOJ, Bloomberg, Nomura

Divergence between CPI inflation and underlying inflati



Note: Five year-ahead inflation expectations prior to the January-March 2024 quarter are Osada and Nakazawa estimates (2024). Figures from 2024 2Q onward were calculated by Nomura using Osada's and Nakazawa's methodology (2024)
Source: Osada and Nakazawa (2024), BOJ, Bloomberg, QUICK, Consensus Economics material, Nomura

Inflation (3):
2026 CPI forecasts clearly show effects of policy measures

- **Various policy measures are directly suppressing CPI for FY2025-2026. However, the BOJ’s Outlook Report only factors in measures that have been official enacted.**
- **Currently anticipated measures would depress FY2026 core CPI (ex. fresh food) by c.0.3% year-on-year, but this is not accounted for in the BOJ’s Outlook Report.**
- **The significance of examining underlying inflation will increase in importance.**

2026 CPI forecasts clearly show effects of policy measures

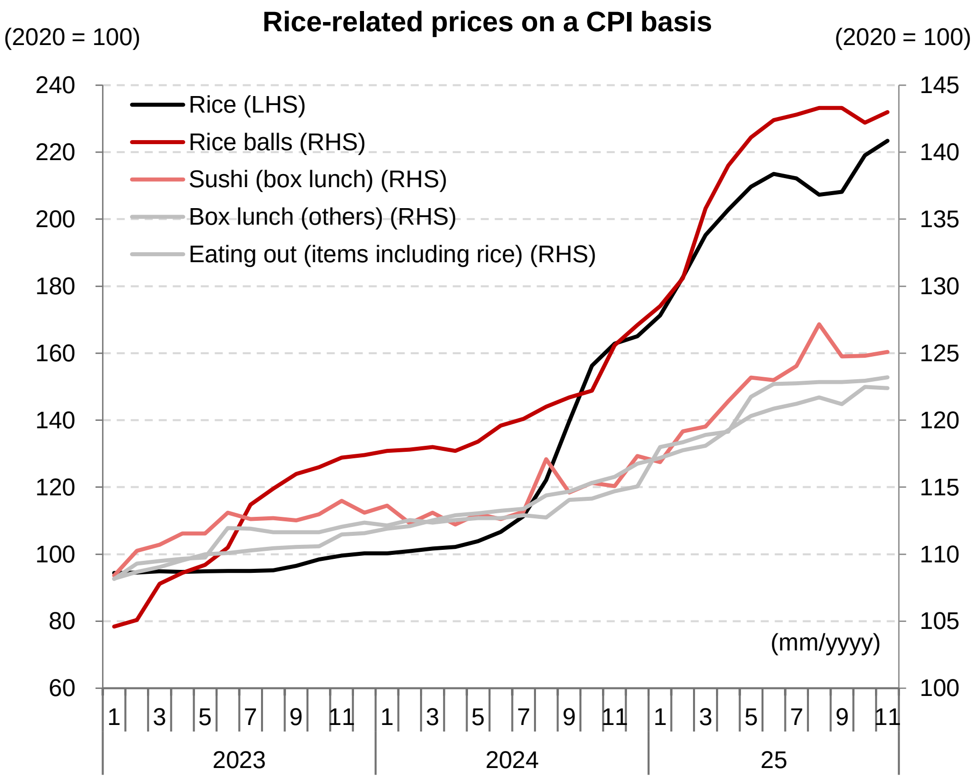
Date of implementation	施 策 内 容	Impact on core CPI inflation (ppt)		Factored into CPI forecasts?		Core	BOJ	MIC
（Some TBD）		Nationwide	Tokyo	Nomura	BOJ		Core-core	Core-core
2025 April ～	Free education at high schools (public)	-0.18	-	○	○	○	○	○
June ～	Gasoline subsidies	-0.12	-0.03	○	○	○	×	×
June ～ September	Free water charges **(only Tokyo)**	-0.02	-0.25	○	○	○	○	○
August ～ October	Measures to control electricity and gas charges	Approx. -0.3	Almost -0.3	○	○	○	×	×
September ～	Free childcare fee **(only Tokyo)**	-0.04	-0.52	○	○	○	○	○
November ～	Gasoline subsidies, gasoline tax cuts	-0.31	-0.09	×	×	○	×	×
2026 February ～ April	Measures to control electricity and gas charges	Approx. -0.6	Approx. -0.6	×	×	○	×	×
April ～	Free education at high schools (private)	-0.18	-	○	×	○	○	○
April ～	Free lunch at elementary schools	-0.13	-	○	×	○	○	○
TBD	Free lunch at junior high schools	-0.06	-	×	×	○	○	○
TBD	Consumption tax cuts	?	?	×	×	○	○	○

Note: 1. Impact on core CPI (ex. fresh food) is estimated by Nomura.
2. Core-core: The BOJ figure excludes fresh food and energy, while the MIC figure excludes foods (ex. alcoholic beverages) and energy.
3. Whether or not measures have been factored into CPI forecasts is based on Nomura assumptions.
4. Since subsidies to control electricity and gas charges change by the month, figures here are a rough estimate of average impact.
5. Since gasoline subsidies gradually increase from November 2025, impact here accounts for the full subsidy (equivalent to the ¥25.1/liter provisional tax rate)
Source: MIC, various materials

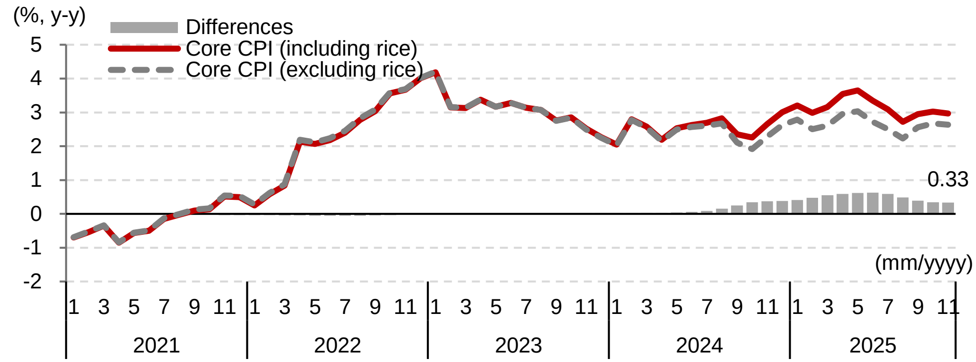
Inflation (4):
Rice prices look likely to settle down early in 2026

