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Japan | Economic and Financial Market Outlook

7

JUL. 2025

Daiwa Asset Management

Economy

Stalled US-Japan Tariff Negotiations Raise Concerns Over Corporate Earnings

The Export Price Index for May indicated that companies are responding to the increased US tariffs not by passing on the costs, but by lowering prices. Meanwhile, real exports to the US declined, partly due to a reactionary drop following a surge in last-minute shipments. Going forward, if companies begin to pass on the tariff-related costs, demand may fall, potentially leading to a continued decline in exports and, consequently, profits. In light of these developments and the uncertainty surrounding US-Japan tariff negotiations, the real GDP growth forecast for 2025 (YoY) has been revised downward from 1.0% to 0.6%.

Rising Food Prices and US Tariff Risks Cast a Shadow Over Consumer Spending

The May CPI for Tokyo's 23 wards, excluding fresh food, rose by 3.6% YoY (up from 3.4% in April), indicating persistent inflationary pressures, particularly in food items such as rice. The strong growth in the overall index may have secondary effects on underlying price trends through wages and inflation expectations, and continued caution is warranted regarding its negative impact on consumption. Looking ahead, Bank of Japan Governor Kazuo Ueda has stated that price risks exist in both upward and downward directions, but he recognizes that the downside risks are greater due to the impact of US tariff policies.

Economic Sentiment: Clouds Returning After a Brief Clearing?

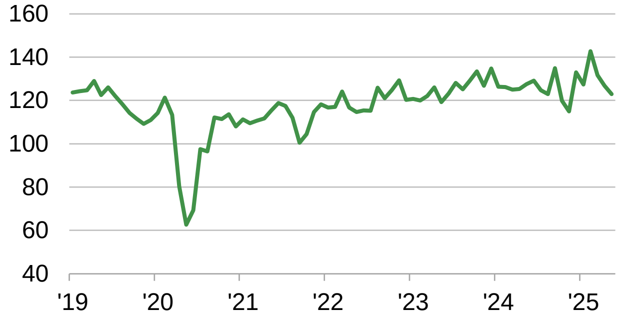
Sentiment-related indicators showed signs of improvement in May, reflecting a retreat from excessive pessimism following the US-China trade agreement. However, caution is warranted as this rebound may prove transitory. With the impact of US tariff policy expected to materialize in the latter half of the year, prolonged US-Japan tariff negotiations could lead to renewed deterioration in both corporate and household sentiment.

Wage Increases Supporting Consumption Amid Future Risks

While sentiment-related indicators continue to show a long-term downward trend, hard data remains resilient. Real consumption has been restrained as households become more frugal due to rising prices, but robust wage increases have provided support, resulting in overall steady performance. However, looking ahead, if the impact of US tariff policies becomes more pronounced in the latter half of the year, attention should be paid to the possibility that the deterioration in economic sentiment could extend to hard data as well.

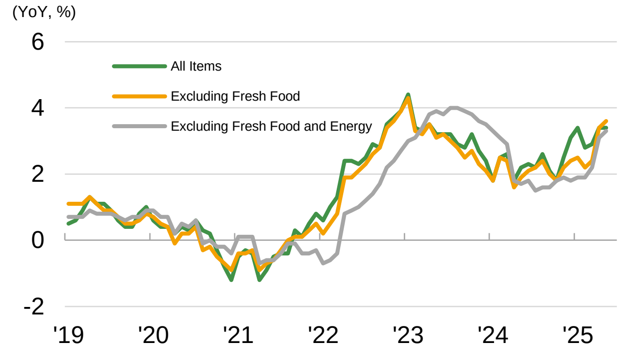
(Written by Satsuki Yuba, Research Department)

Real Export Index (to the US)



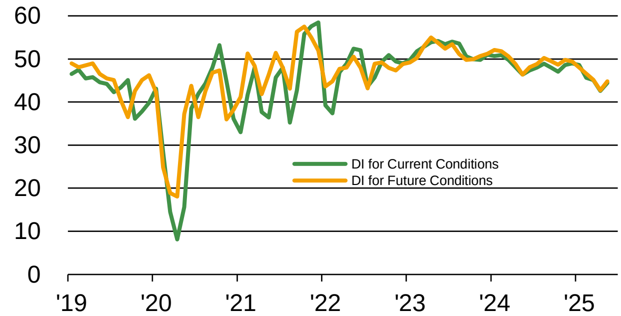
※The latest value is from May 2025, Year 2020 average = 100, seasonally adjusted
Source: Bank of Japan; Complied by Daiwa Asset Management

