CareEdge Global reaffirms State of Japan's rating at 'CareEdge AA-/Stable'

Issuer rating (Long-Term Foreign Currency)	CareEdge AA-/Stable (Unsolicited)

CareEdge Global has reaffirmed the Long-Term Foreign Currency issuer rating for **State of Japan** at **'CareEdge AA-/ Stable'** (Unsolicited).

Rationale

The reaffirmation reflects Japan's solid credit fundamentals, supported by its large and diversified economic base, strong external position, high-quality institutional framework, and deep domestic funding market. These structural strengths continue to balance the risks from very high public debt levels and moderate medium-term growth prospects, which are further shaped by adverse demographics and a weak trend in labour productivity.

Japan's persistent surpluses in primary income have supported a structural current account surplus, while Japan's substantial stock of foreign assets underpins a strong positive net international investment position (NIIP). NIIP stands at 87.5% of GDP in 2024, one of the highest globally.

Japan's credit profile is underpinned by its large economy, estimated at around USD 4.3 trillion in 2025, making it the world's fourth largest. A highly diversified economic structure, with strong contributions from both services and manufacturing, provides resilience and supports growth stability. In addition, Japan benefits from a high-quality institutional framework, as reflected in strong scores for government effectiveness, the rule of law, and regulatory quality.

Japan's fiscal profile is weighed down by high debt levels, ~230% of GDP in 2025, and structurally rigid public finances. These fiscal risks are partially offset by a large and stable domestic investor base, the Central Bank's large holdings of government bonds, and a comfortable debt profile that supports Japan's rating.

Japan's macroeconomic environment has shifted following its exit from a prolonged deflationary phase. In response to elevated inflationary pressures, the Bank of Japan (BoJ) is continuing to raise the policy rate gradually from its ultra-accommodative stance. The policy rates have risen to ~0.75% by December 2025. Stubborn inflation, mainly driven by cost-push factors, could prompt a further increase in policy rates in 2026.

Notwithstanding rising global protectionism and trade tensions on the external front, the economy is expected to grow around 0.7% in the medium term (2025-29). The recently announced fiscal stimulus, estimated at ~3.5% of GDP (the largest since the pandemic), is also expected to support short-term economic activity. The government expects higher growth due to fiscal stimulus, which remains a monitorable.

Policy normalisation, alongside delays in fiscal consolidation, has contributed to a rise in long-term government bond yields to multi-year highs (10-year yields stand at ~2.2% in Jan 2026), up from near-zero levels before the pandemic. Over time, higher yields could weigh on debt affordability.

In addition, the snap elections in Feb 2026, intended to consolidate power, could support policy continuity. The outcomes of elections and their impact on policy direction remain monitorable.

Outlook: Stable

The stable outlook reflects our expectation that the country's robust institutional structure, strong external position, along with a large domestic investor base and favourable debt structure, will enable it to partially offset the risks from high public debt levels, moderate medium-term growth prospects and the recent shift towards monetary policy normalisation characterised by rate hikes and rising yields.

Upside Scenario

We may revise our outlook to positive if real GDP growth prospects improve or if we observe a sustained reduction in public debt, thereby improving the fiscal position.

Downside Scenario

We may revise our outlook to negative if there is significant deterioration in the external position, reflected by potential compression of external income and depletion of NIIP. Further, a more expansionary fiscal stance without improvement in growth could weigh on the credit profile.

Key Rating Drivers

Economic Structure & Resilience

Japan's economic profile is characterised by a large and diversified economy. However, growth performance has remained structurally weak with the economy recording real growth of ~0.6% during FY2000–FY2024. Rapid population ageing, a declining workforce, and limited immigration continue to constrain labour supply, weighing on the economy's productive capacity over time. Alongside modest productivity gains, these dynamics have contributed to weaker manufacturing competitiveness and subdued medium-term growth prospects. While Japan remains firmly in the high-income category, per capita income gains have been modest. The economy's high trade and financial linkages with the US and China add vulnerability to external shocks.

Japan has experienced macroeconomic re-adjustments post-pandemic. While price and wage dynamics have risen from historically low levels, these changes have not yet led to higher domestic demand. Therefore, despite improvement in nominal wages, real income growth has remained weak, limiting household consumption and the pace of recovery. Growth performance has therefore remained uneven. After a modest pickup in activity in early 2025, supported by private demand, real GDP contracted in Q3 2025. Meanwhile, higher producer costs have kept business sentiment subdued. On the external side, frontloading of exports in response to US tariffs supported growth in the first half of 2025. However, emerging domestic supply constraints are aligning with rising global protectionism and trade tensions, adding pressure to Japan's export performance and overall growth trajectory.