- **Rice prices started rising again in October (after settling back previously) as rice harvested in 2025 hit the market.**
- **The associated boost to y-y inflation is generally shrinking. As of November, higher rice prices are pushing up core CPI inflation by about 0.3ppt–0.4ppt.**
- **Marketing of new rice as "freshly harvested" should wind down in early 2026, and prices should settle back to reflect the change in the supply/demand landscape.**

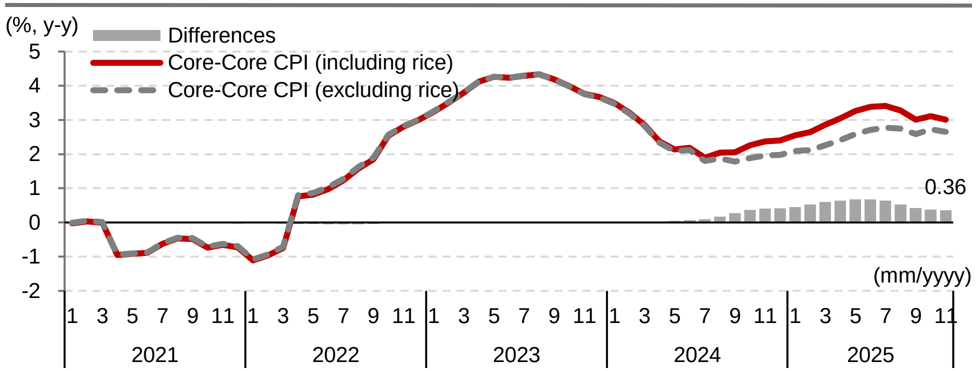
Prices for rice and related products (CPI basis)



Trajectory of core CPI inflation



Trajectory of BOJ-style core-core CPI inflation



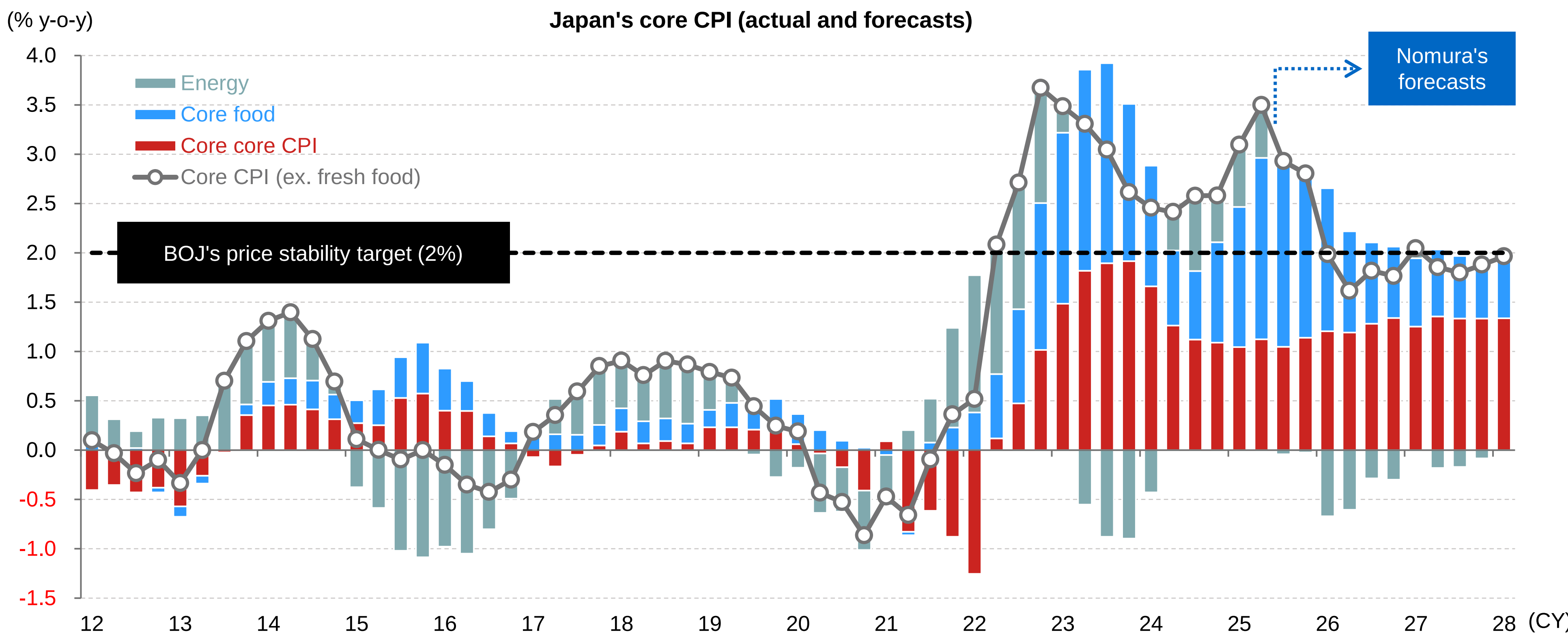
Note: *Left-hand chart: "Sushi (box lunch)" is the weighted average of "Sushi (box lunch)-A" and "Sushi (box lunch)-B". "Box lunch (others)" is the weighted average of "Box lunch-A" and "Box lunch-B". "Eating out (items including rice)" is the weighted average of "Sushi (eating out)-A", "Sushi (eating out)-B", "Tempura bowls (eating out)", "Curry & rice (eating out)", "Beef bowls (eating out)", "Pork cutlet set meals (eating out)", and "Ginger pork set meals (eating out)".*

Source: *Nomura, based on Ministry of Internal Affairs and Communications data*

Inflation (5): Core CPI inflation likely to fall below 2% in 2026, and come closer to 2% in 2027

- **Japan's core CPI inflation (less fresh food) will likely come down to below 2% with the contribution of food declining.**
  ⇒ We think the BOJ will pause as long as inflation remains below 2%.
- **Inflation will likely come closer to 2% in 2027 in a more endogenous, home-grown manner.**
  ⇒ We think the BOJ will resume rate hikes in 2027.

CPI inflation is expected to fall below 2% in early 2026, and stabilize at a lower level



Note: Core CPI is overall CPI excluding fresh food. Core core CPI is overall CPI excluding energy and core food (food except fresh food and alcoholic beverages).
Source: Nomura, based on MIC data. Forecasts are by Nomura

BOJ (1): We forecast a pause in rate hikes in 2026, followed by additional hikes in January and July of 2027

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BOJ monetary policy: Expecting policy rate to reach 1.25% in July 2027

(1) Expecting <u>real core CPI inflation</u> to fall below 2% y-y in 2026

⇒ Our forecasts have core CPI inflation (all items, less fresh food) dropping below 2% y-y in the Jan–Mar 2026 quarter.

