

# Japan | Economic and Financial Market Outlook

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**Daiwa**  
Asset Management



### Economy

#### Economic Sentiment Remains Firm Despite US Tariff Headwinds

In the June Tankan survey by the Bank of Japan, the current Diffusion Index (DI) for business conditions remained solid despite concerns over US tariff policy. Large manufacturers posted a DI of 13, while non-manufacturers recorded 34, both reflecting favorable sentiment. Sector-wise, automotive outlook deteriorated, whereas steel—despite significant tariff hikes during the survey period—showed improvement. Capital expenditure plans remain robust, driven by structural labor shortages and rising demand for automation and operational efficiency. Although prolonged uncertainty may pose downside risks to the domestic economy, the overall Tankan results support the Bank of Japan's hawkish policy stance.

#### Price Upside Risks Driven by Yen Depreciation and Supply-Demand Imbalances

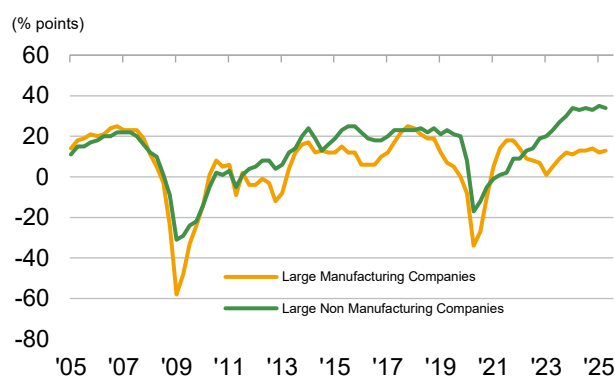
While Bank of Japan Governor Ueda acknowledged in June that inflation faces both upside and downside risks, he emphasized that downside pressures—particularly those stemming from US tariff policy—were more pronounced. However, the recent renewed depreciation of the Yen has intensified upward pressure on import prices, amplifying inflationary risks. Concurrently, labor market tightening has become more evident, prompting firms to engage in proactive wage and price-setting behavior. In June, the Consumer Price Index (CPI) for Services rose by 1.9% YoY (up from 1.7% in May), reflecting an accelerated pass-through of labor costs. As food prices continue to surge, market-based inflation expectations are also on the rise, drawing continued attention to their impact on underlying price trends.

#### Political Uncertainty Accelerated by Upper House Election

Following the 27th House of Councillors election, the ruling coalition fell short of a majority, resulting in a marked decline in its political clout. Prime Minister Ishiba has expressed his intention to remain in office, but dissatisfaction within the party is growing, and attention is now focused on his political future. Looking ahead, the following scenarios can be envisioned: (1) continuation of a minority government, (2) expansion of the ruling coalition through broader alliances, and (3) a change in government driven by opposition party unification. However, due to insufficient coordination among opposition candidates and inadequate policy consultations, the possibility of an immediate change in government remains low. For the time being, a political framework based on policy cooperation and coalition arrangements is expected to continue. Expansionary fiscal policies, such as the consumption tax cuts pledged in the opposition's campaign platform, are expected to have a higher likelihood of being enacted.

(Written by Satsuki Yuba, Research Department)

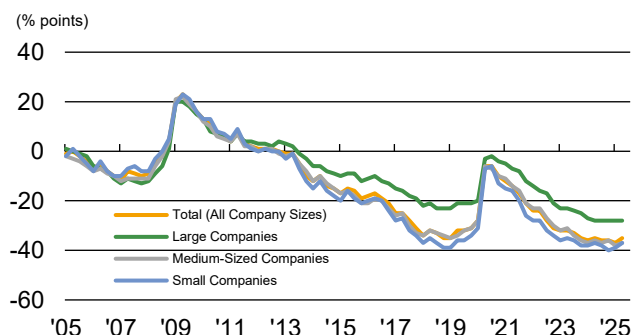
#### BOJ Tankan (Business Conditions DI)



