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Japan | Economic and Financial Market Outlook

Page

Daiwa Asset Management

10
OCT. 2025

Forecast for Economy, Interest Rates, Equity Markets, REITs, and Foreign Exchange

How to read the table

... Forecast revised upward (previous estimates)

... Forecast revised downward (previous estimates)

	Real GDP (YoY, %)			
	Actual figures		Estimates	
	2023	2024	2025	2026
US	2.9	2.8	1.5	1.6
Japan	1.4	0.2	0.6	0.8
Euro	0.4	0.9	1.2	1.2

Monetary Policy Outlook

US	• Two additional 25bp rate cuts are expected in October and December, with the easing cycle likely ending in 2026 at a terminal rate of 3.00–3.25%. • Balance sheet reduction continues: $5B/month in Treasuries and $35B/month in MBS runoff.
Japan	• Starting October 2025, 25bp rate hikes are expected every six months—brought forward from the previous outlook • JGB purchase tapering: From April 2026, the quarterly reduction will be halved from approximately ¥400 billion to ¥200 billion.
Euro zone	• With inflation stabilizing and uncertainty receding, the central bank has completed its rate-cut cycle by lowering the deposit rate to the neutral level of 2%. • Redeemed securities will not be reinvested.

	Policy interest rate (%)				
	Actual figures		Latest figures	Estimates	
	End of 2023	End of 2024	As of 2025/9/19	End of 2025	End of 2026
US*1	5.50	4.50	**4.25**	3.75 ← (4.00)	3.25
Japan	-0.10	0.25	**0.50**	0.75 ← (0.50)	1.25 ← (0.75)
Euro*2	4.00	3.00	**2.00**	2.00	2.00

	10-year government bond yield (%)				
	Actual figures		Latest figures	Estimates	
	End of 2023	End of 2024	As of 2025/9/19	End of 2025	End of 2026
US*1	3.9	4.6	**4.1**	3.9	4.1
Japan	0.6	1.1	**1.6**	1.6 ← (1.4)	1.7 ← (1.5)
Euro*2	2.0	2.4	**2.7**	2.4 ← (2.2)	2.4 ← (2.2)

1. US policy rate is the upper limit of the FF rate guidance target
2. The policy rate for the Euro area is the Central Bank deposit rate, and the 10-year government bond yield is the German government bond yield.

Source: Actual values from government and statistical bureaus of each country and Bloomberg; forecast values from Daiwa Asset Management

		Equity Index									
		Actual figures				Latest figures		Estimates			
		End of 2023	Annual Rate of Change	End of 2024	Annual Rate of Change	As of 2025/9/19	YTD Rate of Change	End of 2025	Annual Rate of Change	End of 2026	Annual Rate of Change
US	**S&P500**	4,770	+24%	5,882	+23%	**6,664**	+13%	6,800 ← (6,600)	+16%	7,400 ← (6,900)	+9%
	DJIA	37,690	+14%	42,544	+13%	**46,315**	+9%	47,000 ← (46,800)	+10%	50,000 ← (48,900)	+6%
Japan	**TOPIX**	2,366	+25%	2,785	+18%	**3,148**	+13%	3,250 ← (3,200)	+17%	3,450 ← (3,400)	+6%
	Nikkei 225 Index	33,464	+28%	39,895	+19%	**45,046**	+13%	46,000 ← (45,000)	+15%	48,000 ← (47,000)	+4%
Euro	**STOXX600**	479	+13%	508	+6%	**554**	+9%	570	+12%	600	+5%

		REIT									
		Actual figures				Latest figures		Estimates			
		End of 2023	Annual Rate of Change	End of 2024	Annual Rate of Change	As of 2025/9/19	YTD Rate of Change	End of 2025	Annual Rate of Change	End of 2026	Annual Rate of Change
US	**NAREIT Index**	22,848	+14%	24,843	+9%	**25,588**	+3%	27,000	+9%	29,700	+10%
Japan	**TSE REIT Index**	1,807	-5%	1,653	-9%	**1,932**	+17%	1,850	+12%	1,950	+5%

	Exchange Rate (vs. JPY)									
	Actual figures				Latest figures		Estimates			
	End of 2023	Annual Rate of Change	End of 2024	Annual Rate of Change	As of 2025/9/19	YTD Rate of Change	End of 2025	Annual Rate of Change	End of 2026	Annual Rate of Change
USD	141	+8%	157	+11%	**148**	-6%	141	-10%	136	-4%
EUR	156	+11%	163	+5%	**174**	+7%	162	-0%	156	-4%

