FX & Rates	4Q24F	1Q25F	2Q25F	3Q25F
USD/JPY	141	138	135	133
JPY Policy Rate	0.50	0.50	0.50	0.50
Economic Indicator	**2022**	**2023**	**2024F**	**2025F**
GDP (%)	1.2	1.7	0.2	1.7
CPI (avg y/y %)	2.5	3.2	2.6	1.8
Unemployment Rate (%)	2.7	2.4	2.8	2.8
Current Account (% of GDP)	1.9	1.5	2.5	2.3
Fiscal Balance, FY (% of GDP)	-13.2	-6.0	-5.0	-4.5

ECONOMY

Growth rebound to extend into 2H with downside risks

2Q24 GDP growth rebounded but the extent of the recovery was revised lower to 2.9% q/q SAAR (from prelim 3.1%) as the rebound in private consumption (0.9% q/q from prelim 1.0%) and business spending (0.8% q/q from prelim 0.9%) were revised. Rises in residential investment (1.7%) and public investments (4.1%) supported 2Q growth, offsetting the drags from net exports (-0.1ppt) and net private inventories (-0.1ppt). 1Q's contraction was revised to -2.4% (previous: -2.3%). When compared to one year ago, Japan's GDP contracted by -1.0% y/y in 2Q after declining by -0.9% y/y in 1Q, the first back-to-back outright y/y contraction since the Covid-19 pandemic. Prior to the contraction, Japan's GDP recorded 11 straight quarters of y/y expansion between 2Q21 and 4Q23. In real terms, the economy expanded to JPY 558.1 tn in 2Q (from JPY 554.1 tn in 1Q), highest since post-pandemic peak of JPY 563.3 tn (in 3Q23).

We expect Japan's growth trajectory to extend into 2H, supported by the wage-induced consumption recovery. Continued influx of tourists and the positive impact on the tourism-related in-person services will also anchor the domestic growth outlook together with the loosening of monetary conditions in the international markets, and Japanese manufacturers reaping the benefits from the electronics upcycle. Recent accelerated investments into semiconductor technology and production will bode well for its long-term potential and may lead to a bump up in investments spending in the upcoming quarters though not likely to add much to near-term production. That said, the downside factors still loomed large including resumption of weak domestic demand, the extent of global and China growth slowdown, the tighter monetary stance from Bank of Japan (BOJ) and the sharp strengthening of the yen.

Despite 2Q's rebound, it should be noted the back-to-back y/y decline in 1H is material (-0.9% y/y) and will negatively affect the full year growth outturn even though we priced in a reasonably strong sequential growth trajectory in 2H. As a result, we downgrade our 2024 GDP growth forecast to 0.2% (2023: 1.9%), before picking up pace to 1.7% for 2025.

CPI inflation rose 3.0% y/y in Aug (My-Jul: 2.8%) fastest pace so far in 2024 while core CPI (excluding fresh food) steadily edged higher to 2.8% y/y in Aug (from Apr's low of 2.2%). Core-core CPI (excluding fresh food, energy) returned to 2.0% y/y (after briefly easing to 1.9% y/y in Jul). Services prices rose by 1.4% y/y in Aug (same pace as Jul). The BOJ projected (in Jul Bank View) that risks to prices are skewed to the upside for FY2024 and FY2025. We have upgraded our headline and core CPI to average 2.6% for 2024 (from 2.4% and 2.3).

Politics: A new Prime Minister in Oct. In mid-Aug, PM Kishida announced he will not be running for the presidency for the Liberal Democrat Party (LDP) – the ruling party that controls the Japanese parliament – effectively stepping down as PM at end-Sep. Campaign for the LDP presidency started on 12 Sep with 9 lawmakers contesting the 27 Sep election. The winner is voted by LDP's rank-and-file, and the public does not vote on this. We think 43-year-old Shinjiro Koizumi, the son of a former PM, may emerge victorious. Political stability and continuity is assumed, with a supplementary budget being eyed by end-2024, providing some uplift to growth.

CENTRAL BANK

Normalisation path more measured & cautiously

The BOJ kept its policy rate unchanged at 0.25% in its Sep meeting as widely expected. The first increase in consumption spending in 2Q after 1 year of y/y declines is seen as a strong signal that wage growth is translating to increase in spending while the higher Aug CPI inflation prints further affirmed the underlying price trends. Both factors should boost the BOJ's confidence to stay on its path for monetary policy normalisation. But the volatile market response to its Jul rate hike imply that the central bank will tread carefully before raising rates again so soon. We continue to expect the BOJ to stay on the rate tightening trajectory although it may not be a continuous cycle and likely to be a limited normalisation path. We expect BOJ to resume normalisation in 4Q 24 (likely the Oct MPM), via a 25-bps hike to 0.50% which we believe will be the terminal rate. This path will also be subject to further CPI forecasts changes in the subsequent MPMs.

CURRENCY

JPY to gain further

Notwithstanding the 12% plunge in 3Q24, USD/JPY is still biased to further downside, albeit at a more gradual pace as a large portion of the speculative JPY carry trade may have already been unwound across late Jul to early Aug. Monetary policy divergence between the Fed (easing bias) and the BOJ (tightening bias) anchors our existing view of further weakness in USD/JPY in the coming quarters. Overall, our updated USD/JPY forecasts are now at 141 in 4Q24, 138 in 1Q25, 135 in 2Q25 and 133 in 3Q25.

At this juncture, we highlight two risks that may drive a steeper decline in USD/JPY compared to our current forecasts. The first is the return of the JPY as a safe-haven currency if US conditions worsen to a recession rather than our base case of a soft landing. The second is a material shift in the behavior of Japanese life insurers where they repatriate or increase the hedge ratio of their US assets.