Japan Economic Outlook, Q4 2026: Tightening into an Imported Shock

Global Strategy Files, October 31, 2026

1. Verdict: tightening into an imported shock

The Bank of Japan is raising rates into a shock it did not create: an oil-and-yen surge has pushed import prices up 24.5% and producer prices up 6.8%, but shop prices carry only one-seventh of it, services inflation is 1.5% against 3.8% pay growth (August), and real GDP is growing 0.9% a year. Policy at 1.25% is defensible on a rule-based benchmark. The case for going much further in 2027 rests on a wage-price loop that the data do not yet show.

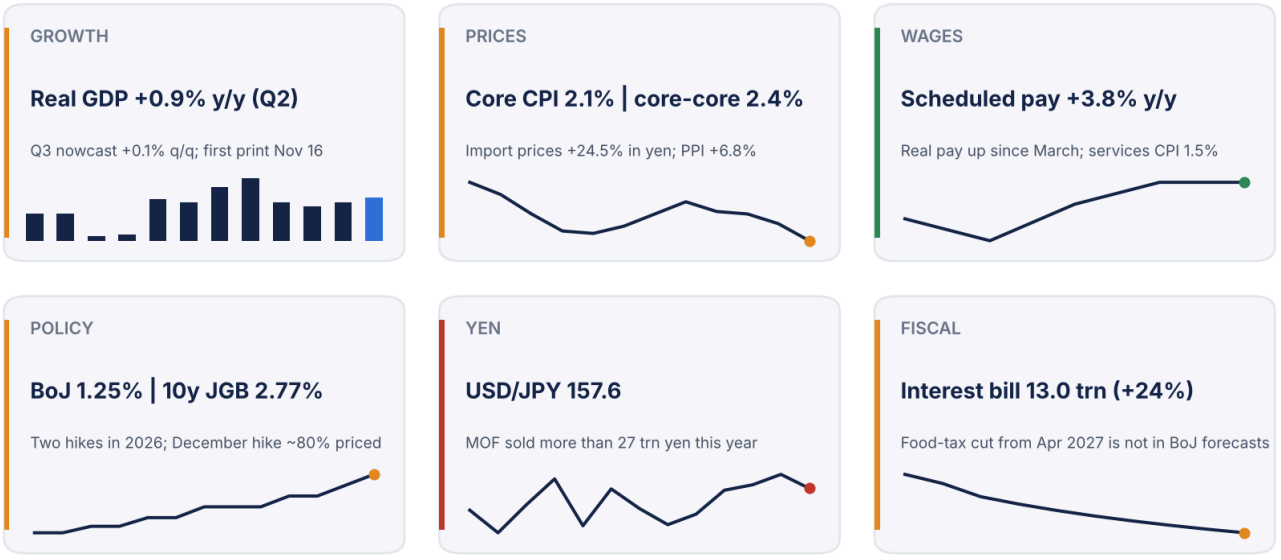


Figure 1. Cockpit, as of October 31, 2026.

Our five calls:

- **Growth stays near 1%, with a statistical lift in Q3.** The first Q3 print (Nov 16) is more likely weakly positive than negative, but a contraction is far from ruled out: we nowcast +0.1% q/q (5-95%: -0.25 to +0.46), a 31% chance of contraction. The year-on-year rate still jumps to about 1.3%, because the -0.4% quarter of Q3 2025 drops out of the comparison.
- **The inflation shock fades faster than the BoJ projects.** Our core CPI (ex fresh food) averages 1.85% in 2027 before any tax change, against 2.6% in the BoJ's fiscal-2027 median. The BoJ's own median excludes the food consumption-tax cut planned for

April 2027; if enacted (we put 70%), it would take about 1.3 points off core CPI once in force (from April), or about 0.9 point off the calendar-2027 average, pulling it to roughly 1.0%.

- **A December hike to 1.50% is our modal call** (the three scenarios that hike in December carry 85% of our judgmental weight; markets price about 80%). We end 2027 at 1.75% (scenario range 1.50-2.25%), the median of twelve broker forecasts, but for different reasons: we see inflation fading, and the hikes as insurance against yen weakness.
- **The debt arithmetic is a growth question, not a yield question.** The effective interest rate on government debt rises from 1.15% to about 2.2% by 2030. With 3% nominal growth, debt falls to 167-171% of GDP by FY2035; at 2% growth and a 10-year yield of 3.5-4.0%, it stops falling at about 179-180% by FY2030 and drifts back up to 183-187% by FY2035. The 167-171% range covers yields of 3.0-3.5% only; 4.0% with 3% growth gives 174%.
- **The yen is the swing variable.** USD/JPY is 157.6 after more than 27 trillion yen of intervention; our scenarios put it between 146 and 164 at end-2027.

Indicator	Latest	2026	2027	Reference points
Real GDP, % (calendar year)	+0.9 y/y (Q2)	0.9 (0.8-1.1)	0.7 (-0.1 to 1.4)	IMF 0.7 / 0.7; OECD 0.8 / 0.7
Q3'26 real GDP, % q/q (first print)	n/a	+0.1 (-0.12 to +0.33)	n/a	Consensus about 0.0-0.1
Core CPI, ex fresh food, year average, %	2.1 (Sep)	1.85 (1.8-1.9)	1.85 (1.7-2.0) before tax cut; 1.0 (0.7-1.9) with it	BoJ (fiscal years) 2.5 / 2.6
Core-core CPI, ex fresh food and energy, %	2.4 (Sep)	2.2	2.25 (2.1-2.4)	BoJ (fiscal years) 2.4 / 2.7
BoJ policy rate, year-end, %	1.25	1.50	1.75 (1.50-2.25)	Broker median 1.75; Dai-ichi 2.0
10-year JGB yield, year-end, %	2.77 (Oct 30)	2.9	3.0 (2.6-3.7)	Highest close since Aug 3: 3.105 (Oct 7); intraday 3.12 (Oct 1)
USD/JPY, quarterly average	157.6	157 (Q4)	153 (Q4'27)	Cabinet Office assumes 161
Brent, USD per barrel	Q3 avg 96	106 (Q4)	79 (Q4'27)	EIA 105 / 74

