2026 WORLD ECONOMIC AND FINANCIAL CONDITIONS AND JAPAN

SAYURI SHIRAI
PROF. KEIO UNIVERSITY

Official Website URL: http://www.sayurishirai.jp/

Structure of Presentation

Part 1

- Trends in the Global and Japanese Economies

Part 2

- Trends in Monetary Policy, Prices, and Exchange Rates — A Japan–U.S. Comparison

Part 1.
Trends in the Global and Japan’s Economies

Key Developments in 2025

US	Euro Zone
Impact of tariff policies remain limited on consumption and prices	Germany relaxed its fiscal rule. EU excluded defense spending up to 1.5% from fiscal rule (NATO members 3.5%＋infrastructure/software 1.5% commitment)
Growth rate: around 2.3%（Q3: 4.3%） Inflation rate: 2.7%（Dec. 2.7%）	Growth rate: around 1.4% Inflation rate: 2% (Dec. 2%
2024 2.8% 3.0%	2024 0.9% 2.3%
Stock prices overvalued（AI、strong earnings 、Fed rate cuts), US dollar remained stable after a decline in January-April	Stock prices overvalued, euro remained stable since July after an appreciation

Uncertain US Economic Policies

Changing tariff policies

- (As of Nov.) Effective tariff rates 16.8%, 14.4% including substitution, 12% including import decline)
- Aluminum and steel tariffs uniformly set at 50%
- ITC products remain duty-free or low-tariffs under WTO
- For Japan, South Korea, and the EU, tariffs capped at a maximum of 15%