Source: Bloomberg for actual figures, Daiwa Asset Management for forecast figures

Economy

Manufacturing Sector Shows Signs of Deceleration, While Non-Manufacturing Provides Support

According to the Corporate Financial Statistics for the April–June quarter, recurring profits in the manufacturing sector declined to ¥9.3 trillion, down from ¥9.9 trillion in the January–March quarter, marking the second consecutive quarterly contraction. Notably, the transportation equipment segment—including automobiles—experienced a nearly 30% year-over-year decline, reflecting a slowdown in external demand. This trend appears to be driven by factors such as the diminishing impact of Yen depreciation and the adverse effects of US tariff policies. In contrast, the non-manufacturing sector (excluding financial and insurance industries) posted recurring profits of ¥20.2 trillion, up from ¥19.4 trillion in the previous quarter, marking a third consecutive quarterly increase. This suggests that, at the macroeconomic level, overall corporate earnings remain resilient. However, the impact of US trade policy is expected to gradually materialize, and continued monitoring will be necessary to assess the extent of its influence.

Real Wages Turn Positive for the First Time in Seven Months

According to the latest Monthly Labour Survey, Scheduled Cash Earnings have continued to show robust growth, reflecting the higher-than-expected wage hike rate achieved in this year's spring labor negotiations. Furthermore, special payments—such as summer bonuses—saw a substantial increase in July, resulting in a YoY rise of +0.5% in real wages, marking the first positive growth in seven months (compared to -0.8% in June). Looking ahead, real wage growth is expected to remain on an upward trajectory, supported by a deceleration in the inflation rate. However, downside risks remain. The impact of US tariff policies may exert negative pressure on corporate earnings, particularly in the manufacturing sector, potentially affecting winter bonus payouts and next year's spring wage negotiations. Should this lead to a loss of momentum in wage growth—previously driven by structural labor shortages—market expectations for a Bank of Japan rate hike could recede significantly.

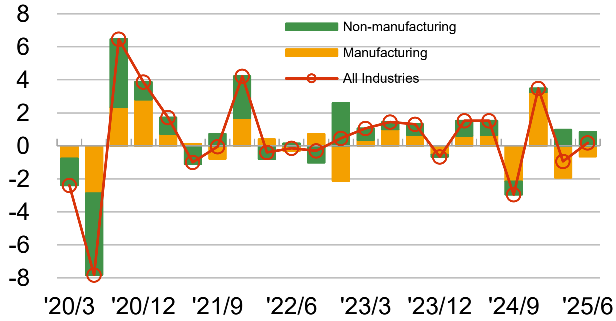
Leadership Transition in Focus: Coalition Dynamics with Opposition Parties Take Center Stage

Following the resignation announcement by Prime Minister Ishiba, the Liberal Democratic Party (LDP) is set to hold a presidential election on Saturday, October 4. Unless opposition parties consolidate their support behind a single candidate in the subsequent Diet vote to appoint the next prime minister, the newly elected LDP president is expected to form the next administration. Since it will be a minority government, regardless of who is elected, cooperation with opposition parties advocating an expansionary fiscal policy will be essential for passing budgets and legislation. While the opposition advocates for expansionary fiscal policies, the ruling party faces pressure to maintain a sustainable fiscal framework. As such, the nature and structure of collaboration with opposition parties will be a critical issue in the leadership race. Candidates are not only exploring policy-specific coordination but also considering broader coalition-building strategies. In particular, the Democratic Party for the People and Nippon Ishin no Kai are emerging as likely partners in potential alliance scenarios.

(Written by Satsuki Yuba, Research Department)

Corporate Statistics (Ordinary Profit)

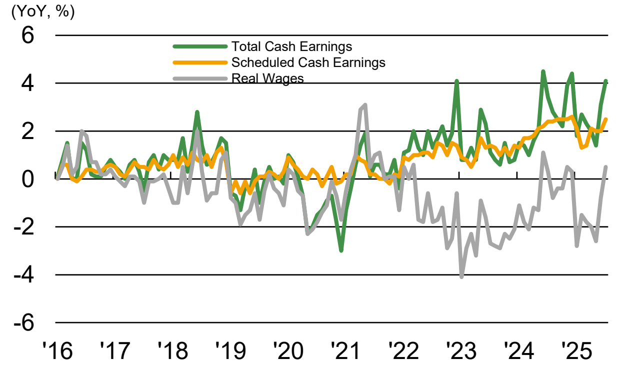
(Change from previous period, trillion Yen)



