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Japan | Economic and Financial Market Outlook

6

JUN. 2025

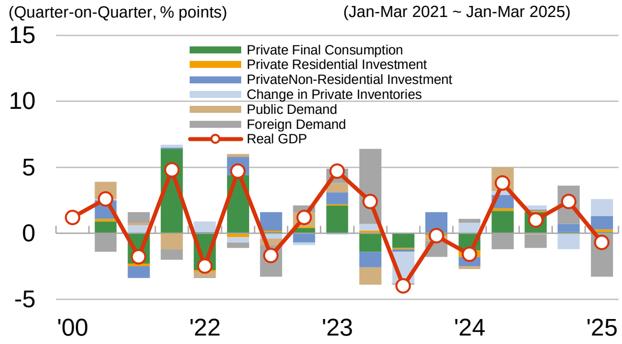
Daiwa Asset Management

Economy

Tug of War Between US Tariff Risks and Wage Increases

Real GDP growth in January-March 2025 was -0.7% YoY (+2.4% in October-December 2024), the first negative growth in four quarters. The primary driver of the decline was a temporary surge in imports, largely reflecting a rebound effect from the previous quarter's strong performance. Looking ahead, robust wage increases achieved during the 2025 "Shunto" spring labor negotiations are expected to support household consumption through a rise in real wages. However, the potential adverse effects of US tariff policy are likely to become increasingly pronounced. In particular, attention should be paid to the deterioration in corporate and household sentiment caused by rising prices and US tariff policies.

Real GDP and Contribution by Demand Item

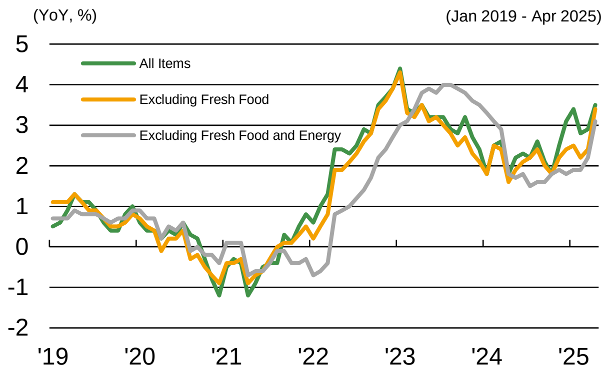


Source: The Cabinet Office; Compiled by Daiwa Asset Management

Focus on Pricing Behavior Under US Tariff Policies

The April CPI for Tokyo's 23 wards showed a significant acceleration in growth, with the core index (excluding fresh food) increasing by +3.4% YoY (compared to +2.4% in March). However, this surge was largely driven by temporary factors, such as the waning impact of Tokyo's tuition-free policy for high school education and should be interpreted with caution. Although April is typically a month when price revisions are implemented, such movements—excluding rents—have been relatively subdued. The uncertainty surrounding US tariff policy may also be affecting corporate pricing behavior. Going forward, close attention should be paid to how US tariff policy influences domestic prices.

Tokyo Metropolitan CPI

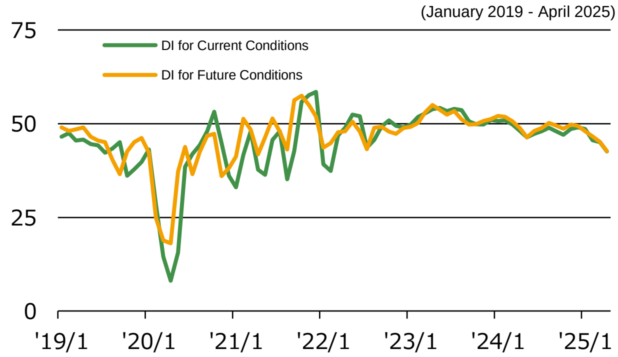


Source: Ministry of Internal Affairs and Communications; Complied by Daiwa Asset Management

Growing Caution Among Businesses and Consumers

In the April Economy Watchers Survey, which reflects the so-called "street-level" economic sentiment, the DI for Current Conditions fell to 42.6 (from 45.1 in March), and the DI for Future Conditions declined to 42.7 (from 45.2 in March), both showing a drop from the previous month. Some businesses expressed concerns over the impact of US tariff policies, citing delays or cancellations of planned projects. Looking at consumer sentiment, the Consumer Attitude Index also continued to deteriorate, falling to 31.2 in April (from 34.1 in March), indicating that the domestic economy lacks momentum.