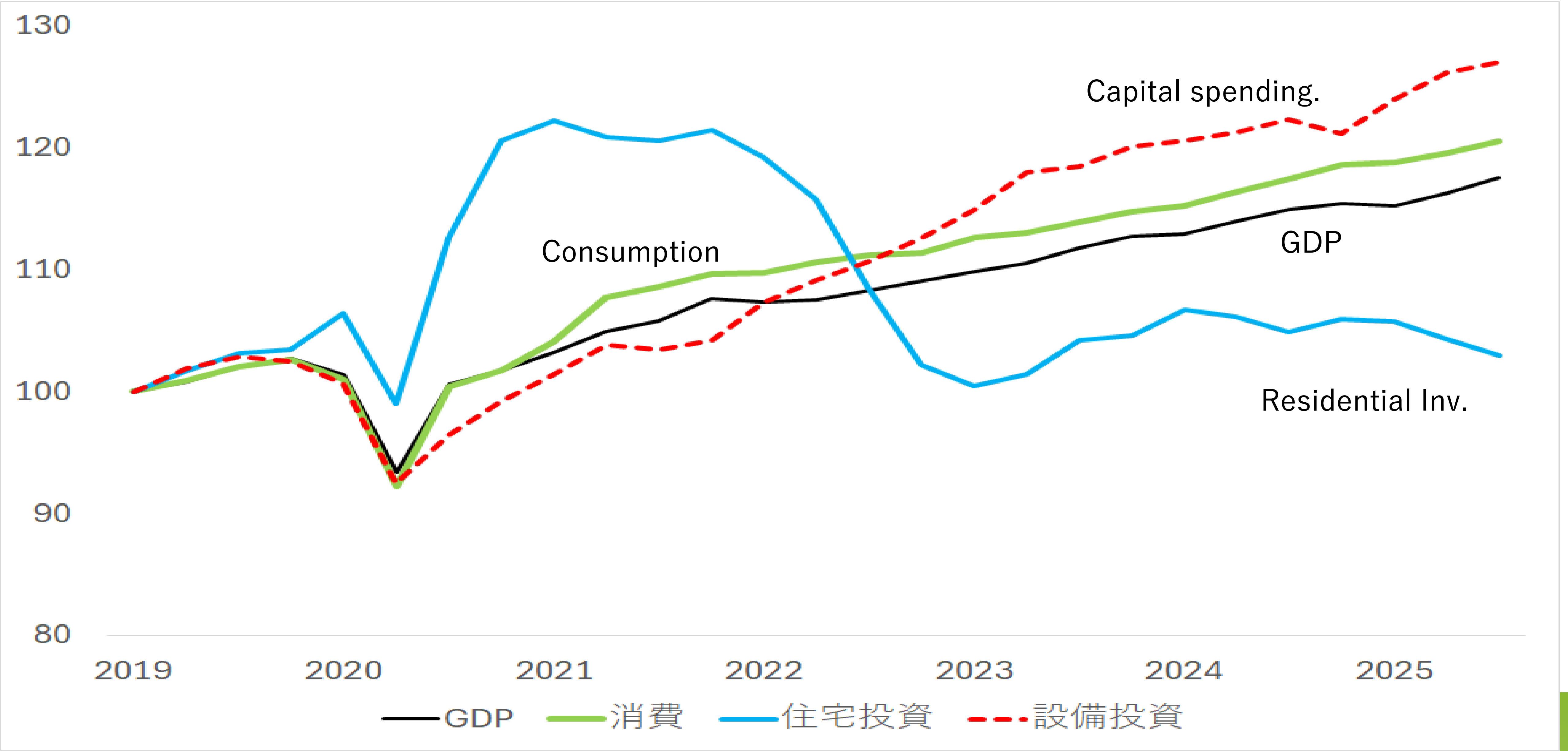
Immigration Policies

- Stronger enforcement. expansion of forced deportations
- Tighter entry control systems for people coming from certain countries
- Labor-intensive industries face labor shortages

FRB Rate Cuts

- Concerns about independence
- Inflation remain above 2%, but services inflation remain higher
- Economic growth remains strong, but the labor market is showing mixed signs

US：Real GDP and Demand Components



Key Developments in 2025

Japan

Due to U.S. tariff policies, exports and production have declined in August, since then exports recovered.

Growth rate: slightly above 1%

Inflation rate: around 3.2%

2024
minus0.2%
2.7%

USD/JPY shifted from 158 yen in early January to the 140-yen range. The yen depreciated gain since October. Stock prices overvalued

China

Exports to the U.S. decreased, while exports to third-country markets are recovering.

The property slump continues, domestic demand remains weak, and production and exports are active.

