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Japan | Economic and Financial Market Outlook

2

FEB. 2026

Daiwa Asset Management

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		
	2024	2025	2026	2027
US	2.8	1.5	2.0	1.8
Japan	▲ 0.2	0.6	0.8	0.8
Euro	0.9	1.4	1.4	1.4

Monetary Policy Outlook

US	•We expect cumulative rate cuts of 50 bps in 2026 under the next Fed Chair, with the policy rate bottoming out at 3.00–3.25%.
Japan	• Anticipates rate hikes of 0.25 % points roughly every six months. Expected to cap at 1.5%. • Government bond purchases reduction: From April 2026, the quarterly reduction amount will be compressed from the current level of approximately ¥400 billion to ¥200 billion as a general rule.
Euro zone	•With price stability largely assured, the ECB's deposit rate is expected to remain at the neutral level of 2% for an extended period, • Redeemed bonds will not be reinvested, and no active sales are planned

	Policy Interest Rate (%)					10-Year Government Bond Yield (%)				
	Actual figures	Latest figures	Latest figures	Estimates		Actual figures		Latest figures	Estimates	
	End of 2024	End of 2025	As of 2026/1/19	End of 2026	End of 2027	End of 2024	End of 2025	As of 2026/1/19	End of 2026	End of 2027
US*1	4.50	3.75	**3.75**	3.25	3.25	4.6	4.2	**4.2**	4.1	4.3
Japan	0.25	0.75	**0.75**	1.25	1.50	1.1	2.1	**2.3**	2.0	2.0
Euro*2	3.00	2.00	**2.00**	2.00	2.00	2.4	2.9	**2.8**	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 2024	Annual Rate of Change	End of 2025	YTD Rate of Change	As of 2026/1/19	YTD Rate of Change	End of 2026	Annual Rate of Change	End of 2027	Annual Rate of Change
US	**S&P500**	5,882	+23%	6,846	+16%	**6,940**	+1%	7,400	+8%	8,000	+8%
	DJIA	42,544	+13%	48,063	+13%	**49,359**	+3%	50,000	+4%	54,000	+8%
Japan	**TOPIX**	2,785	+18%	3,409	+22%	**3,656**	+7%	3,750	+10%	4,000	+7%
	Nikkei 225 Index	39,895	+19%	50,339	+26%	**53,584**	+6%	56,000	+11%	60,000	+7%
Euro	**STOXX600**	508	+6%	592	+17%	**607**	+3%	600	+1%	640	+7%

		REIT									
		Actual figures				Latest figures		Estimates			
		End of 2024	Annual Rate of Change	End of 2025	YTD Rate of Change	As of 2026/1/19	YTD Rate of Change	End of 2026	Annual Rate of Change	End of 2027	Annual Rate of Change
US	**NAREIT Index**	24,843	+9%	25,558	+3%	**26,740**	+5%	32,000	+25%	35,300	+10%
Japan	**TSE REIT Index**	1,653	-9%	2,014	+22%	**2,050**	+2%	2,100	+4%	2,150	+2%

	Exchange Rate (vs. JPY)									
	Actual figures				Latest figures		Estimates			
	End of 2024	Annual Rate of Change	End of 2025	YTD Rate of Change	As of 2026/1/19	YTD Rate of Change	End of 2026	Annual Rate of Change	End of 2027	Annual Rate of Change
USD	157	+11%	157	+0%	**158**	+1%	146	-7%	142	-3%
EUR	163	+5%	184	+13%	**184**	+0%	168	-9%	162	-4%

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

Economy

Companies' Proactive Wage-Setting Behavior Continues

Turning to the wage environment, labor shortages at companies have become increasingly severe due to population decline and an aging society with a low birth rate, and labor market conditions remain tight. Meanwhile, corporate earnings have been generally resilient, although close attention is still warranted regarding the potential impact of deteriorating Japan–China relations on the domestic economy and prices. Downward pressure stemming from US tariff policies, however, appears to be more limited than initially anticipated. Based on labor–management stances ahead of the 2026 spring wage negotiations (Shunto) and information gathered through the Bank of Japan's hearings, wage-growth momentum has been maintained at a level comparable to FY2025. As a result, we view the risk of a slowdown or interruption in companies' proactive wage-setting behavior as low.