※ The latest figures are for the April-June period of 2025
※ Seasonally adjusted, all industries & non-manufacturing (excl. financial and Insurance
Source: Ministry of Finance; Complied by Daiwa Asset Management

Monthly Labor Survey

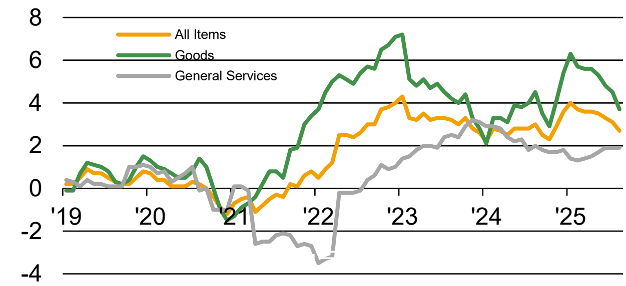
(YoY, %)



※ Companies with at least 5 employees, the latest figures are from July 2025
Source: Ministry of Health, Labour and Welfare; Complied by Daiwa Asset Management

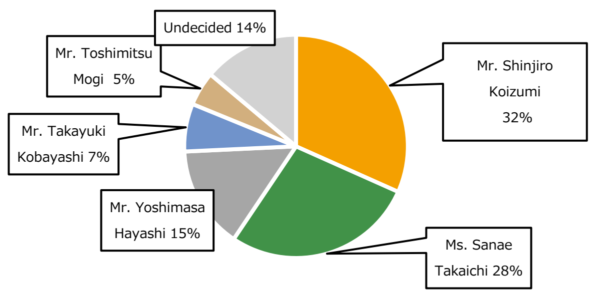
National CPI

(YoY, %)



The latest figures are for August 2025
※ Source: Ministry of Internal Affairs and Communications; Complied by Daiwa Asset Management

LDP Presidential Election: Party Member and Supporter Survey (NTV First Round)



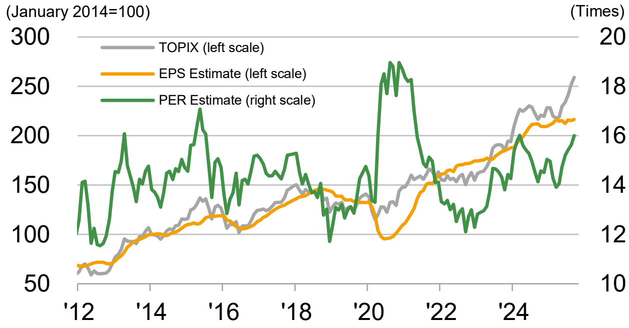
※ Survey conducted by NTV on September 19-20, 2025 (Who do you support?)
※ 1,010 voters nationwide who answered that they are LDP members or friends of the LDP; percentages are rounded to the nearest 100 percent, so totals do not add up to 100 percent
Source: NTV; Complied by Daiwa Asset Management

Equity

Major indices hit all-time highs on favorable supply and demand

Despite heightened uncertainty stemming from US tariff hikes and political instability, favorable supply-demand dynamics—driven by corporate share buybacks and robust capital inflows from foreign institutional investors—have supported the rally, with both the TOPIX and Nikkei 225 reaching all-time highs. Corporate earnings remain generally subdued due to the diminishing tailwind from Yen depreciation and rising labor costs. Nevertheless, the expansion in equity valuations continues to be the primary driver of market upside. However, forward PER and PBR are approaching their upper limits seen since the Lehman shock.

TOPIX Estimated EPS and PER



※ Month-end value, September 2025 is the value on the 19th
※ EPS and PER estimate is 12-months ahead forecast
Source: Bloomberg; Compiled by Daiwa Asset Management

Corporate Earnings Show Mixed Results

Corporate performance for the April–June period has been generally lackluster, weighed down by the fading benefits of Yen depreciation and rising costs such as labor expenses. In sectors such as automobiles and steel, the adverse impact of US tariff hikes has already materialized. Looking ahead, concerns persist over a potential post-rush demand downturn and intensifying competitive pressures, contributing to heightened uncertainty surrounding external demand. Conversely, certain segments of domestic demand—namely AI and defense-related industries, as well as financials, real estate, and construction—saw substantial profit growth, resulting in a mixed earnings landscape.