Growth rate: around 5%

Inflation rate: around 0%

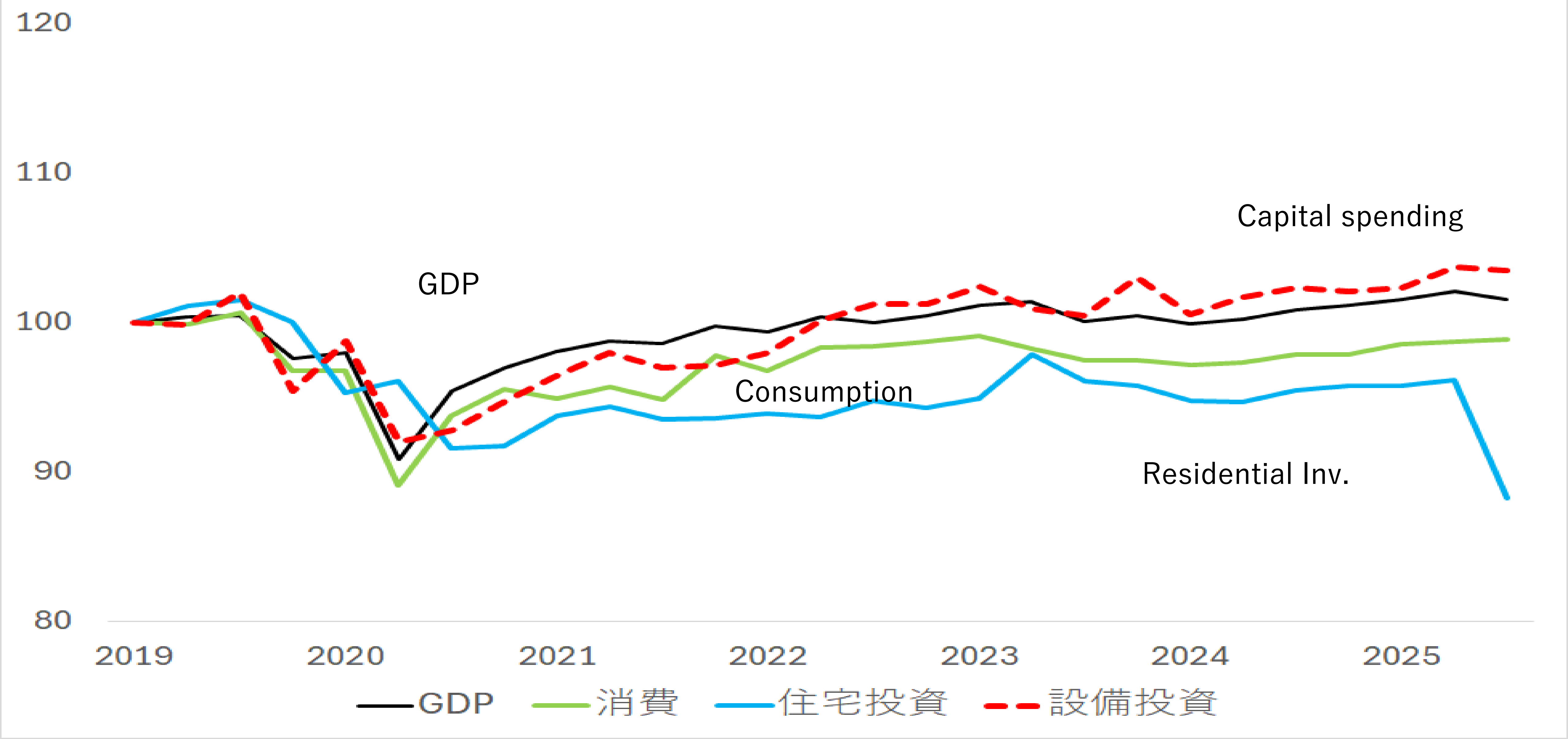
2024
5%
0.2%

The yuan around 7 yuan per U.S. dollar.

From June onward, expectations of easing U.S.–China tensions have supported a stronger yuan.

Stock prices have been trending upward since September.

Japan：Real GDPとDomestic Component



Economic Outlook for 202

Overall outlook: After the upside surprise in 2025, economic growth in 2026 will slow moderately.

- **United States: C**onsumption, and AI-related investment will continue to support the economy. Fiscal spending and corporate investment will also continue, but the pace of growth will gradually settle down.
- **Euro Area:** Defense and industrial investment will expand, while spending in other sectors will become more selective. Growth will be moderate, with clearer differentiation among countries.

Japan: Wage increases will continue, but productivity gains will remain limited overall. Price pass-through and cost increases will coexist, and growth will be confined to a moderate recovery.

China: In manufacturing, adjustments to overcapacity and restructuring will continue. Public investment and exports will provide support

	2025	2026
US	Around 2%	Around 2%
Euro Zone	Around 1.4%	Around 1%
Japan	Around 1 %	Around 0.8%
China	Around 5%	Around 4.5%

Major Risks in 2026

Japan

- Continued yen weakness and persistent cost-push inflation
- Labor shortages constraining economic growth
- Fiscal concerns and delays in structural reform
- Heightened tensions in Japan–China relations

US

- US foreign policies (Iran, Venezuela, etc.)
- Fiscal expansion and instability in the government bond market
- Political pressure on the Federal Reserve and the pace of rate cuts
- Trade and industrial policy developments

