Why Earnings Fears Recede Amid Tariff Measures

Politics and Confidence in Next Year's Earnings Pave the Way for Nikkei Average to Reach 50,000 Yen

October 10, 2025

Tariffs in Place, Yet Optimism for Corporate Earnings Grows

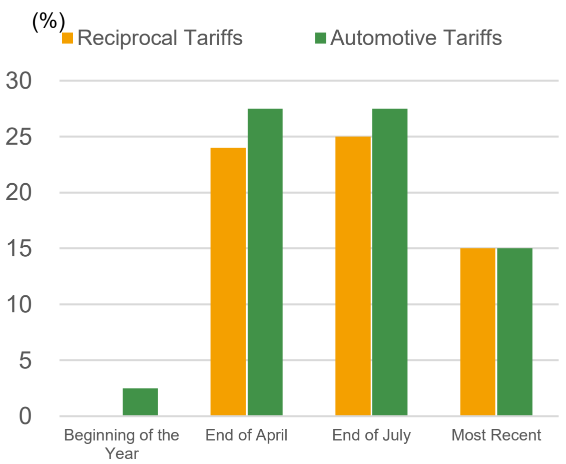
The announcement of interim results for the FY ending March 2026 is approaching. While expectations for political developments are rising, strong earnings momentum remains essential for Japanese equities to move higher. In this letter, we review the current state of corporate earnings.

Starting from late March to early April this year, concerns over the expanding impact of Trump tariffs led to a rapid deterioration in Japanese corporate earnings outlook. By the end of June, TOPIX's FY2025 forecast EPS had been revised down by about 7%, and even as share prices recovered from the sharp drop in early April, the risk of further downward revisions to earnings was strongly perceived. However, as the Nikkei and TOPIX continue to hit record highs, those concerns now seem to have completely faded.

Although the reciprocal tariffs on Japan—24% announced in April and 25% notified in July—were reduced by 10 percentage points under the Japan-US tariff agreement, about 60% of the original level, or 15%, still remains in place. This includes core industries such as automobiles and parts. Tariff rates on Southeast Asian countries, where many Japanese companies have manufacturing bases, are even higher.

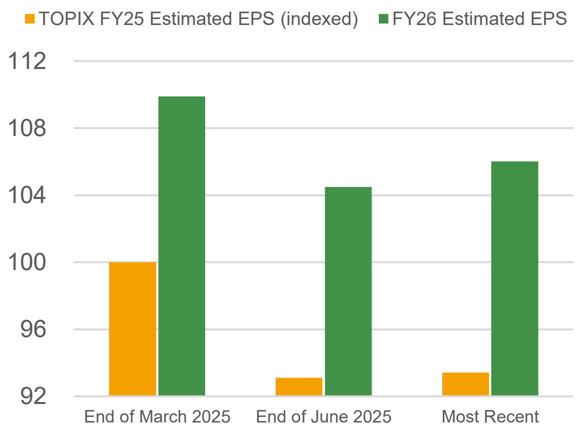
Despite being lower than the rates announced in April, the Trump tariffs that once caused major market turmoil are still in effect. Yet, earnings concerns have receded. This appears to be due to differences in four areas; 1)Impact on the economy 2)Escalation risk 3)Uncertainty and 4)Relative advantage or disadvantage.

15% Tariff Continues Despite Japan-US Deal



※As Announced by the US Government
Source: Various materials; Compiled by Daiwa Asset Management

Estimated EPS Plunged in Apr–Jun, Stabilized, and Recovered Slightly After Summer



※ Estimate based on FactSet consensus; indexed to 100 using FY2025 EPS forecast as of end-March 2025. Latest data as of October 8
Source: FactSet; Compiled by Daiwa Asset Management

Direct Impact of Tariffs Manageable, but Economic Slowdown Hits Hard

The US is one of Japan's most important trading partners, with 16% of the sales of companies constituting the TOPIX directed toward the US. The trend significantly impacts corporate earnings. However, the direct impact of tariffs on earnings is expected to be manageable (even with a 25% tariff rate). The effect on expected EPS is estimated to be in the mid-single digits, which can act as a drag on stock prices but does not impair the medium-term upward trajectory of Japanese stocks. The reason for the sharp decline in stock prices in April was concern that tariffs could trigger a recession in the global economy.