※ Latest value is June 2025 survey

Source: Bank of Japan; Compiled by Daiwa Asset Management

#### BOJ Tankan Survey: Employment Conditions DI (All Industries)

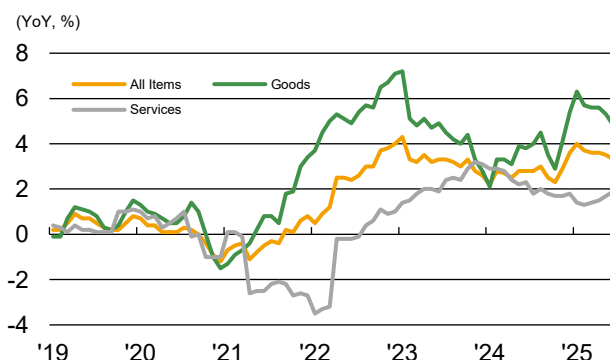


※ The most recent survey was conducted in June 2025

※ Negative values indicate a tight supply-demand balance.

Source: Bank of Japan; Compiled by Daiwa Asset Management

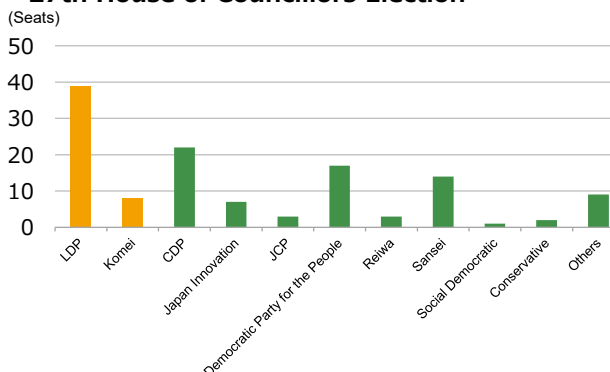
#### Consumer Price Index



※ The most recent figures are for the June 2025 survey.

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

#### Number of seats won by each party in the 27th House of Councillors Election



Source: Various Media Reports ; Compiled by Daiwa Asset Management



## Equity

**Ruling Coalition Suffers Major Defeat in House of Councillors Election, Losing Majority in Both Chambers**

In the July 20th House of Councillors election, the ruling coalition of the Liberal Democratic Party and Komeito secured only 122 seats including uncontested ones, resulting in the loss of its majority in both the Upper and Lower Houses. Prime Minister Shigeru Ishiba has declared his intention to remain in office; however, governance under a minority administration is expected to be challenging, with mounting dissent within his own party contributing to heightened political volatility. However, given the already low expectations priced into the market, the impact on the stock market is expected to be limited. While the outlook remains highly uncertain and difficult to predict, the market may respond positively if expectations for tax cuts or a new administration gain momentum.

**Multiple Headwinds Persist**

Amid heightened political uncertainty, the US economy is expected to face a significant slowdown in demand following a surge in pre-tariff purchases. The market appears to be leaning overly optimistic about the economic outlook. Domestically, persistent inflation has led to a year-on-year decline in real wages for five consecutive months, dampening consumer sentiment. In addition, the fading impact of the weak Yen has capped corporate earnings growth, signaling a plateau in performance.

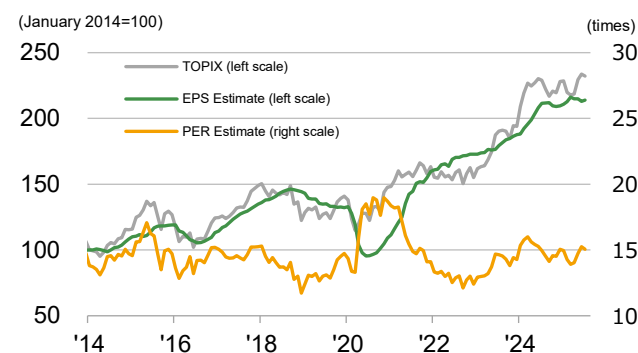
**Foreign Investors Record 13 Consecutive Weeks of Net Buying**

However, the supply-demand environment remains highly favorable. Since last summer, foreign investors had net sold approximately ¥10 trillion in total, but following the announcement of reciprocal tariffs by the US in April, they have shifted to net buying, marking 15 consecutive weeks of purchases in the cash equity market. This trend appears to reflect a reallocation of funds from USD-denominated assets and a reassessment of JPY-denominated assets, which are perceived to be significantly undervalued. Combined with corporate share buybacks—estimated at around ¥20 trillion annually and proceeding at a record pace—the favorable supply-demand conditions continue to provide solid support to the equity market.