Tokyo Metropolitan CPI



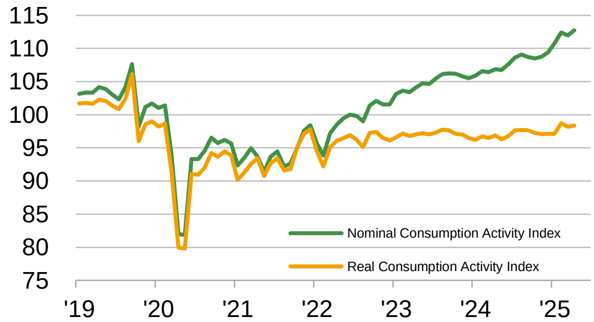
※ The latest value is from May 2025
Source: Ministry of Internal Affairs and Communications; Complied by Daiwa Asset Management

Economy Watchers Survey



※ The latest value is from May 2025
Source: Cabinet Office; Complied by Daiwa Asset Management

Consumption Activity Index



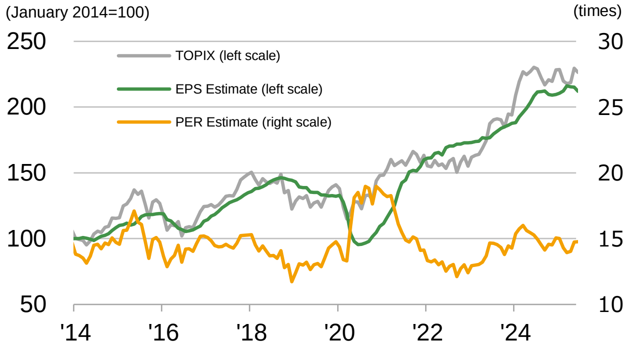
※ The latest value is from April 2025
※ Adjusted for travel income and expenditure, seasonally adjusted
Source: Bank of Japan; Complied by Daiwa Asset Management

Equity

Multiple Headwinds Persist

Uncertainty continues to prevail, as trade negotiations with the US remain unresolved and international conflicts intensify. In the US, a decline in last-minute demand for automobiles and other goods has led to weaker-than-expected economic indicators. While inflation is showing signs of easing overseas, domestically, high prices persist, and business sentiment remains sluggish. Additionally, the fading impact of the weak Yen has contributed to a plateau in corporate earnings growth.

TOPIX Estimated EPS and PER

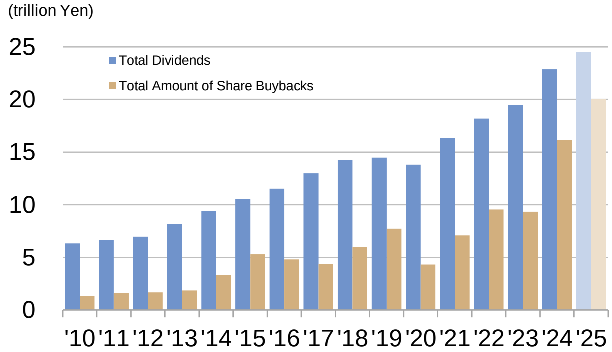


※ Month-end value, June 2025 is the value on the 23rd
※ EPS and PER estimate is 12-months ahead forecast
Source: Bloomberg; Compiled by Daiwa Asset Management

Robust Shareholder Returns Support Favorable Market Supply-Demand Dynamics

Meanwhile, companies remain highly motivated to enhance shareholder returns, driven by factors such as the Tokyo Stock Exchange's requests, growing awareness of capital efficiency, the unwinding of cross-shareholdings, increased ownership by activist investors, and competitive pressures. Recently, not only has the number of share buyback announcements increased, but the scale of individual buybacks has also grown significantly. Overall, Japanese companies maintain strong financial capacity, and even if earnings growth slows somewhat going forward, this trend is expected to continue, providing solid support for stock prices.