Economy Watchers Survey

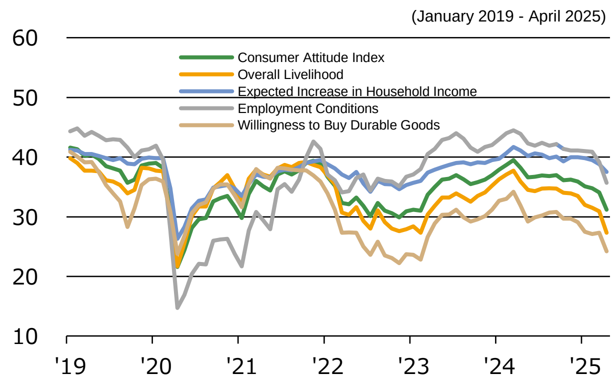


Source: Cabinet Office; Complied by Daiwa Asset Management

Rising Momentum for Consumption Tax Cuts Among Ruling and Opposition Parties

As the Upper House election scheduled for July approaches, economic policy is drawing increased attention, particularly in light of persistent inflation and the implications of US tariff policies. Calls for a consumption tax reduction are gaining traction not only among opposition parties but also within the ruling Liberal Democratic Party (LDP). Although the LDP leadership remains cautious for now, a shift toward tax cuts cannot be ruled out given the party's declining approval ratings. By mid-June, both ruling and opposition parties are expected to unveil their official campaign pledges for the Upper House election, alongside the government's "Basic Policy for Economic and Fiscal Management and Reform" (honebuto no hōshin). These documents will be critical in shaping the fiscal policy debate and warrant close attention.

Consumer Confidence Survey



Source: Cabinet Office; Complied by Daiwa Asset Management

Equity

Plenty of Concerns, but Also Positive Signs

Although concerns over US tariff increases have subsided with the significant reduction of tariff rates by both the US and China, the 10% uniform tariffs and item-specific tariffs are expected to be maintained. In the US, there are ongoing concerns about price increases due to the passing on of costs and a potential drop in demand following a rush to buy. On the positive side, a large-scale tax cut is planned for the next fiscal year, which could provide a meaningful boost to economic activity from October onwards. Additionally, the global disinflationary trend and anticipated monetary easing across major economies are expected to offer further support to growth.

Dark Clouds Over Upper House Election Due to Worsening Domestic Economic Sentiment

In Japan, concerns are mounting over the domestic impact of US tariff hikes, compounded by surging food prices—particularly rice—and broader inflationary pressures. These developments have heightened uncertainty over the economic outlook. Public dissatisfaction with rising living costs has contributed to a downward trend in the Cabinet's approval ratings. As a result, the ruling party is likely to face tough challenges in the Tokyo Metropolitan Assembly election in June and the Upper House election in July. However, the opposition party has pledged to reduce the consumption tax as part of their campaign promises, and even if the ruling party loses a significant number of seats, the possibility of implementing tax cuts might prevent a negative perception.

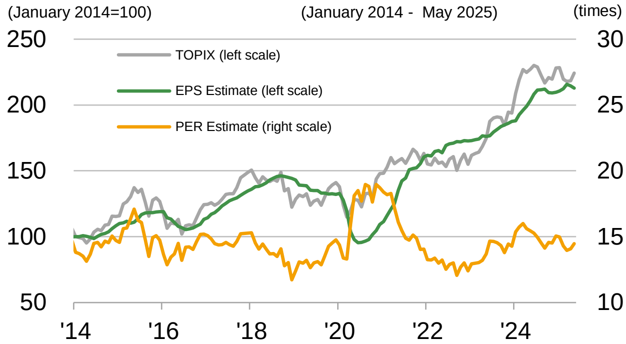
Corporate Earnings Slightly Underwhelming

Full-year earnings announcements for companies with March fiscal year-ends have now been released. However, the outlook for the current fiscal year appears generally subdued. This is due to several headwinds: the fading impact of Yen depreciation that had previously boosted earnings, growing uncertainty in overseas economies—particularly the US—intensifying competition with foreign firms, and rising costs such as labor expenses. Notably, the automotive sector, which is highly exposed to tariff risks, has significantly dragged down overall profit forecasts. However, excluding the automotive sector, there are not many companies forecasting substantial profit declines, and overall, the decrease in profits is expected to remain in the single-digit percentage range.