Watch for Upside Risks to Inflation

The core Consumer Price Index (excluding fresh food) has recently been hovering at around +3% YoY, remaining clearly above the 2% price stability target. Looking ahead, inflation may temporarily fall below 2%, as upward pressure on food prices such as rice eases and as the effects of government measures—including free education initiatives and the abolition of the former provisional gasoline tax surcharge—come into play. Thereafter, under a scenario in which the mechanism of moderate increases in both wages and prices is preserved, inflation is expected to move at levels broadly consistent with the 2% price stability target, supported by a resilient economic backdrop. That said, amid a continuing weaker Yen trend, there remains a risk that persistently elevated inflation could push prices higher than anticipated via rising inflation expectations in the market.

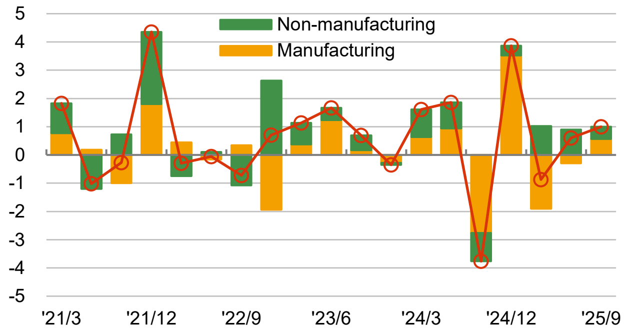
Lower House Dissolution Accelerates Consumption Tax Cut Race Between Ruling and Opposition

Prime Minister Takaichi formally announced her intention to dissolve the House of Representatives at the opening of the ordinary Diet session convened on the 23rd. The election schedule is expected to be announced on January 27, with voting and ballot counting on February 8. Against the backdrop of high cabinet approval ratings, the move is seen as an attempt to increase parliamentary seats and strengthen the administration's political base. At the same time, however, the formation of a new party—the Centrist Reform Alliance—by the Constitutional Democratic Party and Komeito has made it difficult to expect an additional boost from Komeito's voter base. As a result, the outlook has become more uncertain, and the election could prove to be a challenging contest for the Liberal Democratic Party. In the lower house election, both ruling and opposition parties are stepping up efforts to include consumption tax cuts in their campaign pledges. Caution is warranted, however, as advancing tax cuts without sufficient discussion of funding sources could intensify concerns over fiscal deterioration.

(Written by Satsuki Yuba, Research Department)a

Corporate Statistics (Recurring Profit)

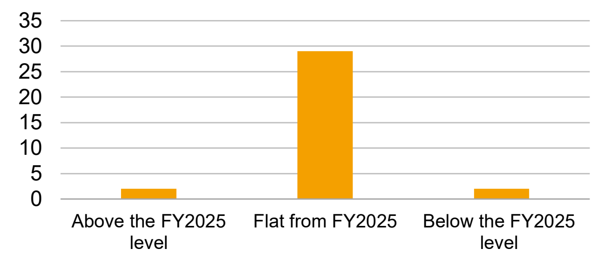
(Change from previous period, trillion Yen)



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

Corporate wage-increase stance for FY2026

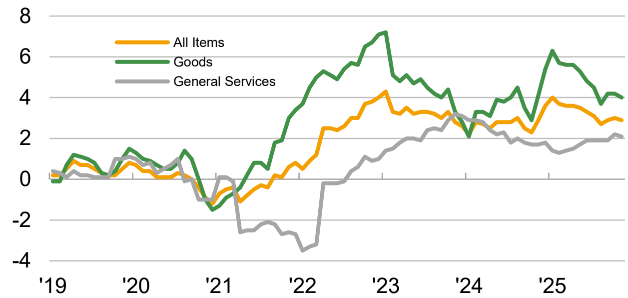
(comparison with the previous fiscal year, number of branches)



※Hearing survey results from the BOJ Head Office and 32 nationwide branches (Dec. 15, 2025)
Source: BOJ; Complied by Daiwa Asset Management