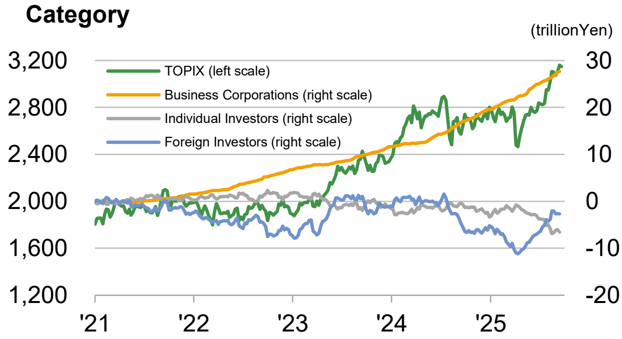
Actual PBR of TOPIX

※ Month-end value, September 2025 is the value on the 19th
Source: QUICK; Complied by Daiwa Asset Management

Supply-Demand Conditions Remain Highly Favorable

The sustained favorable supply-demand dynamics continue to underpin the market rally. Since last summer, foreign investors—who had been net sellers of roughly ¥10 trillion—turned net buyers from the third week of April, driving the rally. Although the pace of foreign capital inflows has recently moderated, the record-breaking momentum in share buybacks remains intact, preserving the robust supply-demand environment. In the absence of aggressive sellers, there is a growing possibility that elevated valuation may persist over the longer term.

TOPIX and Total Trading Value by Investment Category

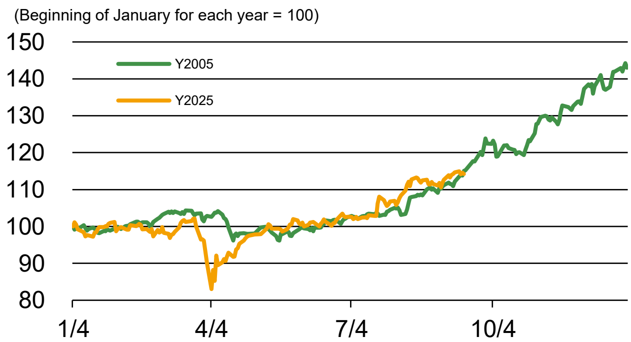


※Trading value (including Futures) by investment category through the week of September 12th
※Weekly data, the latest value for TOPIX is as of September 19th 2025
Source: Quick; Compiled by Daiwa Asset Management

Similarities to 2005 Market Conditions

There are similarities between 2005 and this year, both ending in the digit "5." In 2005, the United States was under the Bush administration's "Triple Red" situation. In Japan, the dissolution of the Diet on August 8 led to heightened expectations for Prime Minister Koizumi's structural reforms, resulting in a sharp surge in stock prices. Meanwhile, on August 8 this year, expectations for an "extraordinary presidential election" rose following the Liberal Democratic Party's joint plenary session of both Houses. Also, while emerging market stocks rallied back then, this year AI-related stocks have surged in a similarly excess liquidity-driven market. Another commonality is the issuance of new banknotes in the previous year.

TOPIX Year-to-Date Trends in 2005 and 2025



※ The latest value is September 19, 2025
Source: Bloomberg; Compiled by Daiwa Asset Management

(Written by Kensuke Togashi, Research Department)