Part 2.
Trends in Monetary Policy, Prices, and Exchange Rates
- A Japan–U.S. Comparison-

US and Japan: Inflation Dynamics

US

- Inflation(CPI):2.7% (excluding food and energy:2.6%)
- Underlying inflation remain relatively strong (Services inflation 3%)
- Wage growth rate :3.8%(real 1%)

Japan

- Inflation:2. 9% (exc. fresh food 3、exc. food and energy 1.6%)
- Underlying inflation remain weak (Services inflation 1.6%)
- Wage growth 0.5% (Real -2.4%)

Tariff Increases and Inflation in US

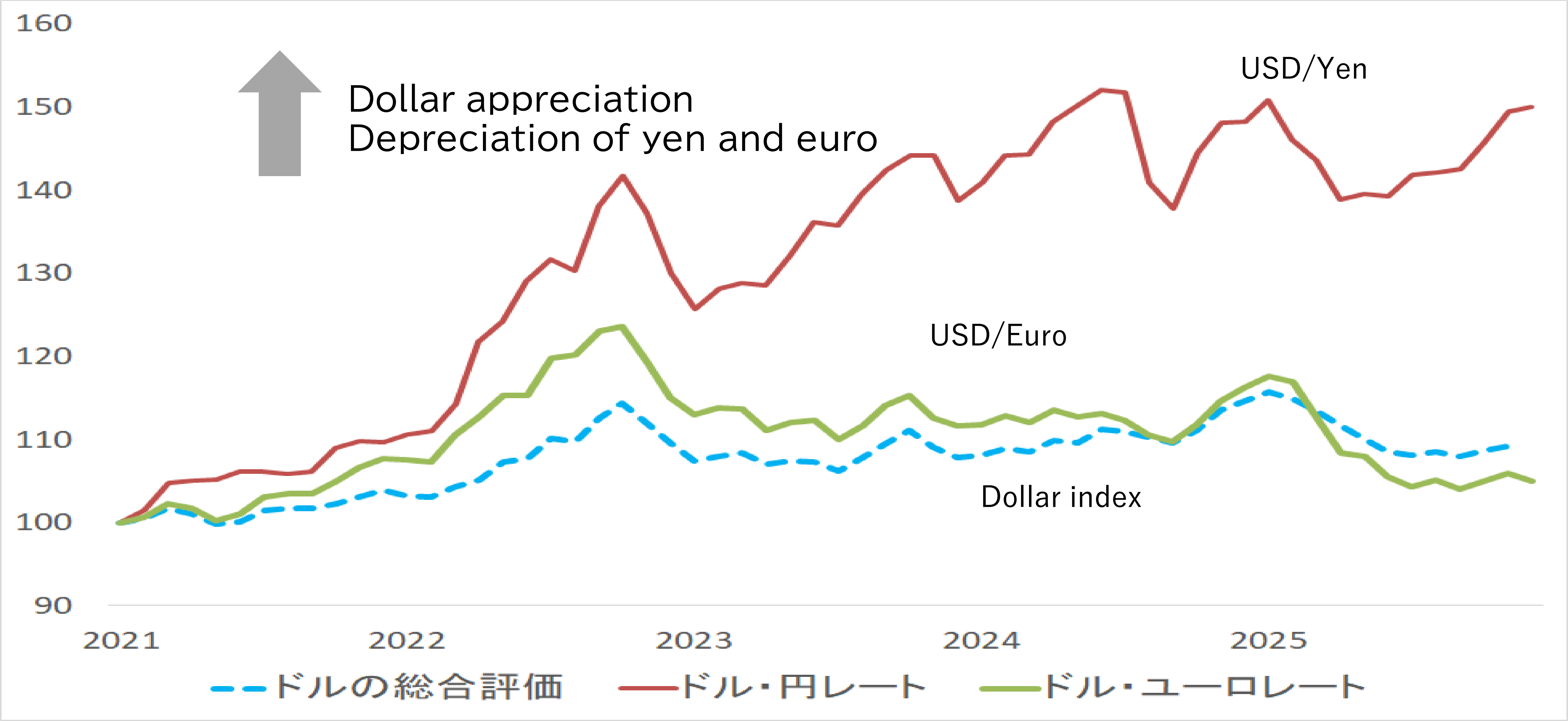
Trump's position: The burden of tariff costs borne mainly by foreign companies.