⇒ The BOJ's latest Outlook Report (issued on 30 October) also sees inflation falling below 2% in FY26 (based on the Policy Board members' median forecast).

(2) Expecting <u>underlying inflation</u> to stall in 2026 but then rise back to around 2% in 2027

⇒ We see underlying inflation stalling in 2026 as core CPI inflation drops below 2% y-y.

⇒ During 2026, we expect services to take over from foods and energy as the engine powering inflation.

⇒ We see underlying inflation returning to 2% or so in 2027.

(3) We forecast BOJ rate hikes in January and July of 2027

⇒ With its December 2025 rate hike, the BOJ's policy rate has reached 0.75%.

⇒ Our expectation of a one-year gap between rate hikes in December and January 2027 rests on our forecast that CPI inflation will slip below 2%.

⇒ We expect this rate-hiking cycle to come to a close with a final hike in the policy rate to 1.25% in July 2027.

NOMURA 100 YEARS

Risks to our monetary policy forecasts

(1) Bigger-than-expected upside moves in the output gap and longer-run inflation expectations

⇒ A succession of stimulus packages, for example, could drive up the output gap and longer-run inflation expectations.

⇒ Bigger-than-expected rise in the neutral rate of interest. ← Risk 1

⇒ A higher terminal rate than we currently forecast.

(2) More yen depreciation than expected

⇒ Heightened worry in the markets over the government's fiscal policy handling.

⇒ Rise in long-term interest rates alongside a weakening yen (a breakdown in the relationship between the exchange rate and the US-Japan interest rate spread).

⇒ A need to hike the policy rate to a level higher than the neutral rate. ← Risk 2

⇒ A higher terminal rate than we currently forecast.

(3) Poor forward visibility on the neutral interest rate

⇒ Uncertain outlook for the potential growth rate and the gap between the natural interest rate (r*) and the potential growth rate.

⇒ Difficulty in reading the outlook for the neutral interest rate. ← Risk 3

⇒ Risks to our monetary policy forecast scenario.

BOJ (3): Monetary policy under the Takaichi administration and changes in BOJ policy board members

Monetary policy under the Takaichi administration

(1) Demand-pull inflation, not cost-push inflation, is key

⇒ The central bank's monetary policy mainly addresses demand-pull inflation (while exchange rate stability achieved through monetary policy does affect import prices [cost-push inflation], exchange rate stability is actually the responsibility of the government [Minister of Finance] under Article 7-3 of the Foreign Exchange Act).

⇒ BOJ Governor Kazuo Ueda is well aware of the difference between cost-push and demand-pull inflation.

⇒ We see no need for Ueda to change his policy stance even under the Takaichi government.

⇒ We have not changed our BOJ scenario.

(2) Focus on successors as terms of BOJ policy board members expire

⇒ Asahi Noguchi in March 2026 and Junko Nakagawa in June 2026.
Hajime Takata and Naoki Tamura in July 2027.

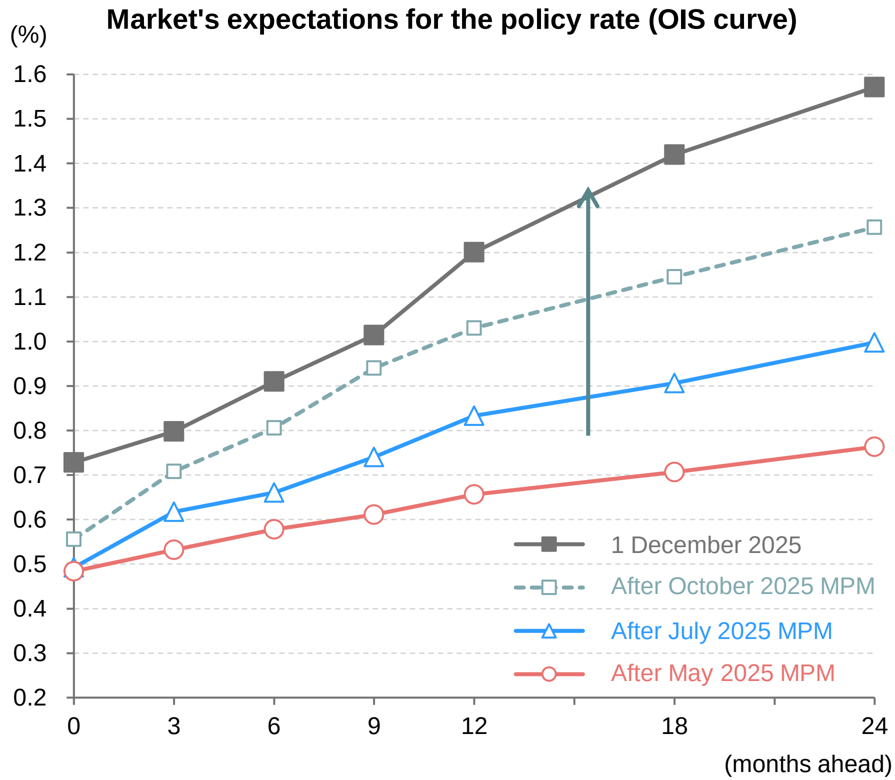
under the Takaichi government

BOJ deputy governors Shinichi Uchida and Ryozo Himino in March and Ueda in April 2028.