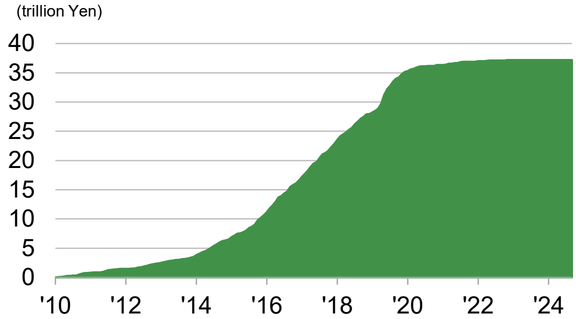
Interest Rates

Upward Revision of Policy Rate and Long-Term Interest Rate Outlook

At its September Monetary Policy Meeting, the Bank of Japan decided to maintain the current policy interest rate. Simultaneously, it announced a disposal policy for its holdings of ETFs and J-REITs, targeting annual sales of approximately ¥330 billion for ETFs and ¥5 billion for J-REITs on a book-value basis. This move is believed to reflect a strategic intent to secure capital gains in order to avoid fiscal deficits, amid rising interest payment burdens associated with rate hikes and increasing risks of balance sheet deterioration. It may also signal the Bank's willingness to proceed with a gradual tightening of interest rates. Governor Ueda assessed the impact of US tariff policies, stating that Japan's domestic economy has remained resilient. While he expressed a desire to examine further data before making future decisions, he also remarked, "It's not that we must wait until the very end to know." Assuming strong momentum in wage trends confirmed through the September Tankan survey and regional branch manager meetings, we have brought forward our forecast for the next rate hike to the October meeting. Furthermore, in line with market expectations for a higher terminal rate, we have revised our long-term interest rate outlook upward to 1.6% by the end of 2025 and 1.7% by the end of 2026, each by 0.2 percentage points.

(Written by Satsuki Yuba, Research Department)

BOJ's Exchange Traded Funds (ETFs) holdings (book value basis)



※ The latest value is September 19, 2025
Source: Bank of Japan; Complied by Daiwa Asset Management

10-year JGB Yield

※ The latest value is September 19, 2025
Source: Bloomberg; Complied by Daiwa Asset Management

J-REIT

The Impact of the Bank of Japan's REIT Sale Decision Seen as Limited

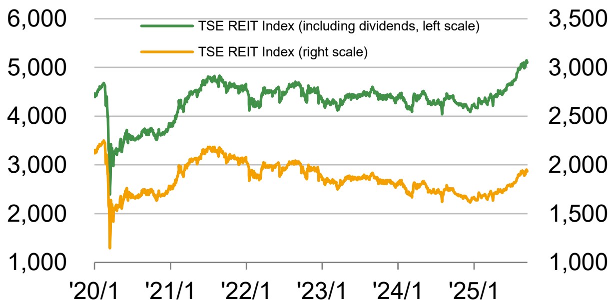
At its September Monetary Policy Meeting, the Bank of Japan decided to sell its holdings of Exchange-Traded Funds (ETFs) and Real Estate Investment Trusts (J-REITs) in the market. For J-REITs, the annual disposal amount is expected to be approximately ¥5 billion on a book-value basis and around ¥5.5 billion at market value (as of the end of March 2025).

The scale of the planned sales is modest, accounting for only about 0.05% of the total market trading volume, indicating a deliberate consideration for market liquidity. Given the relatively small size of the ¥5 billion annual sales, even when observing trading trends, the impact of the Bank's decision will have virtually no impact on the J-REIT market.

The real estate leasing market remains robust, and expectations for continued growth in rental business profits among J-REITs remain unchanged. In addition to rent increases, capital gains from property sales are expected to serve as a driver, enabling the J-REIT market as a whole to offset rising interest costs and continue increasing dividend payouts.

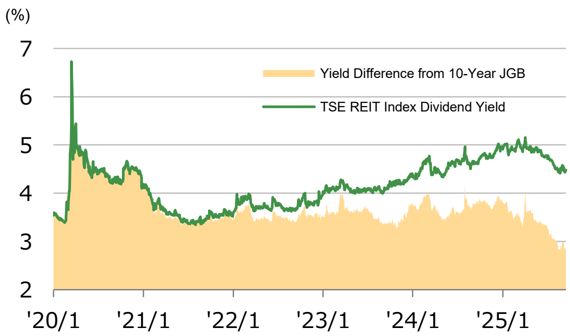
(Written by Kazuhiko Arai, Global Investment Department)

Trend of the Tokyo Stock Exchange REIT Index



※ The latest value is September 19, 2025
Source: Bloomberg; Complied 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 September 19, 2025
Source: Bloomberg; Compiled by Daiwa Asset Management

US Dollar

Falling Rates Hit US Dollar as Risk-On Trade Pressures Yen

Over the past month, while the Yen has weakened against other currencies (see right chart, 25 currencies), the US dollar has depreciated, leaving the USD/JPY rate relatively stable. The decline in US yields, driven by rising expectations of Fed rate cuts, has pressured the dollar. Meanwhile, risk-on sentiment—reflected in equity market gains—has contributed to Yen depreciation. With reciprocal tariff hikes enacted in August, signs of economic slowdown in the US and elsewhere may shift the balance toward dollar weakness from lower rates, outweighing risk-on Yen depreciation and increasing downside risk for USD/JPY.