Notwithstanding these challenges, medium-term growth (2025-29) is projected at around 0.7%, broadly in line with Japan's long-term average. Recent fiscal stimulus measures, including targeted transfers and support for MSMEs and industrial production, are expected to boost growth. The overall impact on the economy remains monitorable.

Fiscal Strength

Japan's fiscal pillar is weighed down by very high gross general government (GGG) debt. Additionally, fiscal rigidities remain high in Japan, defined by a large burden of fixed and committed spending, alongside relatively lower tax revenues compared with advanced-economy peers.

These fiscal risks are offset by large-scale domestic holdings of government debt (with nearly 87% of public debt held domestically, and the Bank of Japan accounting for around 45% of total holdings). In addition, Japan benefits from a deep pool of institutional investors, such as the Government Pension Investment Fund (GPIF), supported by a strong household savings base. The relatively long maturity profile of government bonds provides an additional layer of stability. The ultra-accommodative monetary policy stance has maintained extremely low borrowing costs, with the government's interest payments as a share of revenue declining from nearly 11% in 2000 to 3.8% in 2024, well below the levels in most advanced economies.

Recently, Japan's government has adopted an expansionary fiscal stance, approving a USD 136 bn stimulus package (3.5% of GDP), including a USD 113.2 bn supplementary budget for FY 2025, the largest since the pandemic. These measures are raising concerns about fiscal consolidation, with markets reassessing the risks associated with Japan's fiscal trajectory, driving long-term government bond yields to multi-year highs.

As yields rise, the debt affordability cushion provided by ultra-low borrowing costs is expected to decline gradually over the medium term. The gross government debt-to-GDP ratio is projected to remain elevated, and structurally rigid public finances could add to medium-term fiscal pressures. The impact of higher-than-expected rate hikes on the fiscal profile remains to be monitored.

External Position & Linkages

Japan's external strength remains a key credit anchor. With ultra-low domestic interest rates for decades, the economy has capitalised on the higher yield differential between Japan and global peers, particularly U.S. Treasury yields. This gap, along with a stable yen, has supported carry trade dynamics, where Japanese investors borrow at very low domestic funding costs and invest in higher-yielding foreign assets. This capital export policy has supported a surplus in primary income, leading to a healthy track record of current account surpluses, averaging 3.2% of GDP over the last five years. Additionally, Japan's NIIP is around 87.5% of GDP in 2024, one of the highest among peers with similar ratings. Japan is also among the largest holders of U.S. Treasuries and maintains over USD 1 trillion in foreign exchange reserves, equivalent to nearly 15 months of imports (as of December 2025). This partially mitigates the risk of high external debt at ~108.8% of GDP (2024). Additionally, Japan benefits from the Yen's reserve-currency status.

Recent developments, including the exit from the zero-interest rate policy and rising domestic yields, have led to extended policy divergence with the Fed. This has contributed to a narrowing of the yield differential between Japanese and US 10-year government bonds. However, despite higher yields in Japan, the yen remains weak against the USD. This combination of narrowing yield differential and currency volatility has weakened the premises of traditional yen carry-trade dynamics. Nonetheless, the current account surplus is projected to remain healthy at ~3.5% of GDP over the next five years (2025-29). Japan's extensive asset base, spanning highly liquid foreign exchange reserves and government deposits, semi-liquid pools provide buffers that can limit liabilities from translating into solvency concerns.

Monetary & Financial Stability

Japan operates under a free-floating exchange rate regime, and the yen's status as a reserve currency is a key strength in its monetary assessment. A large, well-developed financial system, along with a lower proportion of non-performing loans to gross loans, bodes well for assessing this pillar.

In the past, the central bank adopted ultra-accommodative monetary stance to lift inflation towards target and support economic activity. However, this long-standing deflationary trend reversed, with inflation staying above the central bank's 2% target since April 2022. In response to high inflation, the BoJ began normalising its ultra-accommodative policy, raising rates gradually to nearly 0.75% in December 2025 and reducing bond purchases, signalling a cautious shift after decades focused on deflation policy.

According to the BOJ, Inflation is expected to be around 2.0–2.5% in FY26, then to ease slightly. Inflation remains stubborn as underlying demand remains weak. Going forward, achieving the 2% inflation target sustainably while effectively managing the divergence in monetary policy between the BoJ and other central banks remains the key challenge for monetary policy.

Institutions & Quality of Governance

Japan’s assessment of this pillar is based on strong performance in government effectiveness, the rule of law, and regulatory quality, as measured by the Worldwide Governance Indicators.

Japan has recently experienced a change in political leadership in October 2025, with Prime Minister Sanae Takaichi heading a minority government following the resignation of Prime Minister Shigeru Ishiba in July 2025. The absence of a parliamentary majority has increased the government’s reliance on coalition partners, including the Japan Innovation Party, for legislative support. While the Liberal Democratic Party (LDP) has traditionally supported fiscal consolidation, the need to build consensus within a coalition framework could moderate this pace of consolidation.