The impact on TOPIX EPS from macroeconomic changes is much greater than the direct impact of tariffs. In past instances of EPS declines, reductions from peaks reached several tens of percent, sometimes even leading to deficits. Furthermore, if companies prioritize survival amidst significant earnings deterioration, capital efficiency and shareholder returns may be sidelined, potentially losing momentum for governance reforms. Additionally, amid worsening domestic business sentiment, companies may hesitate in raising wages, hampering the establishment of domestic inflation. In other words, there was a risk of losing the structural macro and micro changes that have been driving Japanese stocks from 2023 onwards.

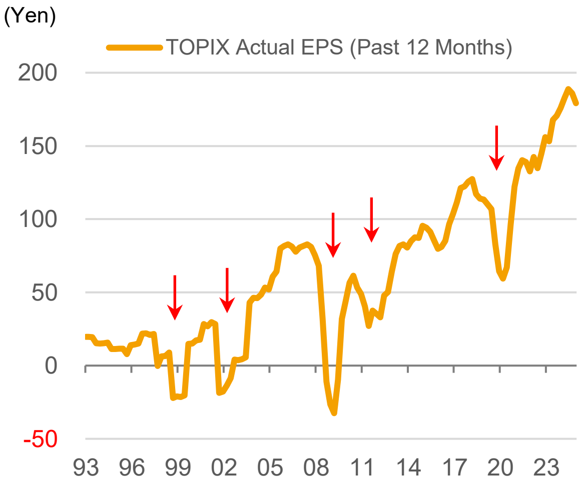
Fortunately, even though signs of easing have emerged in the labor market, the US economy appears robust, and the global economy has not collapsed. Domestic demand remains strong. If macro concerns recede, the direct impact of tariffs is considered manageable, reducing anxiety about earnings under tariff implementation.

The possibility of escalation has also diminished. Initially, it was unclear how counterpart countries would respond to US tariffs, raising concerns about expanding impacts through retaliatory tariffs. However, in the following months, the number of countries and regions reaching tariff agreements increased, and countries without agreements responded in a restrained manner.

The reduction in uncertainty is also critical. Besides the high tariff rates, their opacity presented challenges for companies. Without clear premises for considering business strategies, management decisions must be postponed. However, tariff agreements allow companies to move forward based on these premises.

For Japanese companies, the risk of relative inferiority has also declined. If tariff rates are higher than in other countries, competitiveness will significantly suffer, making this aspect potentially more crucial for companies than the absolute level of tariff rates.

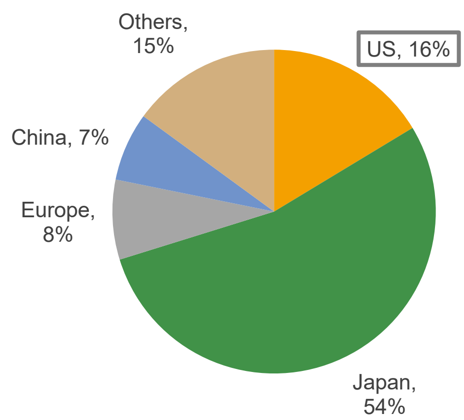
TOPIX Past 12-Month Actual EPS Decline Phases