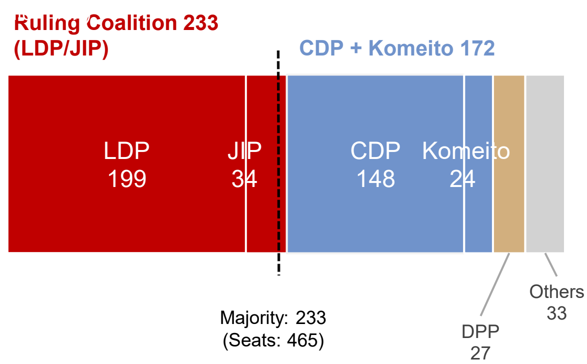
Consumer Price Index (CPI)

(YoY, %)



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

Composition of the House of Representatives



※Number of seats, as of November 28, 2025
Source: House of Representatives website; Complied by Daiwa Asset Management

Equity

A Strong Start to 2026

Japanese equities posted strong gains in 2025, and have also made a robust start to 2026, with the TOPIX up 7.3% year to date as of January 19. This strength is underpinned by expectations for solid global and Japanese economic growth, healthy earnings momentum, ongoing structural changes across macro, micro, and supply–demand dynamics, as well as rising expectations for political developments. Since reports emerged on the evening of the 9th that Prime Minister Takaichi was considering the dissolution of the House of Representatives, Japanese equities have extended their upward momentum.

Prime Minister Takaichi Announces Dissolution of House of Representatives

On January 19, Prime Minister Takaichi formally announced that the House of Representatives will be dissolved on the 23rd. While equity market expectations for the Takaichi administration's policies remain high, the government's political foundation is fragile, as the ruling coalition holds only a slim majority in the House of Representatives and remains a minority in the House of Councillors. If, through the election, the Liberal Democratic Party and its coalition partners are able to significantly increase their number of seats and strengthen the administration's political base, expectations for effective policy implementation would rise, which would be viewed as a positive development for the equity market.

Upside Risk Potential Is Increasing

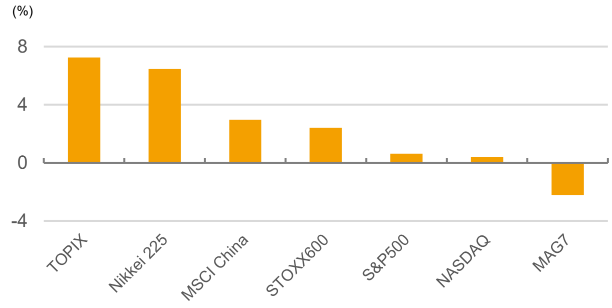
We have viewed a dissolution general election as one of the upside risks for the Japanese equity market in 2026, and the likelihood of this scenario materializing has increased. Should the ruling coalition succeed in significantly expanding its number of seats, there would be a high probability that the TOPIX and the Nikkei 225 would exceed our current forecasts. That said, the outcome of the election remains uncertain, and we will continue to monitor developments closely as the campaign unfolds. At the same time, bond and currency markets have also been showing heightened volatility, warranting close attention to movements across asset classes.

Share Buybacks Remain at Elevated Levels in 2025

The value of share buyback limits set in 2025 totaled ¥17.8 trillion, slightly below the ¥18.0 trillion recorded in 2024, but nonetheless remained at an elevated level. Even amid heightened uncertainty surrounding tariffs and other factors—and strong headwinds to corporate earnings—the fact that share buyback limits were maintained at levels largely unchanged from the previous year can be seen as a reflection of Japanese companies' firm commitment to strengthening shareholder returns and improving capital efficiency. Looking ahead to 2026, share buyback limits are expected to reaccelerate, supported by a recovery in corporate earnings and revisions to the Corporate Governance Code.