Robust Shareholder Returns Continue to Provide Downside Support for Equity Prices

Although many companies are experiencing lackluster performance, the enthusiasm for enhancing shareholder returns is gaining momentum. Factors such as requests from the Tokyo Stock Exchange, progress in unwinding cross-shareholdings, increased holdings by activists, heightened awareness of capital efficiency, and actions by competitor companies may be contributing to this trend. Recently, there has been a noticeable increase in the number of share buyback announcements and the scale of each buyback. Overall, companies have significant financial capacity, and even if there is a slight slowdown in performance growth, this trend is likely to continue, providing strong support for stock prices.

TOPIX Estimated EPS and PER



※ Month-end value, April 2025 is the value on the 21st
EPS and PER estimate is 12-months ahead forecast
Source: Bloomberg; Compiled by Daiwa Asset Management

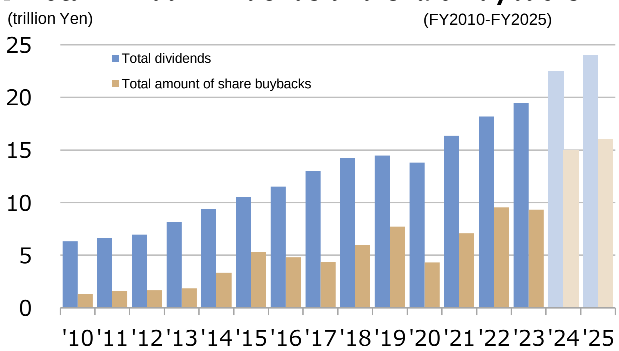
Top Companies by Current Operating Profit Increase/Decrease

(Unit: 100 million JPY)

Name of Stock	Industry Name	Ordinary Income	Name of Stock	Industry Name	Decrease in Ordinary Income
JT	Foods	3,872	Toyota	Transportation Equipment	-20,046
ENEOS	Oil and Coal Products	2,568	Honda	Transportation Equipment	-8,276
Japan Post	Services	2,054	INPEX	Mining	-3,418
Dentsu Group	Services	1,898	Mitsui O.S.K. Lines	Marine Transportation	-2,697
AGC	Glass and Ceramics Products	1,851	Seibu HD	Land Transportation	-2,516
NTT DATA	Information & Communication	1,810	Mitsubishi Corporation	Wholesale Trade	-2,434
Canon.	Electronic Appliances	1,798	Nippon Yusen	Marine Transportation	-2,359
Denso	Transportation Equipment	1,650	Nippon Steel Corporation	Iron and Steel	-2,244
Takeda	Pharmaceutical	1,319	Kawasaki Kisen	Marine Transportation	-2,031
Astellas	Pharmaceutical	1,188	Sony G	Electronic Appliances	-1,937
Fujitsu	Electronic Appliances	1,066	Tokio Marine	Insurance	-1,900
Teijin Limited	Textiles and Apparels	960	Komatsu	Machinery	-1,628
JAPAN POST BANK	Banks	955	Idemitsu Kosan	Oil and Coal Products	-1,588
NTT	Information & Communication	953	SUZUKI MOTOR	Transportation Equipment	-1,502

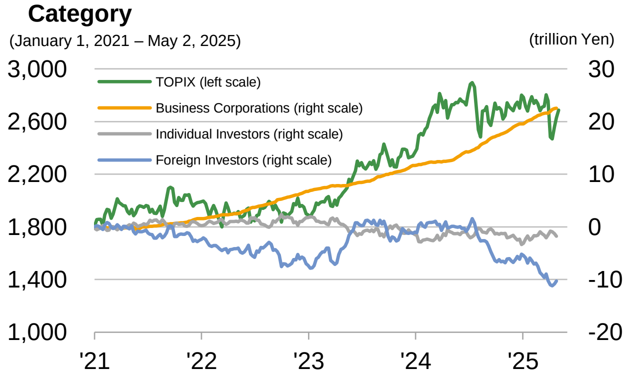
※ Comparison between previous fiscal year results and current fiscal year company forecasts for listed companies in the domestic stock market
※ If no company forecast is available for the current fiscal year, Toyo Keizai forecast is used
Source: QUICK; Compiled by Daiwa Asset Management

Total Annual Dividends and Share Buybacks



※ 2024 and 2025 Figures are Daiwa Securities Forecasts.
Source: Daiwa Securities Co. Ltd.