※ The latest value is end of June 2025

Source: FactSet; Compiled by Daiwa Asset Management

US Sales Account for 16% of TOPIX Constituents' Revenue



※ The latest value is end of September 2025

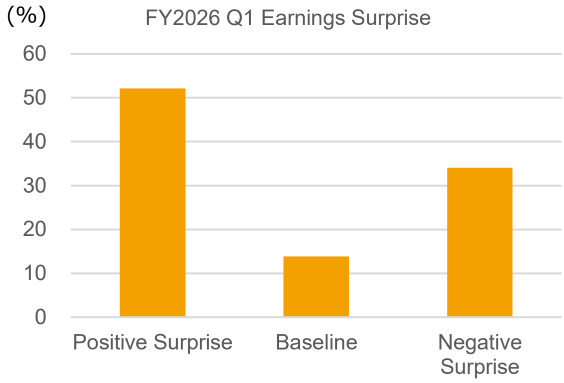
Source: FactSet; Compiled by Daiwa Asset Management

1Q Results Provide Reassurance for Future Outlook

The first-quarter financial results for the FY ending March 2026 (hereinafter referred to as 1Q results), announced in the summer, were encouraging. Initial guidance appeared conservative, with some companies not incorporating the impact of tariffs due to high uncertainty. There was a possibility that the outlook for earnings could be further downgraded in the 1Q results due to the incorporation of new tariff impacts.

However, the actual results for April-June under tariff implementation showed an 8% and 12% year-on-year decline in ordinary profit and net profit, respectively. Nonetheless, due to corporate efforts to mitigate tariff impacts, such as increasing inventories in advance and shifting production sites and procurement sources, the results surpassed consensus expectations. For the full-year company plans, the proportion of companies that revised their plans downward was limited to 3%, which was lower than the proportion that revised plans upward (7%). It appears that the direct impact of tariffs has been largely reflected in earnings forecasts and stock prices.

Q1 Earnings Above Consensus



※ Share of TOPIX March fiscal-year companies with Positive Surprises, Baseline, and Negative Surprises

Source: FactSet; Compiled by Daiwa Asset Management

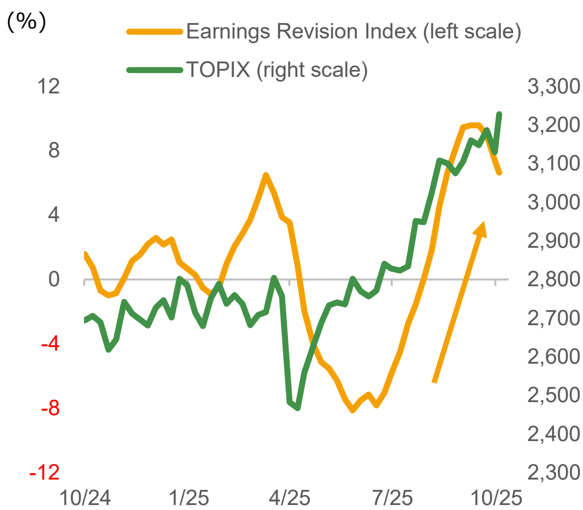
Can the Interim Results Meet High Expectations?

Analysts have broadly upwardly revised their earnings forecasts in response to the strong 1Q financial results, settlement of accounts, and the US-Japan tariff agreement, and the Earnings Revision Index has rebounded sharply.

Given the stock market rally since the summer and the degree of upward revision by analysts, expectations for financial results, settlement of accounts, appear to be quite high. A certain amount of caution is required in case the impact of tariffs is more widespread than expected, or if companies continue to take a wait-and-see attitude due to uncertainty and upward revisions are postponed to the 3Q financial results, settlement of accounts may be a disappointment.

Consensus is for 2Q recurring profit and net income to be +8% and +3% YoY, respectively. Excluding the SoftBank Group, whose earnings are volatile and have a large impact, they are +15% and +13%, respectively (as of October 7). Although there is a technical factor that the hurdle to overcome is low since the 2Q of the previous FY was weak due to the strong Yen and other factors, if the high profit growth rate expected by the consensus is realized, it will encourage investors who are positive about the Japanese stock market.