The LDP's recent snap election represents a political strategy to seek a parliamentary majority. However, its timing at the start of the Diet session and ahead of budget deliberations is monitorable, as it could delay the passage of the FY2026 budget. A positive electoral outcome, however, could support policy continuity and governance stability.

Geopolitical developments, including the fragility of bilateral relations with China and heightened sensitivities surrounding Taiwan, along with tensions with North Korea, remain a monitorable.

Japan – Select Indicators									
	Unit	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025 F**	**2026 F**
Economic Indicators									
Nominal GDP	USD Billion	5,118	5,054	5,039	4,263	4,205	4,019	4,280	4,464
GDP Per Capita (Constant-PPP)	USD	45,114	43,361	44,657	45,240	46,017	46,285	47,011	47,553
Real GDP Growth	%	-0.4	-4.2	2.7	1.0	1.2	-0.2	1.1	0.7
GFCF/GDP	%	25.5	25.5	25.5	26.0	25.8	26.0	-	-
Gross Domestic Savings/GDP	%	25.5	25.0	25.3	23.1	24.7	25.3	-	-
Exports (G&S)/GDP	%	17.5	15.5	18.1	21.5	21.9	22.8	-	-
Working-Age (15-64) Population (% Share in Total)	%	59.0	58.9	58.7	58.7	58.8	58.8	58.8	58.8
Old-Age (65+) Population (% Share in Total)	%	28.6	28.9	29.2	29.4	29.6	29.8	30.0	30.2
Fiscal Indicators – General Government									
Fiscal Balance/GDP	%	-3.0	-9.1	-6.1	-4.2	-2.3	-1.5	-1.3	-2.0
Revenue/GDP	%	34.2	35.5	36.3	37.5	36.9	37.6	37.4	37.2
Expenditure/GDP	%	37.3	44.5	42.5	41.8	39.2	39.1	38.6	39.2
GG Gross Debt/GDP	%	236.4	258.4	253.7	248.2	240.5	236.1	229.6	226.8
GG External Debt (by Creditor)/GG Gross Debt	%	14.1	16.0	14.1	13.6	13.5	11.9	14.2	-
Interest/Revenue	%	4.9	4.7	4.4	4.1	3.8	3.8	-	-
External Indicators									
Current Account Balance/GDP	%	3.4	3	3.9	2.1	3.7	4.8	3.9	3.6
FDI, Net Inflows/GDP	%	0.8	1.2	0.7	1.1	0.5	0.4	-	-
Outstanding FII Liabilities/GDP	%	71.0	81.3	82.0	81.1	84.6	90.2	-	-
NIIP/GDP	%	63.9	68.6	72.7	74.4	78.8	87.5	-	-
Foreign Exchange Reserves	USD Billions	1323.8	1394.7	1405.8	1227.6	1294.6	1230.7	1369.8	-
Import Cover	Months	17.4	20.8	18.0	13.6	15.6	15.3	-	-
External Debt/GDP	%	82.9	95.4	92.1	103.0	106.6	108.8	-	-
Monetary and Financial Indicators									
CPI Inflation	%	0.5	0.0	-0.2	2.5	3.3	2.7	3.3	2.9
Exchange Rate (Average)	LC per USD	109.0	106.7	109.9	131.6	140.6	151.4	149.7	-
Non-Performing Loans/Total Gross Loans	%	1.1	1.1	1.2	1.2	1.2	1.2	-	-
Private debt, loans and debt securities/GDP	%	165.9	184.8	185.4	187.3	182.6	181.4	-	-

Sources: International Monetary Fund, World Bank, Bank for International Settlements, National Sources, CareEdge Global

Note: F - Forecast; PPP – Purchasing Power Parity; GFCF – Gross Fixed Capital Formation; Exports (G&S) – Exports of Goods and Services; GG – General Government; FDI – Foreign Direct Investment; FII – Foreign Institutional Investment; NIIP – Net International Investment Position; Data refers to fiscal/calendar year and actual/estimate as reported by the source; Where general government data is unavailable, central government data is used; Latest available data for 2024

Solicitation Status

The rating is unsolicited

Rating History

Instrument	Type	Rating	Date
Issuer Rating	Long-Term Foreign Currency (Unsolicited)	CareEdge AA-/Stable	February 04, 2026
Issuer Rating	Long-Term Foreign Currency (Unsolicited)	CareEdge AA-/Stable	February 05, 2025
Issuer Rating	Long-Term Foreign Currency (Unsolicited)	CareEdge AA-	October 03, 2024

Criteria Applied

CareEdge Sovereign Rating Methodology

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