BOJ (4):
Real policy rate will likely approach *r** in 2027

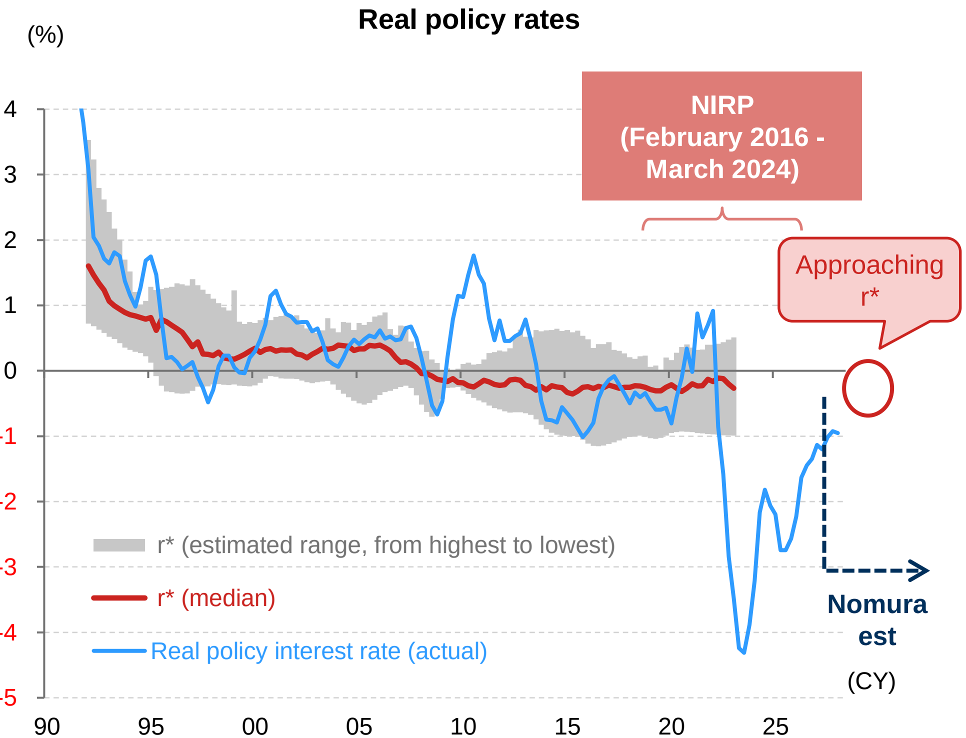
- **The most recent OIS curve factors in more of the BOJ's rate hikes within a twelve-month period.**
- **Nomura believes the BOJ's policy rate will reach the terminal rate of 1.25% in July 2027, bringing the real policy rate into the estimated range of the natural rate of interest, or *r**.**

Markets' expectations for rate hikes gradually rising



Note: 'Present' is based on JPY 3M OIS rate. Others are based on forward rate of JPY OIS rate.
Sources: Bloomberg, Nomura

Real policy rate will likely approach *r** in 2027



Note: (1) Estimated range and median for r* (equilibrium real policy rate) are based on model presented in Figure 2 of August 2024 Bank of Japan Working Paper Series No. 24-J-9 (available in Japanese) titled Shizen rishiritsu no keisoku wo meguru kinnen no doko ("Recent developments in the measurement of the natural interest rate"), by Yuu Sugioka, Shougo Nakano, and Hiroki Yamamoto.
(2) Real policy interest rate = [unsecured overnight call rate] – [y-y change in core-core CPI (excludes fresh food and energy)].
(3) Real policy interest rates for Jul–Sep 2024 onward are Nomura forecasts.
Source: BOJ, Nomura

Following the general election, the Takaichi administration's fiscal policy ("Sanaenomics") will shift to a longer-term vision

(1) Pre-election Sanaenomics

⇒ Focus on supporting household (voter) budgets and improving the Cabinet's approval rating in preparation for a future election

⇒ The market is somewhat wary of the sustainability of the administration's fiscal policy

⇒ Simultaneous sell-off of long-term JGBs and yen (the long-term interest rate rising concurrently with the weakening of the yen)

⇒ A break in the correlation between the USD-JPY exchange rate and the US-Japan interest rate gap

(2) Post-election Sanaenomics

⇒ Through the general election, Prime Minister Takaichi will truly become President of the Liberal Democratic Party (LDP)

⇒ PM Takaichi will solidify her position as Prime Minister and President of the LDP within the party, not just versus the opposition

⇒ The chances of her renewing her term as President of the LDP in September 2027 will rise

⇒ PM Takaichi may gain a foothold for focusing on her original medium- to long-term goals: "crisis management investment" and "growth investment"

(3) After the election, the USD-JPY exchange rate will return to its normal correlation with the US-Japan interest rate gap

⇒ A shift to a longer-term focus in fiscal policy will remedy some of the market's worries about its sustainability

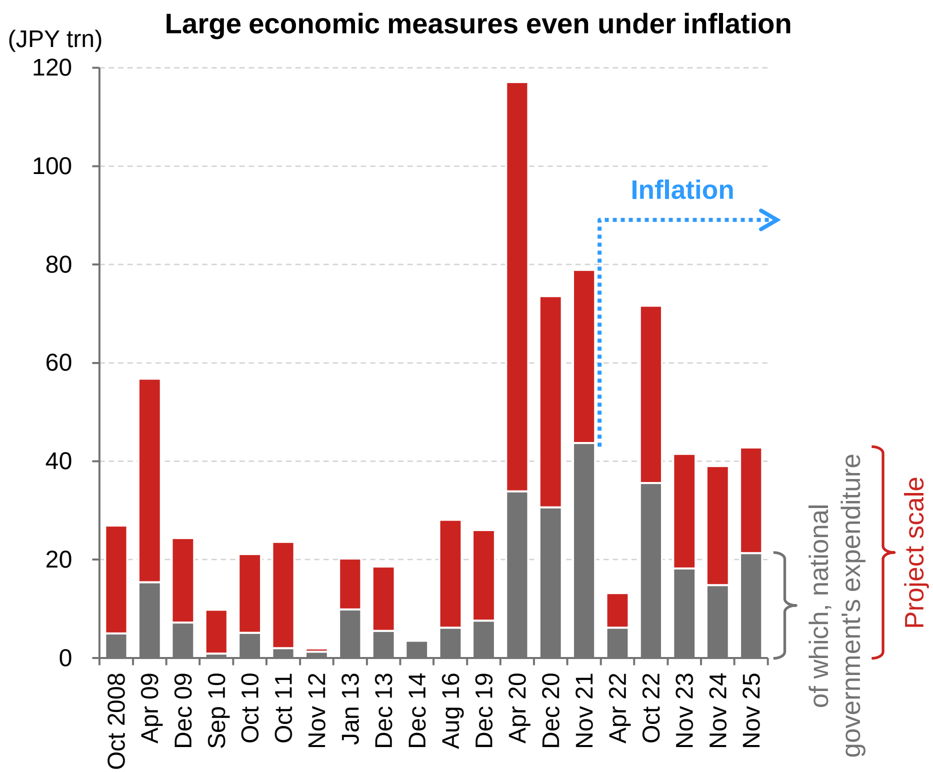
⇒ <u>The USD-JPY exchange rate will return to its normal correlation with the US-Japan interest rate gap</u>

⇒ Continued push for rate hikes by the BOJ and rate cuts by the FRB will strengthen the yen against the dollar in 2026