USD Falls, Yen Rises as Real Rate Gap Narrows

Over the past month, the Japan–US real interest rate differential has narrowed, yet the USD/JPY exchange rate has not declined. . Based on the recent real interest rate gap, the appropriate level for USD/JPY is estimated to be around 139–143, but the actual rate remains above that range, reflecting Yen weakness driven by risk-on sentiment. However, the narrowing of the 5-year real interest rate differential—which had lagged behind the 10-year spread—is also progressing. Going forward, we expect the US-Japan real interest rate differential to narrow further and the USD/JPY to depreciate in tandem with the narrowing.

Risk-On Yen Weakness Recedes on Economic Slowdown Fears

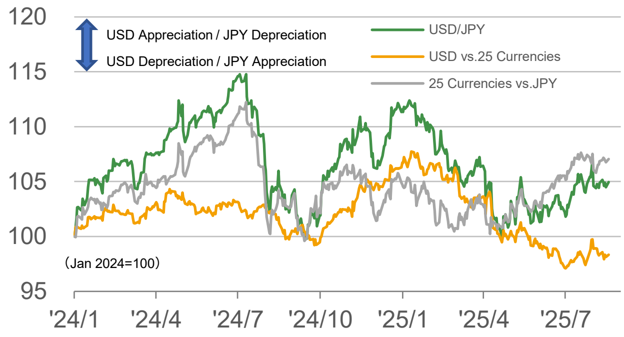
The relatively high number of US economic indicators exceeding market expectations and the rise in the US Economic Surprise Index has supported risk-on-driven Yen weakness. However, the surprise index has been trending lower recently. While wealth effects may continue to support consumption, the combination of higher effective tariff rates and a slowdown in the pace of US dollar depreciation is increasing the likelihood that US economic indicators will unexpectedly deteriorate. As concerns over an economic slowdown grow, risk-on Yen weakness is likely to fade, and the USD/JPY exchange rate may decline.

USD/JPY Expected to Decline in Tandem with Commodity Index

Periods of rising commodity prices tend to coincide with US dollar strength and Yen weakness, driven by higher US interest rates and risk-on sentiment, while periods of falling commodity prices often see US dollar weakness and Yen strength as rates decline and risk-off sentiment prevails. In the first half of September, strong economic indicators in Europe and the US, combined with falling interest rates, fueled risk-on sentiment and pushed commodity indices higher. However, going forward, if economic data come in below market expectations, risk-on sentiment is likely to weaken even if rates decline, increasing the likelihood of a shift toward lower commodity prices. We expect that a decline in commodity prices will be accompanied by US dollar weakness and Yen appreciation.

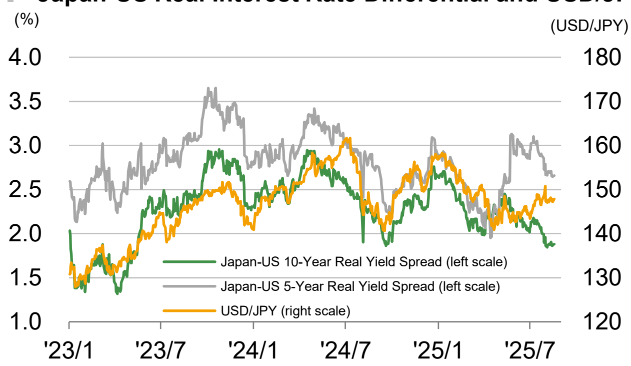
(Written by Yuji Kameoka, Research Department)

Exchange Rates of USD/JPY and Other Currencies



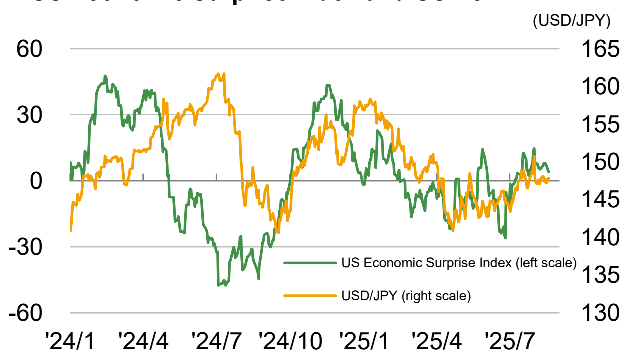
※Weighted average of exchange rates for 25 currencies based on April 2022 trading volumes
※The latest value is September 19, 2025
Source: BIS and LSEG; Complied by Daiwa Asset Management