Total Annual Dividends and Share Buybacks

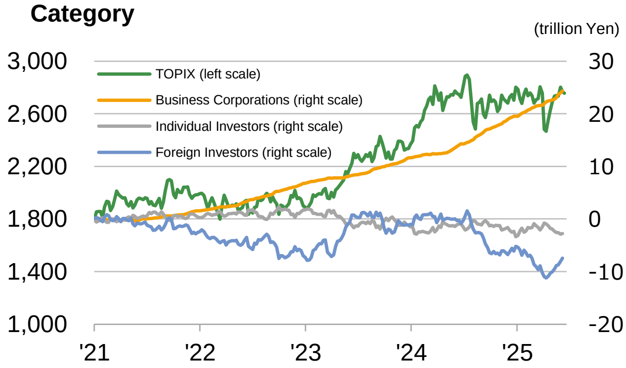


※ The latest value is FY2024
※ 2025 Figures are Daiwa Securities Forecasts.
Source: Daiwa Securities Co. Ltd.

Foreign Investors Record Nine Consecutive Weeks of Net Buying

In addition to the aforementioned factors, foreign investors—who had cumulatively net sold approximately ¥10 trillion since last summer—shifted to net buying following the announcement of reciprocal US tariffs in April. This trend has persisted for nine consecutive weeks across both cash equities and futures. This trend appears to be driven by a shift of funds away from the USD due to concerns over worsening US fiscal conditions, as well as a reassessment of Japanese Yen-denominated assets, which are currently seen as significantly undervalued. The Yen remains significantly undervalued, and if this trend continues, it could serve as a further catalyst for upward pressure on Japanese stock prices.

TOPIX and Total Trading Value by Investment Category



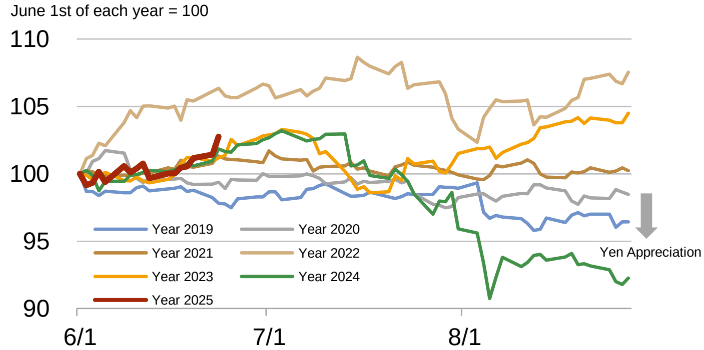
※Weekly data, trading value by investment category through the week of June 6
※The latest value for TOPIX is as of June 13, 2025
Source: Quick; Compiled by Daiwa Asset Management

Upper House Election and Potential Summer Yen Strength

In the recent Tokyo Metropolitan Assembly election, the ruling LDP-Komeito coalition suffered significant seat losses. With limited effective measures to address the public's burden from rising living costs, the ruling parties are expected to face further challenges in the July Upper House election. While political instability is a concern, the opposition parties are generally more supportive of tax cuts, and a major loss of seats by the ruling coalition may not necessarily be viewed negatively. Additionally, US interest rates tend to decline from July onward, often leading to Yen appreciation. Given the current unpopularity of the USD and growing expectations for rate cuts in the US, further Yen strengthening should be closely monitored.

(Written by Kensuke Togashi, Research Department)

USD/JPY Exchange Rate



※ The latest value for 2025 is as of June 23
Source: Bloomberg; Compiled by Daiwa Asset Management