Fiscal policy (2):
Large economic packages adopted even under inflation

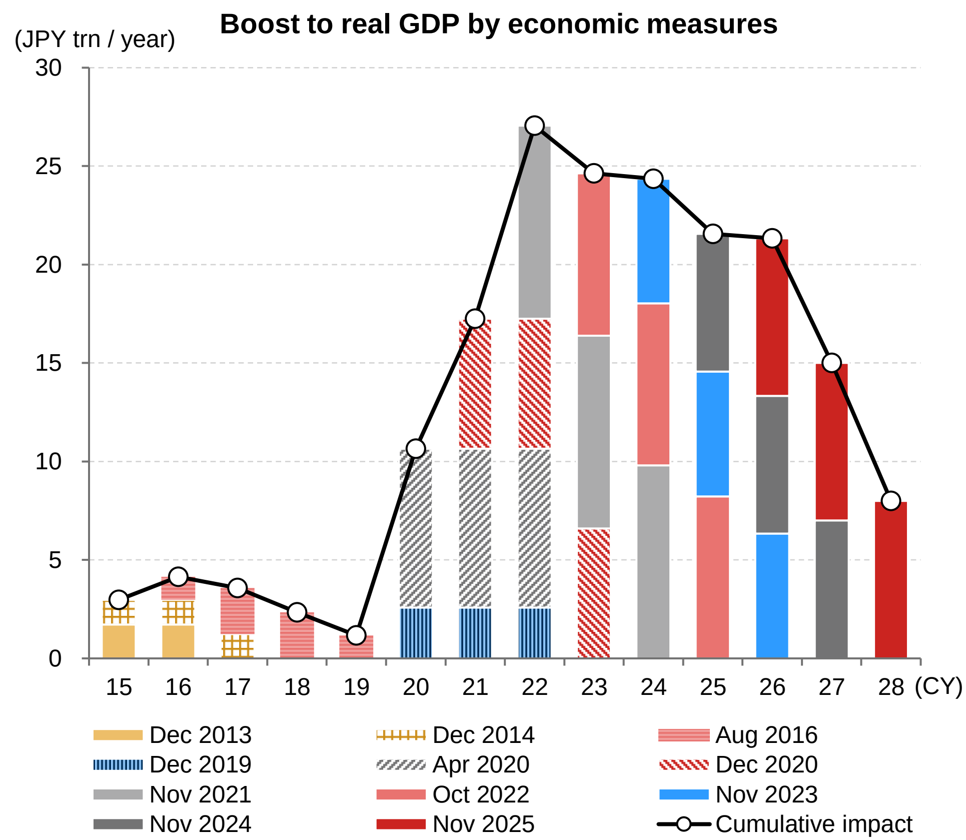
- **The Takaichi cabinet officially determined the first economic package on 21 November 2025, whose project scale amounts to JPY 42.8trn or 6.7% of GDP.**
- **Japan has adopted large economic packages even under inflation and with the output gap almost zero.**

Large economic packages even under inflation



Note: 1. The horizontal axis shows the timing of the cabinet decision of economic measures.
2. The 'project scale' other than expenses by the national government includes expenses by the local governments, Fiscal Investment and Loan Program (FILP) and private investment expected to be induced by economic measures.
Source: Cabinet Office, Nomura

Big push to real GDP

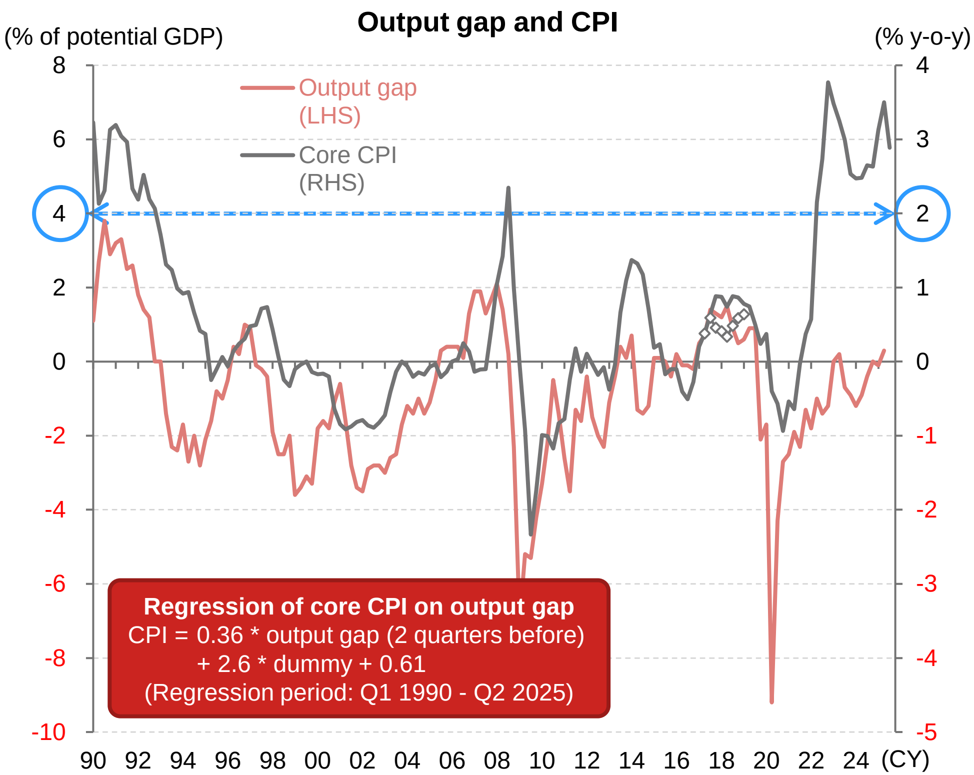


Note: 1. Each item shows the month when economic measures were officially determined.
2. The boost to real GDP of each economic measures is assumed to materialize over a three-year period.
Source: Cabinet Office, Nomura