TOPIX and Total Trading Value by Investment Category



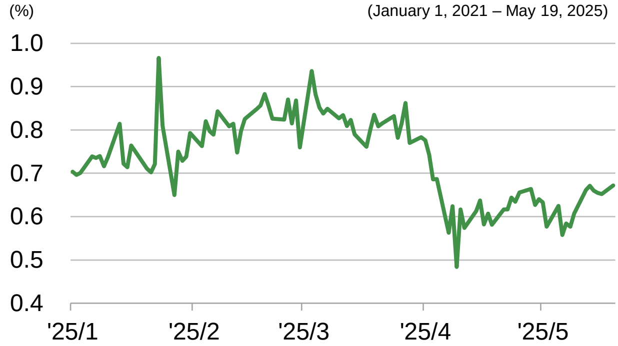
※ Weekly data, trading value by investment category through the week of April 25
Source: Bloomberg; Compiled by Daiwa Asset Management

Interest Rates

Shifting Market Expectations for Rate Hikes

The future direction of the Bank of Japan's monetary policy largely depends on the impact of US tariff policies on the domestic economy and prices, drawing significant attention to the outcomes of tariff negotiations among various countries. Amidst this backdrop, progress in US-China trade negotiations has reduced the downside risks to the global and Japanese economies posed by US tariff policies. Consequently, market expectations for a rate hike by the Bank of Japan have risen again, with the forecast for the policy rate by the end of 2025 recovering to around 0.67%, aligning closely with our prediction (next rate hike expected in October 2025). However, remarks by Governor Ueda during the May Monetary Policy Meeting, suggesting that the economy might temporarily "stall" due to the impact of US tariffs, have indicated a slower pace of rate hikes, preventing a full return to pre-announcement levels of US reciprocal tariffs. Regarding long-term interest rates, we anticipate a lack of clear direction while monitoring tariff negotiations and economic trends among various countries. Additionally, caution is needed regarding the risk of a sharp rise in interest rates due to fiscal deterioration concerns stemming from economic measures ahead of the July Upper House election.

Market Policy Interest Rate Forecast (end of 2025)



Source: Bloomberg; Compiled by Daiwa Asset Management

10-Year Government Bond Yield

Source: Bloomberg; Compiled by Daiwa Asset Management

J-REIT

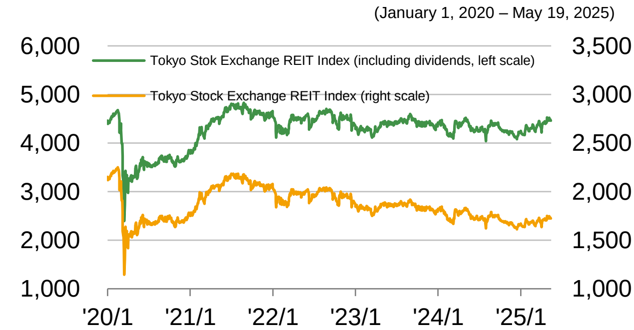
J-REIT Market Shows Resilience

Since May, domestic long-term interest rates have risen to the upper 1.4% range, yet the J-REIT market continues to show resilience. Year-to-date, long-term interest rates have increased from 1.09% to 1.48%, while the Tokyo Stock Exchange REIT Index (including dividends) has risen by 6.2%. The improvement in rental market conditions and the realization of rent increases have driven internal growth, and supply-demand dynamics have been positively evaluated due to measures such as buybacks of own investment units.

Gradual Upside Expected

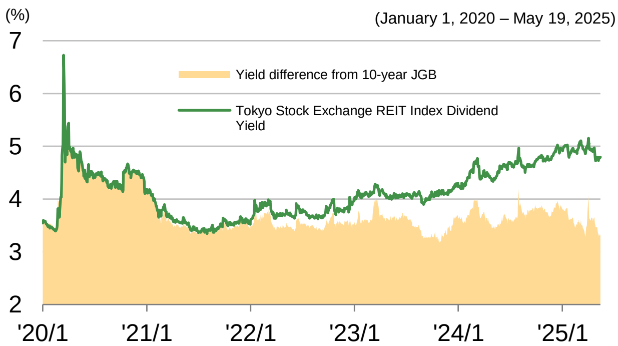
Recent earnings announcements have confirmed an increased focus on dividend growth, driven by rent increases and property sale gains, alongside a management approach conscious of capital costs, including buybacks. Our company values the fact that more entities are striving for "growth," overcoming negative factors such as increased borrowing costs due to rising interest rates. J-REITs, which are expected to provide stable and high yields, remain attractive investment targets, with an anticipated gradual increase in value.

Trend of the Tokyo Stock Exchange REIT Index



Source: Bloomberg; Compiled by Daiwa Asset Management

Trend of the Dividend Yield for the Tokyo Stock Exchange REIT Index



※ Dividend yield is based on the actual performance of the past 12 months
Source: Bloomberg; Compiled by Daiwa Asset Management

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