Analysts Widely Raised Earnings Estimates



※Universe for Earnings Revision Index is TOPIX, most recent value as of October 7

Source: FactSet; Compiled by Daiwa Asset Management

Expectations for Next Year's Earnings Pave the Way for Nikkei Average to Reach 50,000 Yen

Due to the impact of tariffs, the earnings of TOPIX in FY 2025 is expected to be sluggish. Consensus forecasts predict flat revenue growth and only a 1% increase in net profit growth. However, EPS growth is expected to be approximately 2 percentage points higher than net profit growth, driven by increasing share buybacks. Sectors significantly affected by tariffs, such as automobiles and transportation equipment, as well as shipping, trading companies, steel, and energy, are showing notable negative contributions.

For FY 2026, when the impact of tariffs is expected to diminish, the TOPIX earnings is forecasted to be robust, with 4% revenue growth and 13% EPS growth. The positive contributions come significantly from the automotive, transportation equipment, and steel sectors, recovering from the poor earnings of FY 2025. Additionally, sectors such as electronics and precision instruments, banking, services, and pharmaceuticals that performed well in FY 2025 will continue to contribute significantly.

Although the current earnings seems lackluster due to tariff impacts and low profit growth rates of the index, sectors related to AI, competitive global sectors, as well as finance and domestic demand are displaying strong revenue momentum. Nominal GDP high growth driven by domestic inflation, strong domestic demand, and accelerated sales of policy-owned stocks supported by governance reform are boosting the profit levels of finance and domestic demand sectors. Despite remaining uncertainties in overseas economies and US policies, the progress of structural reform domestically provides a favorable outlook for earnings.

Consensus forecasts bottomed out at the end of June, reducing downside risk for the 1Q results. If more companies revise their plans upward during interim results, there is potential for an outperformance in FY 2025, and increased expectations for FY 2026. Additionally, the rapid Yen depreciation in the forex market since the beginning of the month is also providing tailwinds for earnings.

With Sanae Takaichi elected as the new president in the LDP presidential election, expectations for the Japanese stock market have risen amid political changes. If the political and policy outlook, currently somewhat uncertain, progresses steadily, and confidence in accelerated growth for FY 2026 strengthens, the forecasted PER, which currently appears slightly overvalued at the top of the range, could be justified, potentially leading to higher stock prices. If this scenario materializes, the Nikkei Average surpassing 50,000 Yen becomes increasingly realistic.

Nonetheless, the coalition framework remains uncertain, with various reports circulating. Considering favorable supply and demand conditions, there is little need to worry about the downside, and the medium- to long-term upward trajectory for Japanese stocks remains unchanged. However, with the recent significant rise in stock prices, determining whether this is a prelude to further stock price increases or merely an anticipation of the rise over the coming months becomes critical in assessing political and earnings aspects.

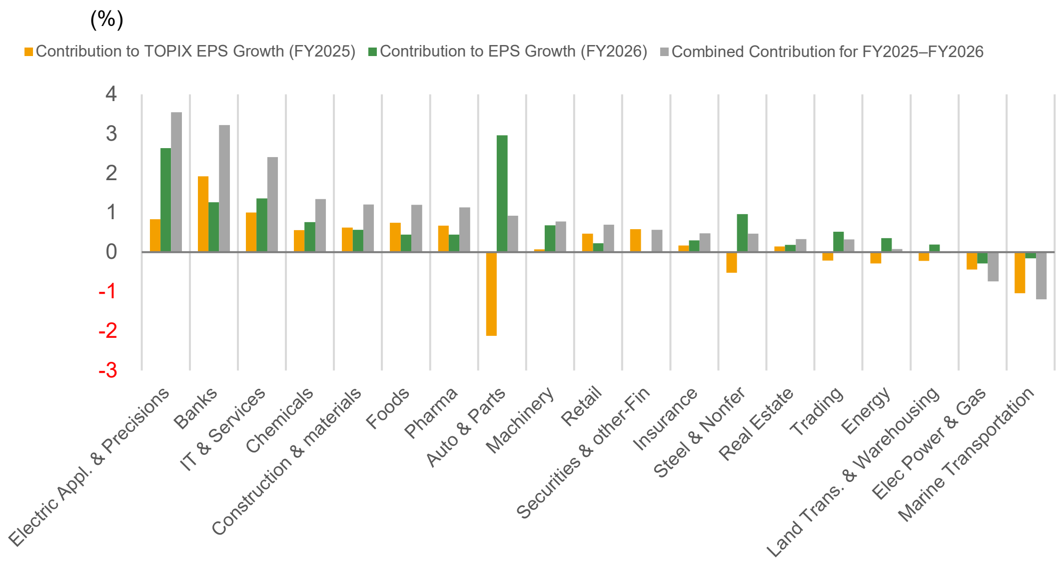
(Written by Kazunori Tatebe, Research Department)