Fiscal policy (3): Japan's output gap is already almost zero

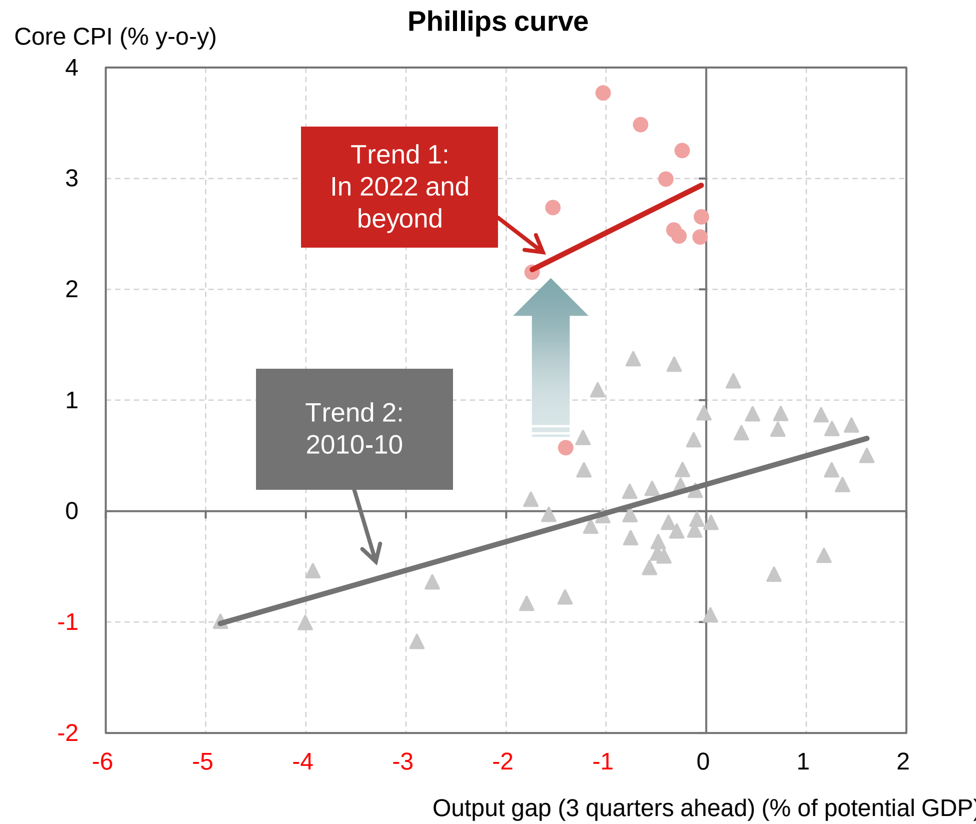
- Japan's output gap is almost zero by now, suggesting Japan needs to enhance not actual but potential GDP.
- Moreover, the Phillips curve suggests the intercept reflecting longer-term inflation expectations may have risen since 2022, further reducing the necessity to simply inject demand through fiscal policy.

Japan's output gap almost zero



Note: 1. The dummy variable is 1 in and after Q2 2022 and zero before that.
*2. Output gap (%) = (actual GDP – potential GDP) / potential GDP * 100.*
Source: Cabinet Office, MIC, Nomura

The Phillips curve may be shifting up



*Note: 1. Output gap (%) = (actual GDP – potential GDP) / potential GDP * 100.*
2. Core CPI is comprehensive CPI, excluding fresh food (and excluding the impact of consumption tax hikes) .
Source: Cabinet Office, Nomura

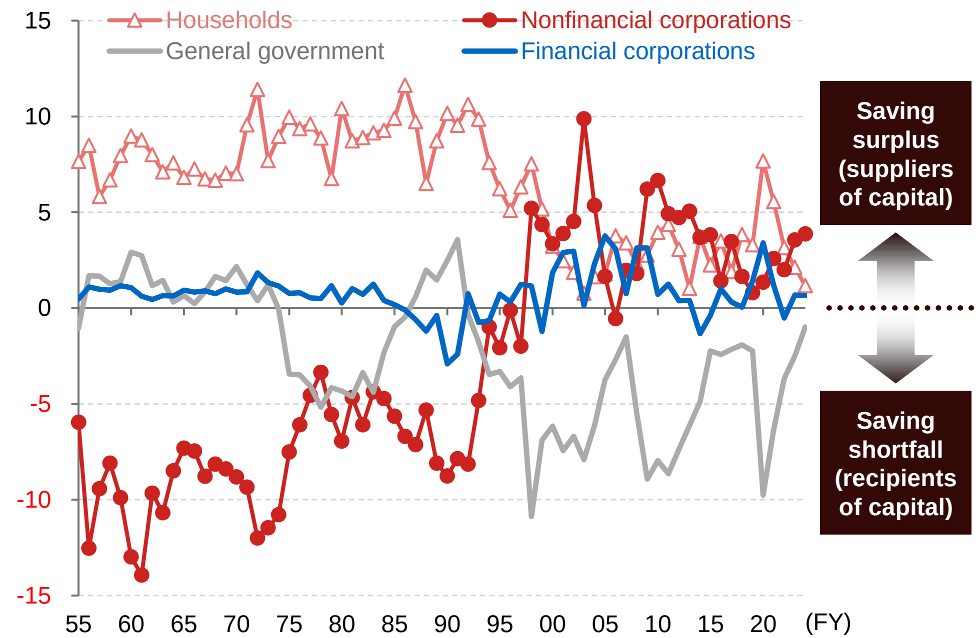
Fiscal policy (4): Will nonfinancial corporations move from a position of excess savings to a savings shortfall?

- **One of the arguments used to justify economic stimulus is the goal of encouraging non-financial corporations to move from excess savings toward a savings shortfall.**
  ⇒ Even in the US, companies often experience periods of excess savings.

Nonfinancial corporations have continued to hold on to excess savings since 1995

＜Japan＞

(as % of GDP) Balance of investment and saving by category

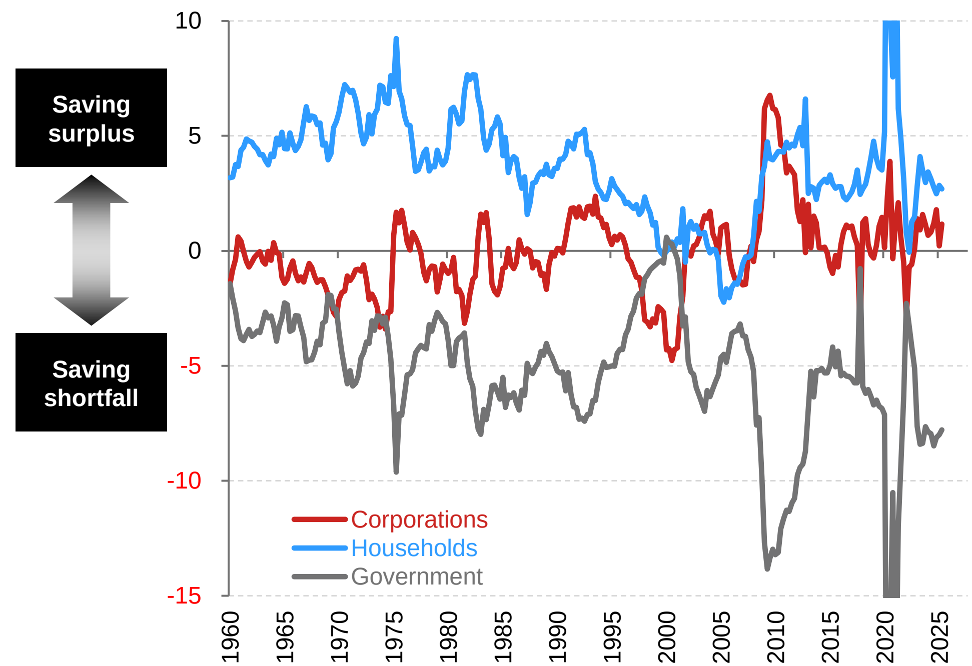


Notes: 1. Funding surpluses and deficits are illustrated based on the "National Accounts" until fiscal 1979 and on the "Flow of Funds" from fiscal 1980 onward. Shows financial surpluses and deficits are based on National Accounts of Japan through FY79 and the BOJ's Flow of Funds Accounts from FY80
2. General government comprises central government, local governments, and social security funds
Source: Nomura, based on Cabinet Office's National Accounts of Japan and BOJ's Flow of Funds Accounts data