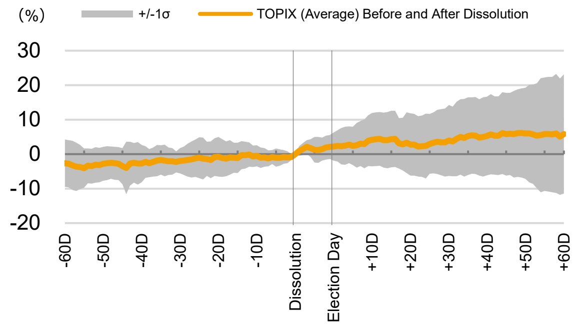
(Written by Kazunori Tatebe, Research Department)

YTD Performance of Major Stock Indices



※As of January 19, 2026, MAG7 = Magnificent Seven
Source: Bloomberg; Complied by Daiwa Asset Management

Stock Prices Tend to Rise After the Dissolution of the Lower House



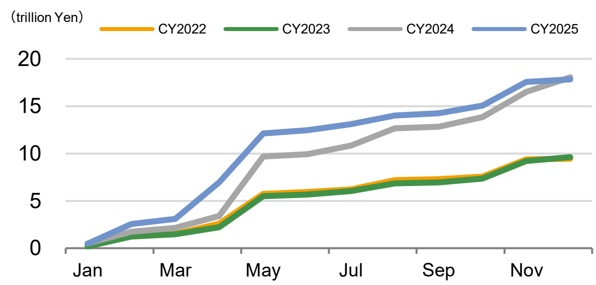
※ TOPIX Performance Before and After the Ten Lower House Elections Since 1993, Calculated with the Dissolution Date as Day 0, σ = Standard Deviation
Source: House of Representatives and Bloomberg; Complied by Daiwa Asset Management

Post-Election Stock Performance Shows a Strong Correlation with Seats Won by the LDP–Ruling Coalition

	Seats won		TOPIX Performance (%)			
Year	LDP	Ruling Coalition	+10D	+20D	+30D	+60D
2014	61%	68%	2	-3	1	11
2005	62%	68%	6	9	9	23
2012	61%	68%	11	13	19	31
2017	60%	67%	4	2	3	9
2021	56%	63%	2	-4	-1	-6
2003	49%	57%	-7	-5	-3	-2
2000	49%	56%	3	-3	-5	-4
1996	48%	51%	-4	-4	-5	-16
2024	41%	46%	5	4	4	5
1993	44%	44%	0	2	1	0
2009	25%	29%	-2	-6	-7	-13

※ TOPIX Performance Indexed to the House of Representatives Election Day
Source: House of Representatives and Bloomberg; Complied by Daiwa Asset Management

Cumulative Year-to-Date Amount of Announced Share Buyback Limits



Source: QUICK; Complied by Daiwa Asset Management

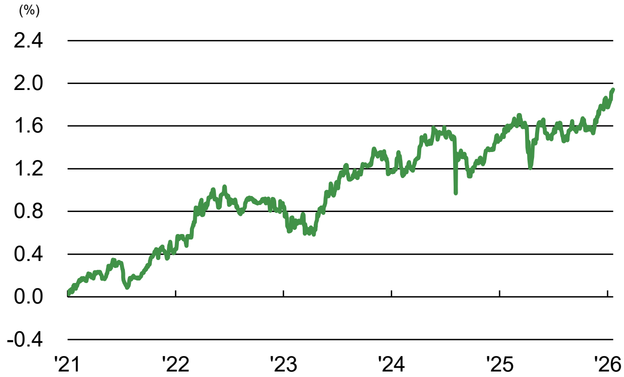
Interest Rates

Rising Upward Pressure on Interest Rates Driven by Political Developments

Since early January, when speculation over an early dissolution of the House of Representatives emerged, expectations for a strengthening of the Takaichi administration's political base have taken hold. Against this backdrop, speculation about fiscal expansion has led to a broad-based rise in interest rates, particularly in the ultra-long-end of the yield curve. In the foreign exchange market, the Yen has weakened, reaching the JPY 158 level per US Dollar. Amid continued wage increases driven by structural labor shortages, together with the ongoing weaker Yen trend, market inflation expectations have been rising. While we continue to assume policy rate hikes roughly every six months, intensifying inflationary pressures have heightened concerns that the Bank of Japan's policy response could lag behind developments, raising the possibility that the BOJ may be forced to raise interest rates earlier than expected. At the same time, the deterioration in Japan–China relations, including China's tightening of export restrictions on Japan, could have a negative impact on Japan's domestic economy and prices, and developments on this front warrant close monitoring. Although we have left our long-term interest rate outlook unchanged for now, ahead of the Lower House election both ruling and opposition parties are increasingly moving to include consumption tax cuts in their campaign pledges. As concerns over fiscal deterioration mount amid a structural shortage of buyers in the bond market, interest rates can be seen as biased toward upward revisions.