TOPIX Earnings Outlook for Current and Next FY (Consensus)

(%)	Sales Growth Rate			EPS Growth Rate		
	FY24	FY25	FY26	FY24	FY25	FY26
TOPIX	5	1	4	10	3	13
TOPIX (Ex-Financial)	5	1	4	6	0	15
Manufacturing	4	0	4	-2	2	22
Non-Manufacturing	5	2	3	17	-2	6
Financial	6	-1	6	32	14	7

※ FY2024 actual; FY2025–FY2026 FactSet & QUICK consensus. Data as of Oct 8
Source: FactSet and QUICK; Compiled by Daiwa Asset Management

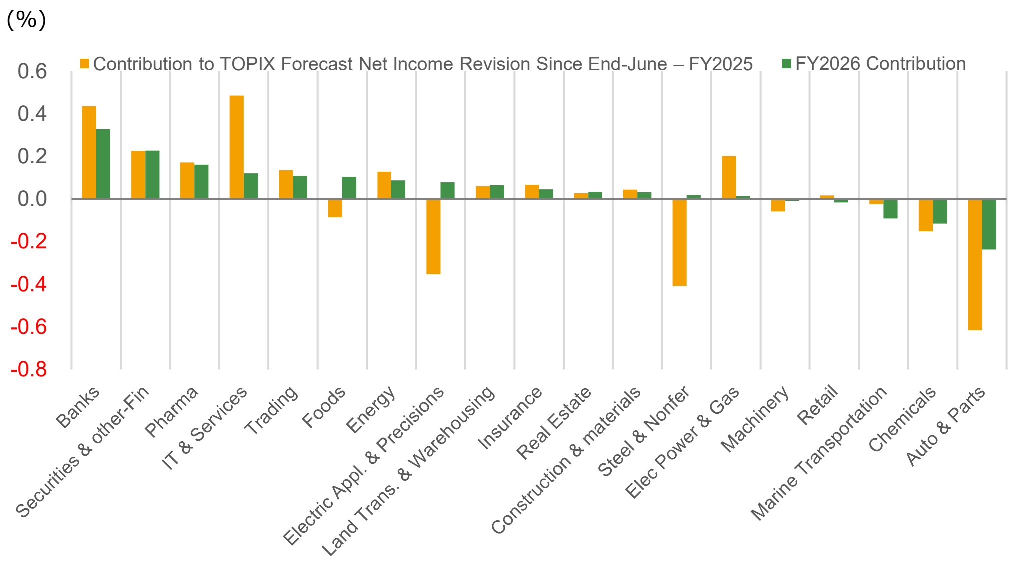
Financials, Domestic Demand, and Competitive Global Sectors Continue to Deliver Solid Earnings Growth



※ TOPIX Constituents, as of October 8

Source: FactSet; Compiled by Daiwa Asset Management

Sector Contribution to TOPIX Forecast Net Income Revision



※ TOPIX Constituents, as of October 8

Source: FactSet; Compiled by Daiwa Asset Management

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