Even in the US, companies frequently experience periods of excess savings

＜US＞

(as % of GDP) Balance of investment and saving by category

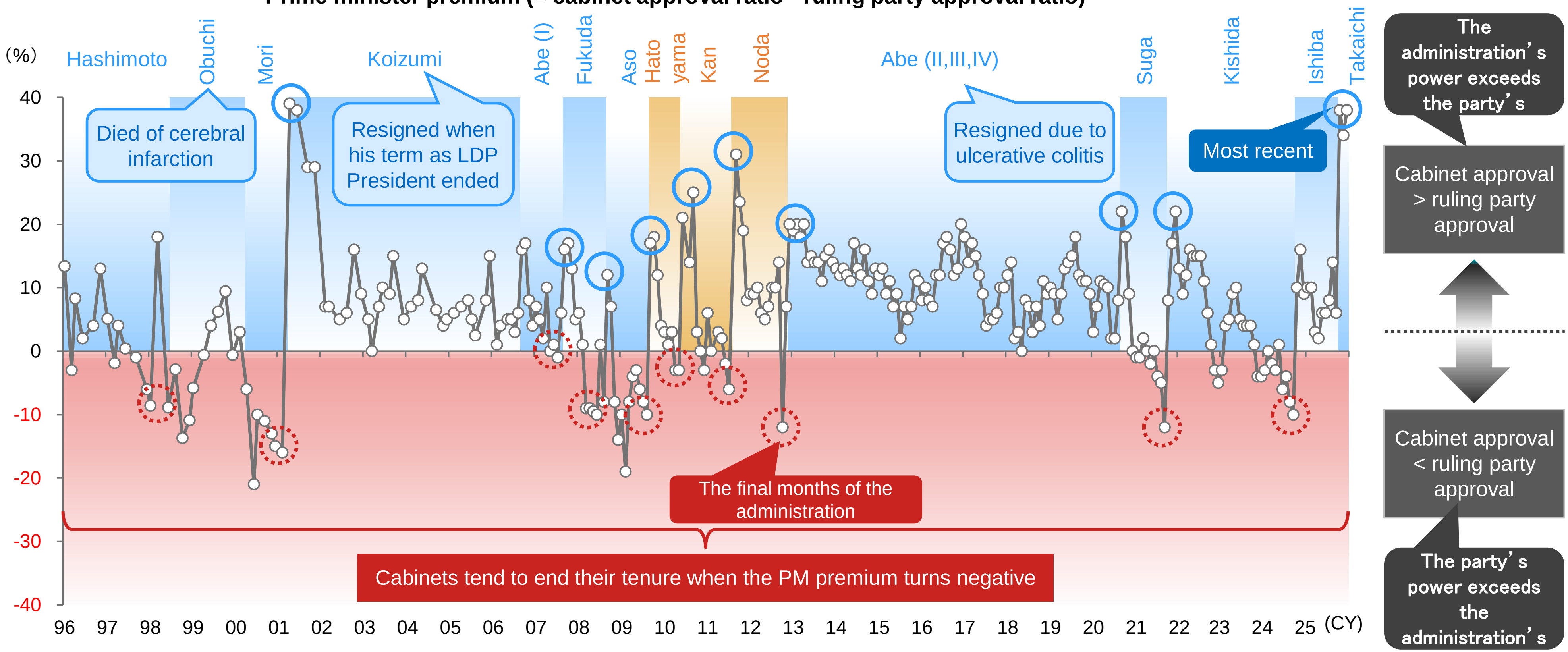


Source: Nomura, using BEA materials

Politics (1):The "Prime Minister premium" has skyrocketed under the Takaichi administration

- The **"Prime Minister premium"** can be used as an index to gauge the sustainability of an administration (premium = Cabinet approval rate - approval rate of the largest ruling party)
  ⇒ Following the Hashimoto Cabinet in the late 1990s, a turn to a negative premium has often signaled the end of that Cabinet (Excepting cases such as PMs Obuchi, Koizumi, and Abe, who left office due to unusual circumstances)

The Prime Minister premium of the Takaichi administration has reached the same heights as the early years of the Koizumi administration

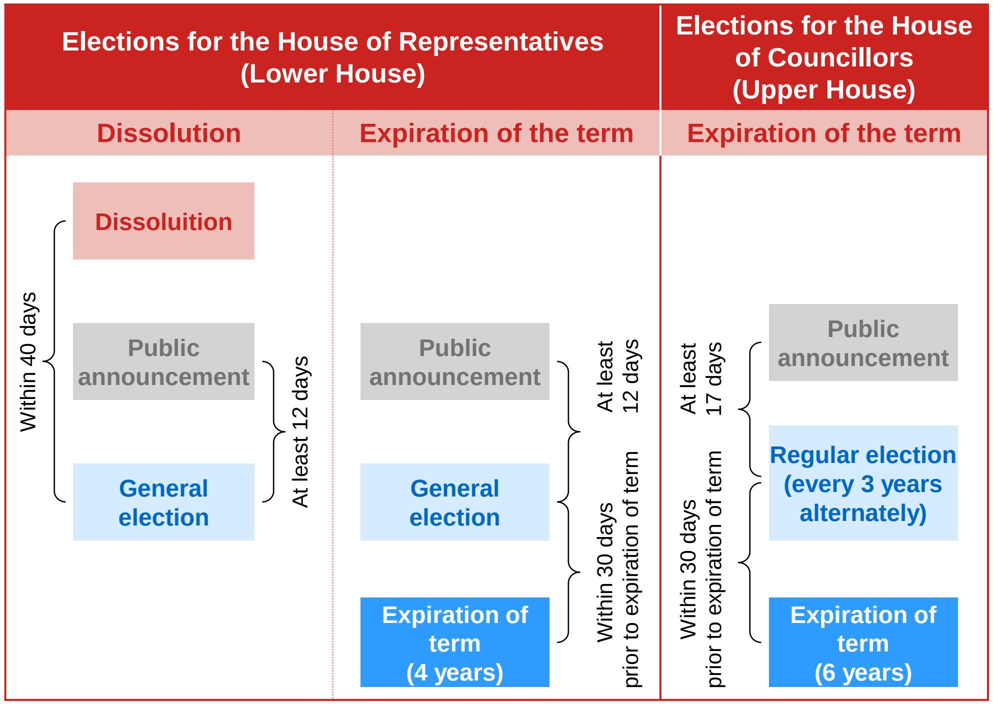


Note: The "Prime Minister premium" refers to the gap in approval rates between the Prime Minister's Cabinet and the largest ruling party (the Liberal Democratic Party in the case of a Liberal Democratic Party Cabinet, and the former Democratic Party of Japan in the case of a Democratic Party of Japan Cabinet)
Source: May 2024 Public Opinion Poll by The Nikkei, Nomura Securities