(Written by Satsuki Yuba, Research Department)

10-Year Break-Even Inflation Rate (BEI)



※ Long-term market inflation expectations; latest value: Jan. 19, 2026
Source: Bloomberg; Complied by Daiwa Asset Management

10-Year Government Bond Yield

※ Latest value as of January 19, 2026
Source: Bloomberg; Complied by Daiwa Asset Management

J-REIT

Rent Increases Are Accelerating, but Rising Interest Rates Are a Concern

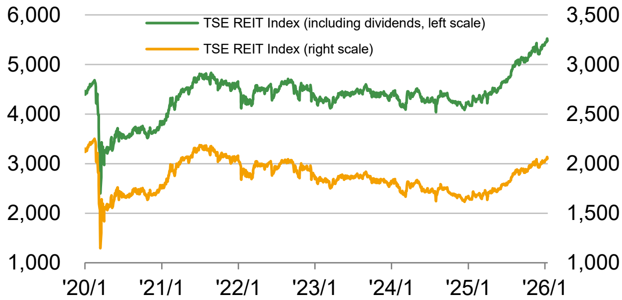
Entering January, even as long-term interest rates continued to rise on concerns over fiscal deterioration, the Tokyo Stock Exchange REIT Index (TSE REIT Index) maintained a gradual upward trend, reaching around the 2,050 level. To date, there have been two public offerings in the J-REIT market announced in January. As their scale was relatively modest, the impact on market supply–demand conditions has been minimal.

In January, a third-party tender offer (TOB) for Sankei Real Estate was announced. Based on net asset value (NAV) as of the most recent fiscal period-end, the offer price corresponds to 1.15x NAV. By comparison, the NAV multiple for the overall J-REIT market stood at 0.95x at the end of 2025, suggesting that the market remains undervalued relative both to the current TOB level and to the historical average of 1.12x (the average since February 2002).

More recently, office rent growth has accelerated further, raising expectations for additional upside to rental income. In an inflationary environment, medium- to long-term earnings growth expectations are strengthening, and we anticipate a continued gradual rise in the J-REIT market. That said, with long-term interest rates continuing to climb, rising borrowing costs remain a near-term concern.

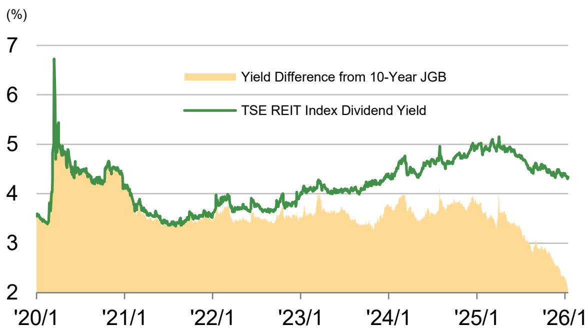
(Written by Kazuhiko Arai, Global Investment Department)

Trend of the Tokyo Stock Exchange REIT Index



※ The latest value is January 19, 2026
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 January 19, 2026
Source: Bloomberg; Compiled by Daiwa Asset Management

US Dollar

USD/JPY Rises on Yen Weakness and US Dollar Strength

Over the past month, the Yen has weakened while the US Dollar has strengthened against other currencies (25 currencies shown in the chart on the right), pushing USD/JPY higher. Concerns over Japan's fiscal deterioration and a risk-on environment have weighed on the Yen, while higher US interest rates relative to Europe and other regions have supported the US Dollar. More recently, expectations of an early dissolution of the House of Representatives and a general election have driven Japanese equities higher, alongside rising interest rates and a weaker Yen. Although Japanese interest rates have risen on a relative basis compared with those in the US, the potential Yen-appreciation effect has been muted, as these moves have been accompanied by risk-on sentiment and fiscal concerns.