Goldman Sachs analysis (mid-October): Tariff costs are shared among U.S. consumers, U.S. and foreign firms *(estimated ranges)*

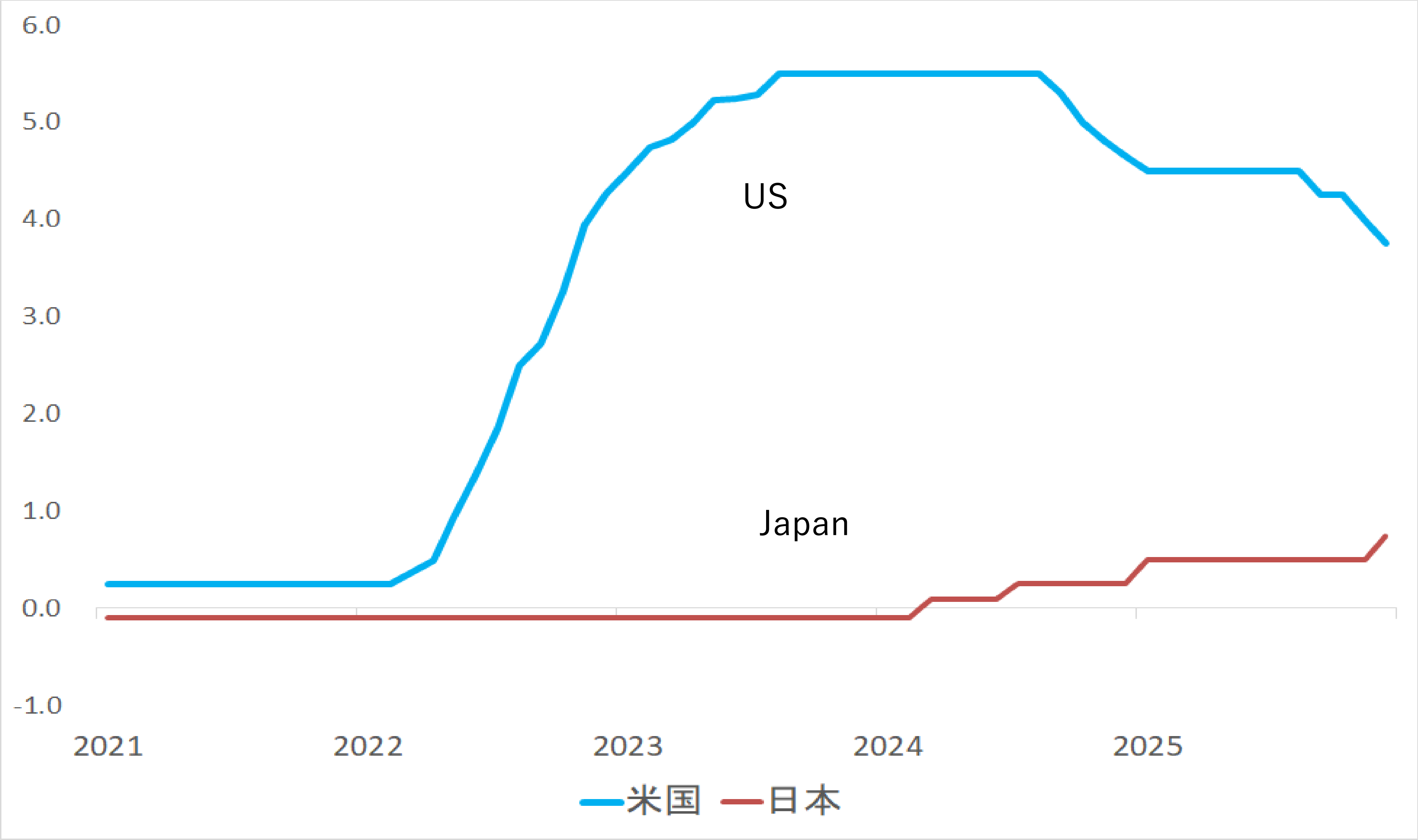
- **US consumers: 40–60%** (part of the costs passed through to prices)
- **U.S. firms: 20–30%** (absorbed through profit-margin compression)
- **Foreign exporters: 10–20%** (price reductions and negotiation effects)