**Will Domestic Demand Continue to Lead the Way?**

Seasonal trends typically lead to lower US interest rates and a stronger Yen during the summer months. Given the waning appeal of the US Dollar and the divergent monetary policy stances between Japan and the US, this is a phase where further Yen appreciation warrants caution. Due to the impact of US tariffs, export-oriented companies—excluding select firms in areas such as AI and semiconductors—are facing a particularly challenging environment. In contrast, domestically focused companies are operating under more favorable conditions, with greater ability to pass on costs and potential benefits from reduced procurement expenses driven by Yen appreciation. As such, the trend of domestic demand outperformance is expected to continue.

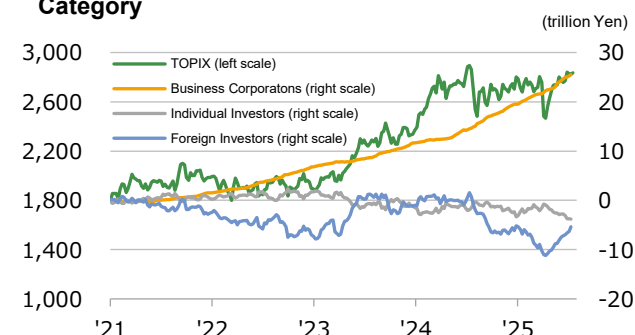
(Written by Kensuke Togashi, Research Department)

**TOPIX Estimated EPS and PER**

※ Month-end value, July 2025 is the value on the 18<sup>th</sup>

※ EPS and PER estimate is 12-months ahead forecast

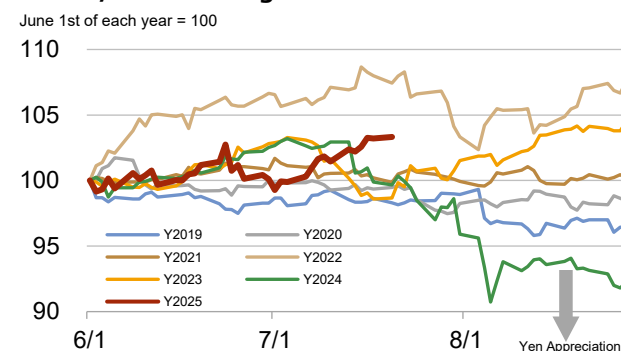
Source: Bloomberg; Compiled by Daiwa Asset Management

**TOPIX and Total Trading Value by Investment Category**

※ Trading value (including Futures) by investment category through the week of July 11<sup>th</sup>

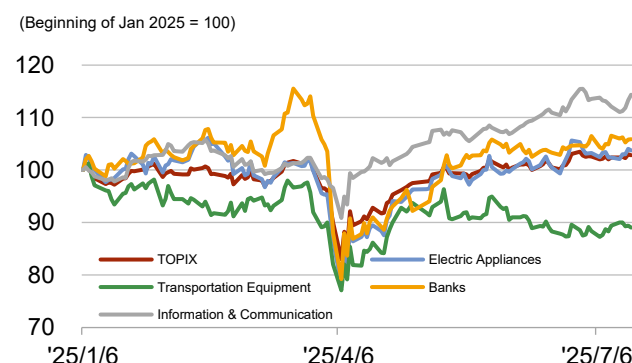
※ Weekly data, the latest value for TOPIX is as of July 18, 2025

Source: Quick; Compiled by Daiwa Asset Management

**USD/JPY Exchange Rate**

※ The latest value for 2025 is as of July 18

Source: Bloomberg; Compiled by Daiwa Asset Management

**TOPIX and TSE Sector Indices**

※ The latest value for 2025 is July 18.