Yen Appreciation as the Japan–US Real Interest Rate Gap Narrows

Based on the recent Japan–US real interest rate differential, we estimate USD/JPY to be around 141–144, but the current level is well above this range. In the second half of 2025, continued risk-on–driven Yen weakness, together with expectations of fiscal expansion under the Takaichi administration—which triggered selling of Japanese government bonds and the Yen—pushed the currency weaker than would be implied by the interest rate differential alone. However, as rising inflation expectations in Japan lift real interest rates and narrow the Japan–US real interest rate gap, we expect the Yen's depreciation to run its course and the trend to shift toward Yen appreciation and US Dollar weakness.

US Economic Slowdown Concerns Drive Yen Strength and Dollar Weakness

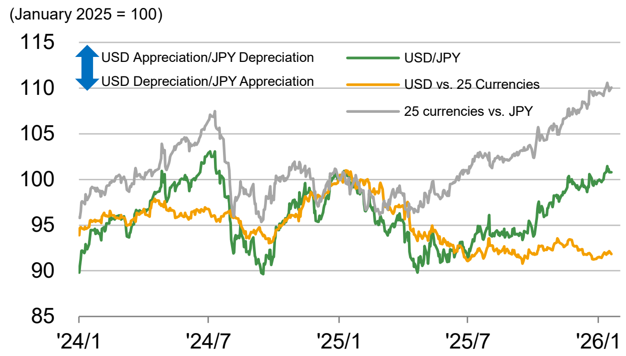
US economic data have exceeded market expectations, lifted the US Economic Surprise Index and supported risk-on–driven Yen weakness. However, in Europe and Japan, the economic surprise indices have turned lower as the positive effects of US tariff reductions have largely run their course. As the effective US tariff rate remains higher than in the past, adverse effects may persist, while a diminishing wealth effect and a slowing pace of US Dollar depreciation could also weigh on the US economic outlook. As the US Economic Surprise Index declines, we expect the risk-on Yen weakness to fade, leading to a decline in USD/JPY.

Yen Weakness Remains Limited Despite Elevated Commodity Prices

In the second half of 2025, a sustained risk-on environment led to higher commodity prices, alongside Yen weakness and US Dollar strength. The commodity price index and USD/JPY tend to move in tandem. However, the recent rise in commodity prices has been driven largely by supply-related oil price increases reflecting heightened tensions involving Iran, as well as safe-haven buying of precious metals amid risk aversion. As a result, risk-on–driven Yen depreciation has been relatively muted despite elevated commodity prices. Looking ahead, as expectations for a global economic recovery lose momentum, we expect the risk-on environment to fade, tipping the balance toward lower commodity prices, Yen appreciation, and US Dollar weakness.

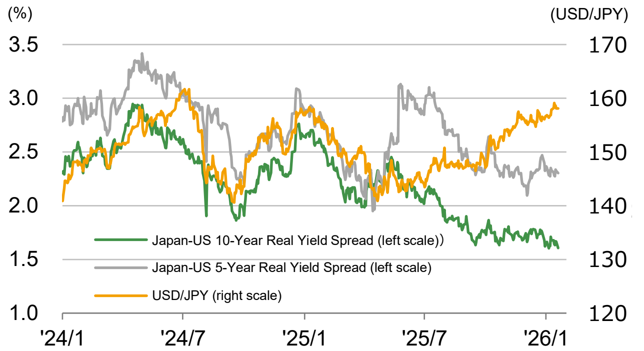
(Written Yuji Kameoka, Research Department)

Exchange Rates of USD/JPY and Other Currencies



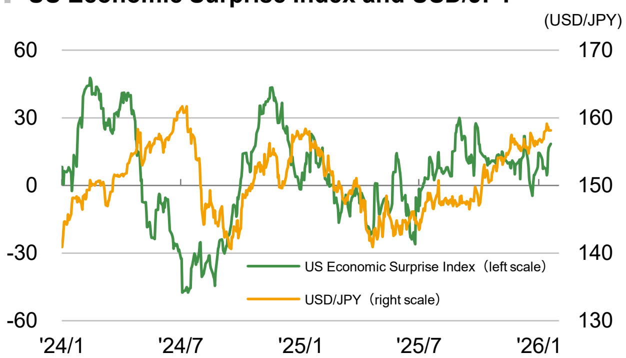
※Weighted average of exchange rates for 25 currencies based on April 2022 trading volumes
※The latest value is January 19, 2026
Source: BIS and LSEG; Complied by Daiwa Asset Management