As of 2025, the main drivers of inflation are **domestic service prices** such as housing and medical care. **Tariffs are not the primary source of inflation**

Main Exchange Rate Developments



Policy Rates in Japan and US

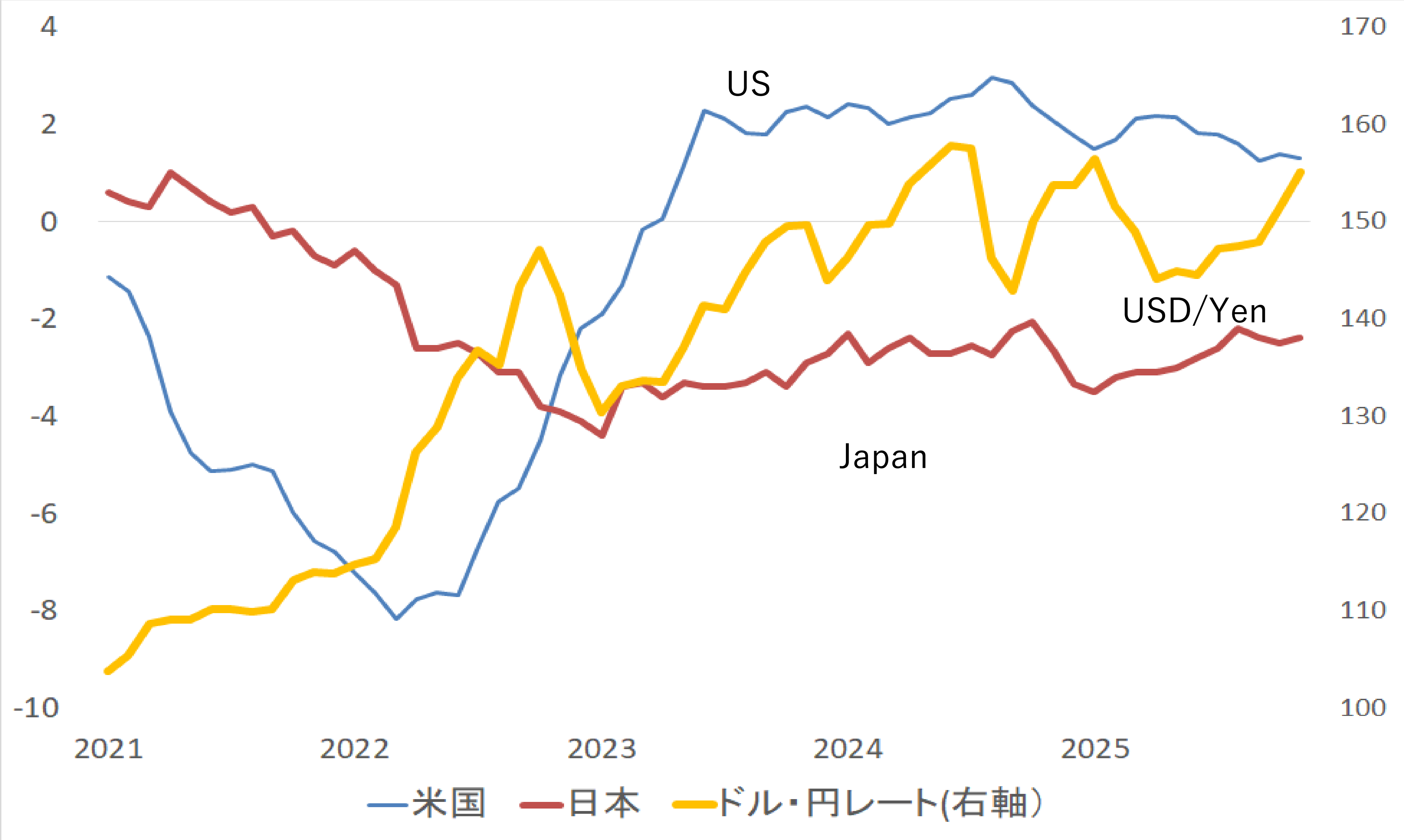


Now:3.5−3.75%
End-2026:around 3−3.25%？

Now:0.75%
End-2026: around 1.25%？

Gaps: from 3% to 2%

Real Policy Rates in Japan and US

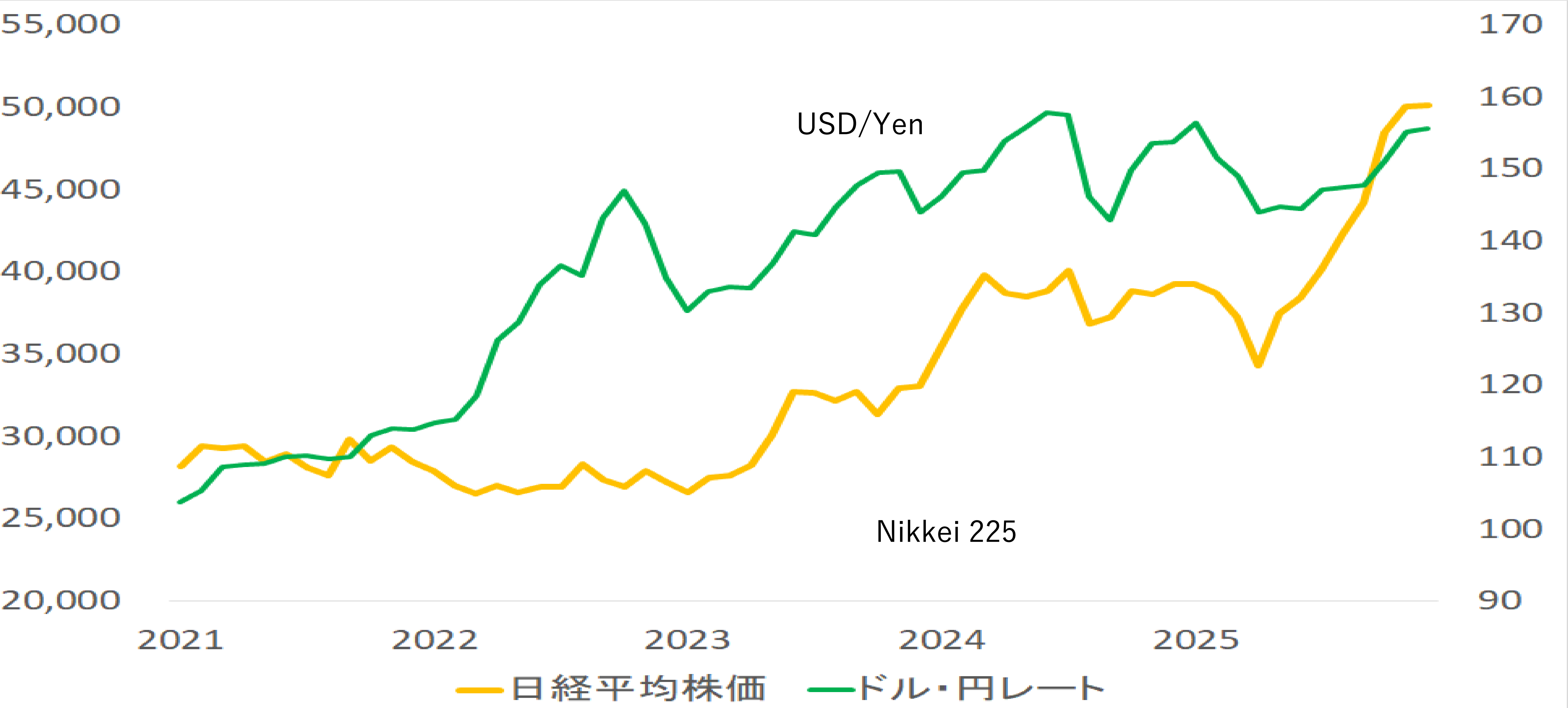


Now:1%
<u>End-2026</u>: Around 0.5~0.75%？

Now:−2.15%
<u>End-2026:</u> Around −0.5%？

Gap:from 3% to 1%?

USD/Yen and Japan’s Stock Prices



Outlook for FRB’s Monetary Policy

- **Market outlook**: Markets expect about two rate cuts in 2026, with the policy rate falling to around 3.0–3.25%
- **FOMC (December dot-plot median)**: Indicates about one rate cut in 2026.
- **Assumption for the long-term policy rate**: The FOMC’s long-run median estimate for the federal funds rate is about 3% (nominal). Assuming the 2% inflation target, this implies a real neutral interest rate (r*) of roughly 1%.
- **Assessment of the current interest-rate level**: Policy rate: 3.5–3.75%, Inflation (CPI): 2.7% → Real rate ≈ +1%