Politics (2):
Lower house dissolution never before June since 1992

- The opening of the ordinary Diet session was shifted to January in 1992. The lower house has never been dissolved before June since that year.
- Should PM Takaichi dissolve the lower house in April 2026, i.e., after the FY26 initial budget passes the Diet, it will be a rare case.

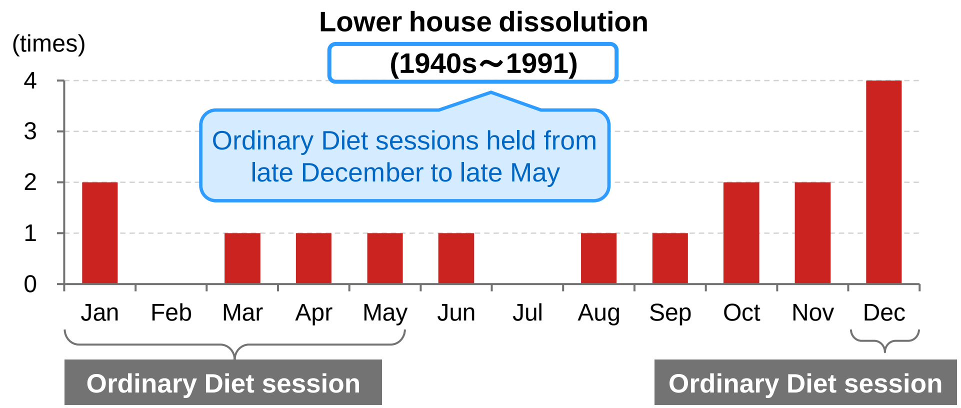
A snap election held within 40days after lower house dissolution

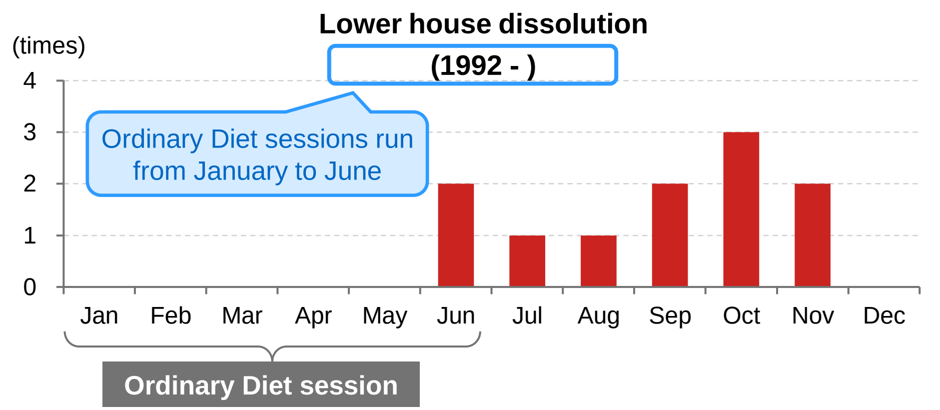


Note: 1. The Public Offices Election Act requires that general elections (elections for the House of Representatives, or the lower house) following the expiration of the term be held (1) within 30 days prior to the expiration of the term or (2) at least 24 days after but within 30 days from the closing of the Diet session if the date specified in (1) falls on the period of the Diet session or within 23 days from the closing thereof and that general elections in the case of the dissolution of the House be held within 40 days from the dissolution.
2. The Public Offices Election Act requires that regular elections (elections for the House of Councillors) be held (1) within 30 days prior to the expiration of the term or (2) at least 24 days after but within 30 days from the closing of the Diet session if the date specified in (1) falls on the period of the Diet session or within 23 days from the closing thereof.

Source: House of Representatives, House of Councillors, Liberal Democratic Party, Nomura

Lower house dissolution never before June since 1992





Source: House of Representatives, Nomura

Author Biography

Kyohei Morita

Chief Economist

As Nomura's Chief Economist, Kyohei Morita analyzes macroeconomic trends across countries and regions, and financial markets across asset classes, to predict what lies ahead for Japan's economy. He is particularly well-versed in monetary policy, having written on the subject for his doctoral thesis; he received his PhD in Economics from Kyushu University in 2018.

Since joining Nomura Research Institute in 1994, he has been engaged in macroeconomic analysis and forecasting. He was at the UK head office of Nomura Research Institute Europe from 2001 to 2004, providing in-depth analysis and forecasts of the Japanese economy for Japanese equities investors in the UK, continental Europe, and the Middle East. During this period, he had opportunities to visit some 500 investors each year. Over the next 14 years, he served as Chief Economist at Barclays Securities (2008-2017) and Credit Agricole (2017-2022). He became Chief Economist at Nomura Securities in 2022.

After graduating from Kyushu University School of Economics in 1994, Kyohei continued his studies at the Graduate School of Brown University from 1998-2000, earning a Master's Degree in Economics. As non-traditional monetary policy came to be adopted around the world, he began work on a doctoral thesis to deepen his understanding of the theoretical and historical underpinnings, culminating in "A Consideration of Monetary Policies Under Low Natural Interest Rates." He received his doctoral degree in economics from Kyushu University in 2018.

As an economist, Kyohei focuses on (1) data analysis that is detailed but easy to understand, (2) generating global, rather than local, economic scenarios, and (3) central bank watching based on meticulous data analysis. Institutional investors have appreciated his insights: thanks to their votes, Kyohei placed second among economists ranked by Nikkei Veritas in 2024.

Kyohei has also contributed to books on economic issues: Asset Formation in an Age of Population Decline (Toyo Keizai, 2005) and Modern Financial Theory, new ed. (Yuhikaku, 2016). He is a frequent guest on the TV Tokyo program, News Morning Satellite, and contributes regularly to Deep Dive into Market Topics by Top Economic Analysts on Diamond Online

Appendix A-1

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