Japan-US Real Interest Rate Differential and USD/JPY



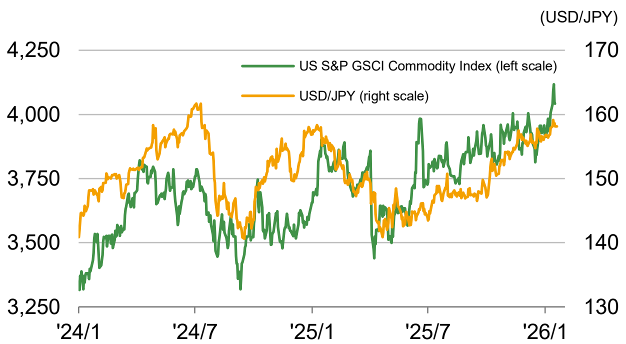
※The latest value is January 19, 2026
Source;LSEG; Complied by Daiwa Asset Management

US Economic Surprise Index and USD/JPY



※ The latest value January 19, 2026
Source;LSEG; Complied by Daiwa Asset Management

Commodity Composite Index and USD/JPY



※ The latest value for GSCI Commodity Index is January 16, 2026, for USD/JPY is January 19, 2026
Source;LSEG; Complied by Daiwa Asset Management

Euro

Signs of Slowing Euro Strength and Yen Weakness

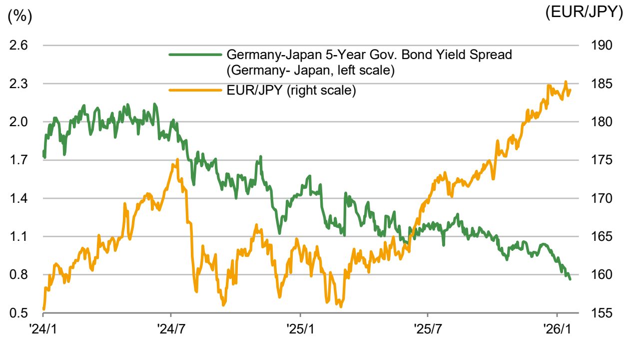
The Euro has appreciated and the Yen has weakened amid a risk-on environment and concerns over Japan's fiscal deterioration, but there are signs that the pace of Yen depreciation is slowing. This is because German interest rates have declined relative to Japanese rates, exerting downward pressure on the Euro and supporting the Yen. Looking ahead, we expect Yen weakness driven by fiscal concerns in Japan to reach a peak. As global economic momentum slows, risk-on driven pressure for Yen depreciation is likely to subside, leading to a shift toward Euro weakness and Yen appreciation.

Euro–US Dollar Entering a Range-Bound Phase

The recent move toward Euro weakness and US Dollar strength has been driven by a relative decline in German interest rates compared with US rates. Euro area economic momentum and expectations for ECB rate hikes are unlikely to strengthen in the near term, suggesting there remains scope for German yields to fall further on a relative basis. That said, depending on the selection of the next Fed Chair, US yields could also decline relative to others if expectations for Fed rate cuts gain traction. Looking ahead, we expect the Euro–US Dollar to trade within a range around current levels.

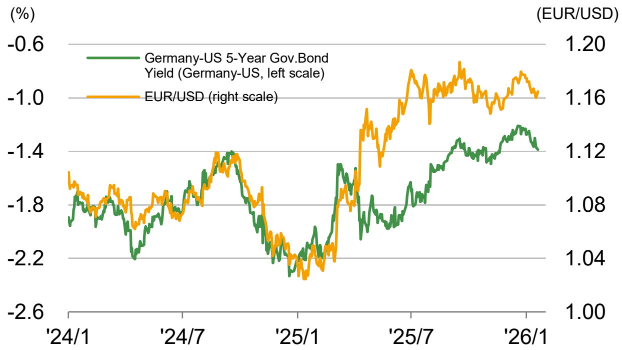
(Written Yuji Kameoka, Research Department)

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



※ The latest value is January 19, 2026
Source;LSEG; Complied by Daiwa Asset Management

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



※ The latest value is January 19, 2026
Source;LSEG; Complied by Daiwa Asset Management

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