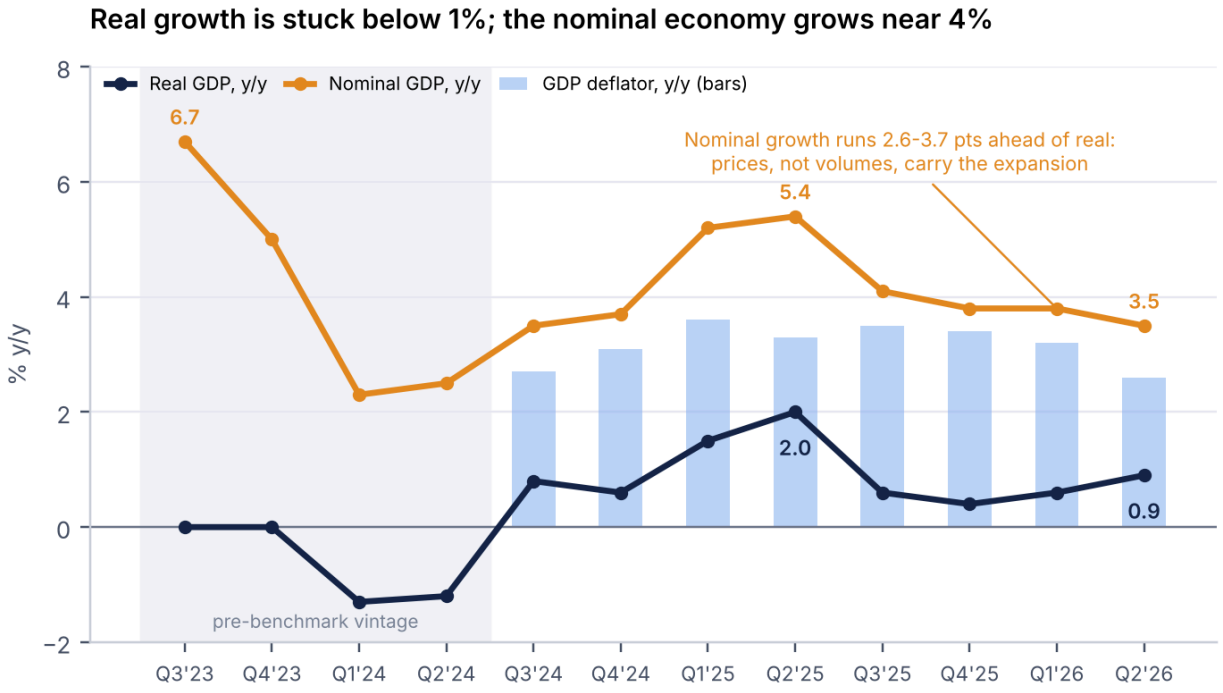
Table 1. Forecast summary. Ranges are 15-85% bands pooled across four scenarios (weights are our judgment; see section 8). Core CPI and core-core are calendar-year averages; BoJ figures are fiscal-year medians (Oct 30 Outlook). The 2026 core figures include a simulated Q4. Scenario ranges for the policy rate and the yield are the spread across scenarios, not statistical bands.

What would change the call: a Q3 GDP print below -0.12% or above +0.33% (our 15th and 85th percentiles), October core-core CPI at 2.6% or more (Nov 20), September scheduled pay below 3.3% (early November), the 10-year JGB above 3.2%, or USD/JPY above 164. Section 9 lists the dates.

2. Growth: nominal strength, real stagnation

Japan's economy is growing 3.5% a year in yen but 0.9% in volume, and the 2.6-point gap is the GDP deflator. Nominal GDP has grown between 2.3% and 6.7% year on year over the last twelve quarters; real GDP has stayed between -1.3% and +2.0%. The deflator

has slowed from 3.5% in Q3'25 to 2.6% in Q2'26, even as import prices rose by a quarter. Part of that slowdown is consistent with a terms-of-trade loss (the deflator measures domestic output prices net of imports, so a dearer oil bill lowers it), but most of it predates the oil shock.



Sources: Cabinet Office, Statistics Bureau, MOF, BoJ, EIA, JNTO, IMF (Oct 30, 2026 vintage); Global Strategy Files models. Q1'26 deflator derived from nominal and real growth (official print missing); Q3'23-Q2'24 predate the Dec-2025 benchmark revision.

Figure 2. Real and nominal GDP growth, Q3'23-Q2'26.

Q2's +0.4% q/q came from inventories and from imports falling, not from demand. Net exports added 0.5 points (exports +0.4% q/q contributed 0.1; imports -1.7% contributed 0.4), inventories 0.3. Consumption and housing added nothing, business capex took off 0.2 (-0.9% q/q) and public demand 0.2. The import drop coincides with the collapse in crude volumes during the Hormuz closure (18.0 million kl in Q2 against 33.6 million a year earlier), a boost that reverses as volumes recover; in Q3 they were back at 34.9 million.

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Japan Economic Outlook Q4 2026

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