Source: Bloomberg; Compiled by Daiwa Asset Management



### Interest Rates

#### Outlook Maintained, but Fiscal Risks Persist

Japan and international financial and economic environment has undergone significant changes. The JPY has depreciated, at one point reaching the 149 level against the USD, raising concerns over its impact on the domestic economy and inflation. In light of these developments, the Bank of Japan's Outlook Report, to be released following the July Monetary Policy Meeting, may consider a downward revision to the GDP growth forecast and an upward revision to the inflation outlook. However, given the time required to fully assess the impact of US tariff policies, we currently maintain our baseline view on monetary policy. In the recent Upper House election, the ruling coalition suffered a major defeat, while opposition parties advocating expansionary fiscal policies gained momentum. However, the results were largely within expectations, and immediate concerns over fiscal deterioration have temporarily receded. Our long-term interest rate outlook remains unchanged at this stage. Nevertheless, if politically driven, unsustainable fiscal policies persist amid rising political uncertainty, renewed concerns over fiscal discipline could trigger a loss of investor confidence and lead to a "Japan sell-off."

(Written by Satsuki Yuba, Research Department)

### J-REIT

#### J-REIT Market on the Rise

In July, despite a temporary increase in domestic long-term interest rates to around 1.6%, the J-REIT market posted gains. Favorable rental market conditions—characterized by improved occupancy rates and upward rent revisions—have contributed to growth in dividend distributions. Additionally, supply-demand dynamics have improved, supported by self-unit acquisitions (buybacks). Since J-REITs primarily lease domestic real estate assets, they are perceived as relatively insulated from the impact of US tariff policies, and continue to attract investor interest as resilient domestic assets

#### Moderate Upside Expected

Rent increases are expected to continue, particularly in the hotel, office, and residential sectors. Market attention is gradually shifting toward how J-REITs can offset the negative impact of rising interest rates by achieving rental growth and expanding earnings. An increasing number of J-REITs are responding to investor expectations by clearly presenting growth targets for per-unit distributions and profits. In addition to offering stable and attractive yields, J-REITs with strong growth prospects remain compelling investment vehicles, and a moderate upward trend is anticipated.

(Written by Kazuhiko Arai, Global Investment Department)

#### 30-year JGB Yield



※ The latest value is July 18, 2025.

Source: Bloomberg; Compiled by Daiwa Asset Management

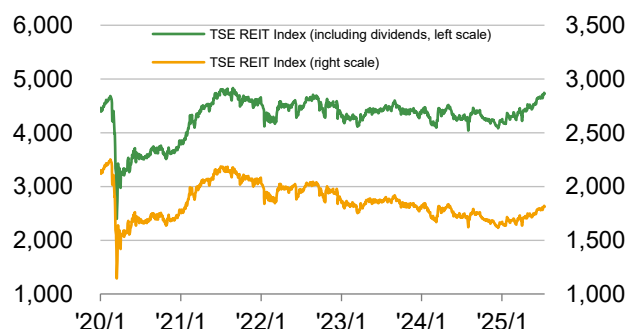
#### 10-year JGB Yield



※ The latest value is July 18, 2025.

Source: Bloomberg; Compiled by Daiwa Asset Management

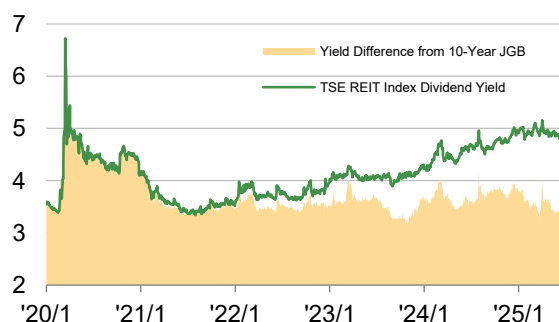
#### Trend of the Tokyo Stock Exchange REIT Index



※ The latest value is as of July 18, 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 July 18, 2025

Source: Bloomberg; Compiled by Daiwa Asset Management

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