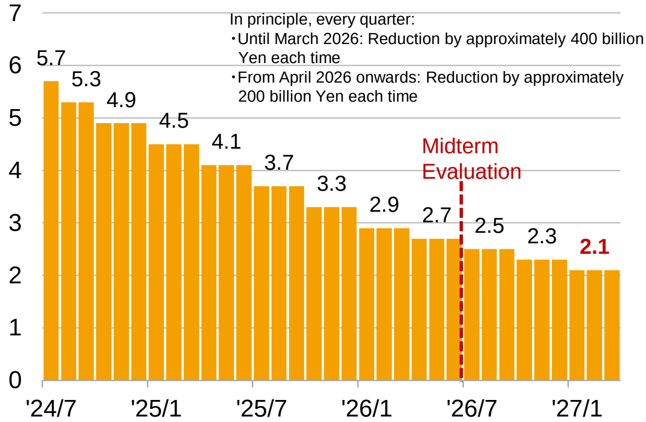
Interest Rates

Rate Hike Outlook Pushed Back Amid US Tariff Concerns

At its June Monetary Policy Meeting, the Bank of Japan decided to maintain its policy rate unchanged. Regarding JGB purchases, the central bank announced a plan to reduce the quarterly tapering pace from the current ¥400 billion to ¥200 billion starting April 2026, with monthly purchases expected to decline to approximately ¥2.1 trillion during the January–March 2027 period. While Governor Kazuo Ueda reaffirmed the BoJ's commitment to a gradual rate hike trajectory, he also expressed caution over the potential impact of US tariff policy on corporate earnings and the upcoming 2026 spring wage negotiations (Shunto). He noted that the effects of US tariffs may become more pronounced in the latter half of the year and emphasized the need to assess subsequent developments before proceeding further. In light of these circumstances, we are pushing back our interest rate hike forecast from our previous forecast. We now expect two 0.25 percentage points hikes—one in April 2026 and another in April 2027, coinciding with the release of the BoJ's Outlook Report—bringing the terminal policy rate to 1.00%. Additionally, based on current supply-demand conditions in the bond market, we have upwardly revised our long-term yield forecasts to 1.4% by end-2025 and 1.5% by end-2026.

(Written by Satsuki Yuba, Research Department)

Monthly Schedule for Long-Term JGB Purchases



※ From April 2027 onwards: Subject to review and announcement during the mid-term evaluation
※ The planned purchase amount is 'approximately in trillions of Yen'
Source: Bank of Japan; Complied by Daiwa Asset Management

10-Year Government Bond Yield

※ The latest value is as of June 23, 2025
Source: Bloomberg; Compiled by Daiwa Asset Management

J-REIT

J-REIT Market on the Rise

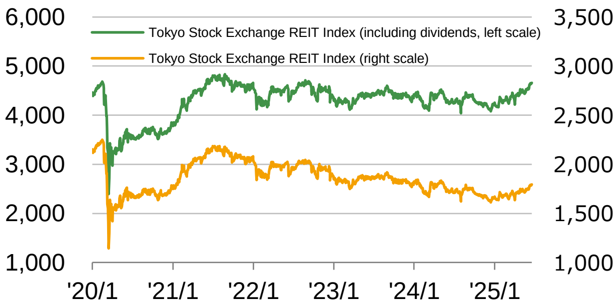
In June, domestic long-term interest rates declined to the low 1.4% range, coinciding with a rally in the J-REIT market. Given their primary exposure to domestic rental real estate, J-REITs are increasingly viewed as resilient assets, relatively insulated from external shocks such as US tariff policy and geopolitical tensions in the Middle East. The improving rental market, along with rising occupancy rates and rent increases, is contributing to growth in dividend distributions. Additionally, supply-demand dynamics have been supported by self-unit repurchases (buybacks), further contributing to market strength.

Moderate Upside Expected

Recent earnings releases reflect a growing management focus on capital cost efficiency—including share buybacks—as well as stronger awareness of distribution growth driven by rental income increases and capital gains from property sales. We view positively the increasing number of J-REITs positioning themselves for "growth," despite headwinds such as rising borrowing costs due to higher interest rates. Given their stable and attractive yield profile, J-REITs remain a compelling investment target, and we expect a gradual upward trend going forward.

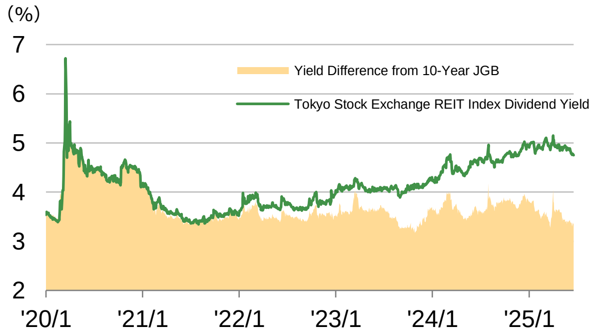
(Written by Kazuhiko Arai, Global Investment Department)

Trend of the Tokyo Stock Exchange REIT Index



※ The latest value is as of June 23, 2025
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
※ The latest value is as of June 23, 2025
Source: Bloomberg; Compiled by Daiwa Asset Management

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