- **Current monetary conditions**: neutral or slightly tight

•**Price environment**: Inflation in 2026 is expected to remain in the upper 2% range. Service prices and wages remain firm, and the economy is resilient.

•**Risk of easing too quickly**: If the Fed cuts rates too rapidly, financial conditions may ease, creating a risk of rekindling inflationary pressures.

•**Current policy stance**: “Data-dependent, cautious rate cuts.”

•**Personnel factor**: Chair Powell’s term runs until May 15.

•**Successor outlook**: The announcement is expected in January
(the new chair would take office after Powell’s term expires).
If the new leadership leans more toward rate cuts,there is a possibility of a stronger easing bias, which could increase the risk of an inflation overshoot and market instability

Outlook for BOJ’s Monetary Policy

- **Baseline scenario**：The BOJ will maintain a very gradual normalization policy.
- **Assessment of the current interest-rate level**: Policy rate 0.75%, inflation 2.9% → Real rate is around –2%, but inflation is mainly cost-push. Inflation in 2026 is expected to decline to around 2%. Wage growth may slow, and the recovery in household consumption will be limited
- **Policy judgement priorities:**
  - Preventing an economic downturn will be given priority
  - No rapid or aggressive rate hikes
  - Careful attention to the impact on the government bond market, housing, and corporate financing
- **Possibility of a small rate hike (conditional):** If the weak-yen trend becomes prolonged or the yen depreciates further. If resource prices or import prices rise more than expected

Uncertain Outlook for Exchange Rates and Stock Prices

- Market consensus outlook (end-2026）
  Range：around 140～155yen with the medium around 145～150 yen

Upside risk (stronger dollar / weaker yen / higher stock prices): (a) Delayed Fed rate cuts (inflation remains elevated and the economy stays firm), (b) **Risk-on environment** (capital inflows into global equity markets)

Downside risk (weaker dollar / stronger yen / lower stock prices): (i) Fed rate cuts proceed further, (ii) The Bank of Japan adopts a somewhat more proactive tightening stance, (iii) Global risk-off environment caused by uncertain US policies