Japan-US Real Interest Rate Differential and USD/JPY



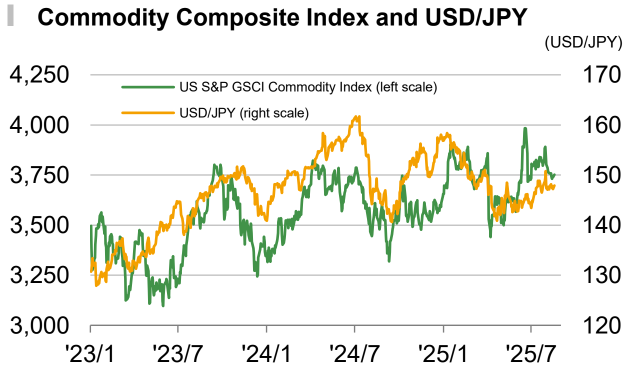
※ The latest value is September 19, 2025
Source;LSEG; Complied by Daiwa Asset Management

US Economic Surprise Index and USD/JPY



※ The latest value is September 19, 2025
Source;LSEG; Complied by Daiwa Asset Management

Commodity Composite Index and USD/JPY



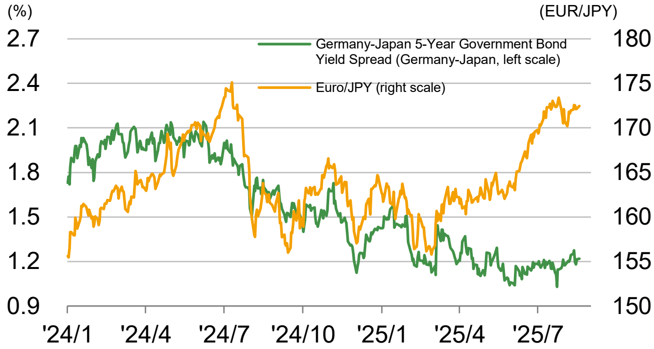
※ The latest value is September 19, 2025
Source;LSEG; Complied by Daiwa Asset Management

Euro

Shift to Euro Weakness and Yen Strength Expected

The Euro has been strengthening while the Yen has been weakening, driven by risk-on sentiment fueled by strong economic indicators in Europe and the US combined with falling interest rates, which have put downward pressure on the Yen. However, expectations of a Bank of Japan rate hike have caused Japanese interest rates to rise relative to German interest rates, creating a factor for Euro weakness and Yen strength. Looking ahead, as global economic slowdown concerns intensify and risk-on-driven Yen weakness fades, we expect a shift toward Euro depreciation and Yen appreciation.

5-year German-Japanese Government Bond Rate Differential and EUR/JPY Exchange Rate



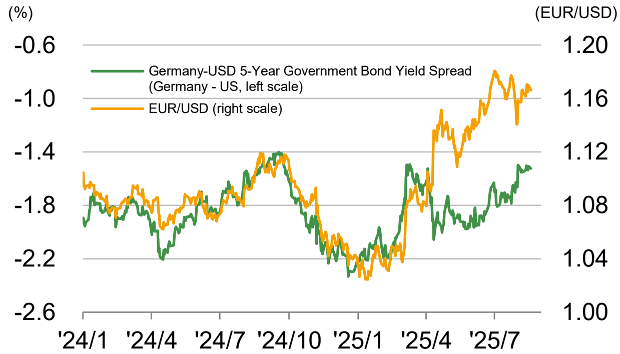
※ The latest value is September 19, 2025
Source;LSEG; Complied by Daiwa Asset Management

Euro Strength and Dollar Weakness Likely to Ease

The Euro has been strengthening against the US dollar, driven by expectations that the ECB has ended its rate-cut cycle and that the Fed will continue cutting interest rates, which has pushed German interest rates higher relative to US interest rates, as well as by risk-on sentiment. While this relative rise in German interest rates and decline in US interest rates will likely continue to support Euro strength, we see limited upside. As the impact of US tariffs slows global economic growth, risk-off pressure favoring Euro weakness and Dollar strength is expected to emerge, curbing further Euro appreciation against the Dollar.

(Written by Yuji Kameoka, Research Department)

5-year German-US Government Bond Rate Differential and EUR/USD Exchange Rate



※ The latest value is September 19, 2025

Source;LSEG; Complied by Daiwa Asset Management

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