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NOT FOR RETAIL CLIENTS

Japan | Economic and Financial Market Outlook

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AUG. 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 2024	Actual figures 2025	Estimates 2026	Estimates 2027
US	2.8	2.1	2.1	2.0
Japan	▲ 0.2	1.1	0.5	0.8
Euro	1.0	1.4	0.6	1.4

Monetary Policy Outlook

United States	• Interest rate cuts are expected to come to an end, with rates projected to remain steady at 3.50–3.75% in 2026. • The outlook for 2027 points toward interest rate hikes.
Japan	• Interest rates are expected to rise by 0.25 percentage points roughly every six months, with the cycle ending at 1.5%. • Reduction in government bond purchases: In principle, purchases will be reduced by approximately 200 billion Yen per quarter through March 2027. From April of that year onward, monthly purchases of approximately 2 trillion Yen will be conducted.
Eurozone	• If crude oil prices stabilize, further rate hikes will be avoided. • Matured bonds in the portfolio will not be reinvested. Bonds in the portfolio will not be sold.

	Policy Interest Rate (%)					10-Year Government Bond Yield (%)				
	Actual figures		Latest figures	Estimates		Actual figures		Latest figures	Estimates	
	End of 2024	End of 2025	As of 2026/7/20	End of 2026	End of 2027	End of 2024	End of 2025	As of 2026/7/20	End of 2026	End of 2027
US *1	4.50	3.75	**3.75**	3.75	4.00	4.57	4.17	**4.59**	4.3	4.5
Japan	0.25	0.75	**1.00**	1.25	1.50	1.10	2.07	**2.70**	2.6	2.0
Euro *2	3.00	2.00	**2.25**	2.25	2.00	2.37	2.86	**3.15**	2.8	2.6

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 figures from government and statistical bureaus of each country and Bloomberg; forecast figures from Daiwa Asset Management

Equity Index

		Actual figures End of 2024	Annual Rate of Change	End of 2025	Annual Rate of Change	Latest figures As of 2026/7/20	YTD Rate of Change	Estimates End of 2026	Annual Rate of Change	End of 2027	Annual Rate of Change
US	**S&P500**	5,882	+23%	6,846	+16%	**7,443**	+9%	7,900	+15%	8,600	+9%
	DJIA	42,544	+13%	48,063	+13%	**51,839**	+8%	54,000	+12%	58,000	+7%
Japan	**TOPIX**	2,785	+18%	3,409	+22%	**3,919**	+15%	4,400	+29%	4,800	+9%
	Nikkei 225 Index	39,895	+19%	50,339	+26%	**64,141**	+27%	79,000	+57%	86,000	+9%
Euro	**STOXX600**	508	+6%	592	+17%	**640**	+8%	650	+10%	690	+6%

REIT

		Actual figures End of 2024	Annual Rate of Change	End of 2025	Annual Rate of Change	Latest figures As of 2026/7/20	YTD Rate of Change	Estimates End of 2026	Annual Rate of Change	End of 2027	Annual Rate of Change
US	**NAREIT Index**	24,843	+9%	25,558	+3%	**31,128**	+22%	30,600	+20%	34,000	+11%
Japan	**TSE REIT Index**	1,653	-9%	2,014	+22%	**1,838**	-9%	2,000	-1%	2,150	+8%

Exchange Rate (vs. JPY)

	Actual figures End of 2024	Annual Rate of Change	End of 2025	Annual Rate of Change	Latest figures As of 2026/7/20	YTD Rate of Change	Estimates End of 2026	Annual Rate of Change	End of 2027	Annual Rate of Change
USD	157.20	+11%	156.71	-0%	**162.50**	+4%	155← (153)	-1%	147← (145)	-5%
EUR	162.78	+5%	184.01	+13%	**185.48**	+1%	174	-5%	165	-5%

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

Economy

The Japanese Economy's Resilience as Reflected in the BOJ's Tankan Survey

In the Bank of Japan's Tankan survey for June (response reference date: June 11), which drew attention due to the impact of the situation in the Middle East, the business conditions DI for large companies improved across the board, reaching 22 in the manufacturing sector (March survey: 17) and 37 in the non-manufacturing sector (March survey: 36). In the manufacturing sector in particular, given that production-related impacts had become apparent in the energy and materials sectors against a backdrop of deteriorating terms of trade due to a price hike in crude oil and supply constraints on raw materials, the improvement in business sentiment can be considered a positive surprise. This is believed to be due not only to the diversification of suppliers and the shift to alternative sourcing, which alleviated supply constraints to a certain extent, but also to robust demand in the AI and semiconductor sectors providing underlying support.

Broadening Price Pass-Through as Reflected in Producer Prices

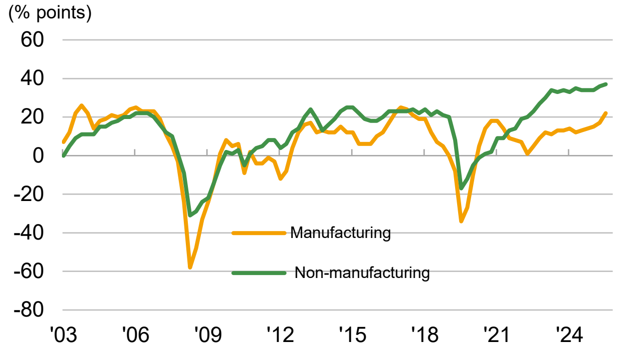
The Corporate Goods Price Index for June rose 7.1% year-on-year, accelerating from May's 6.6% increase. At the upstream end of the price chain, prices for non-ferrous metals continue to rise due to a price hike in crude oil and naphtha driven by the situation in the Middle East, compounded by AI-related demand, resulting in persistent upward pressure from both cost and demand sides. These upstream price hikes are beginning to spill over into midstream products, such as plastic products. Even if the rise in energy-related import prices were to subside as the situation in the Middle East stabilizes, the risk of inflationary pressures persists. This is because price pass-through by companies will eventually trickle down to consumer prices with a time lag, compounded by a price hike driven by semiconductor memory that is fueled by AI-related demand.

Inflation Expectations and the Case for the BOJ Being Behind the Curve

In the June "Public Opinion Survey on Household Financial Behavior," the average annual inflation forecast for the next five years rose slightly to +10.8%, but remained within the range of a gradual upward trend, while the median remained flat at +5.0%. There are no signs that households' perceptions of inflation have shifted significantly. However, with crude oil prices remaining high at present, corporate pricing behavior has become more aggressive than before, making it easier for high oil prices to trigger price increases across a wide range of goods and services. It is important to note that if these rising costs further boost household inflation expectations and generate secondary spillover effects that push up core inflation, the "behind-the-curve" theory—suggesting the Bank of Japan's policy response is lagging—could reignite.

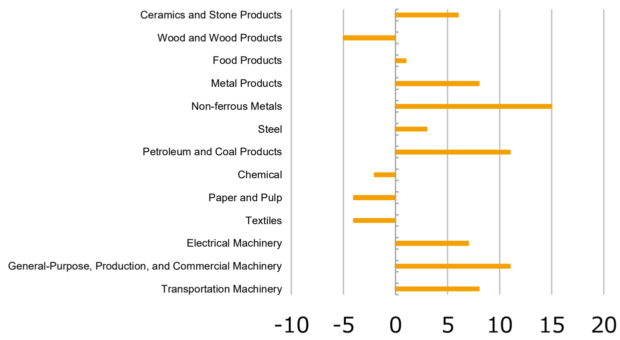
(Written by: Satsuki Yuba, Research Department)

Business Conditions Index (Tankan survey)



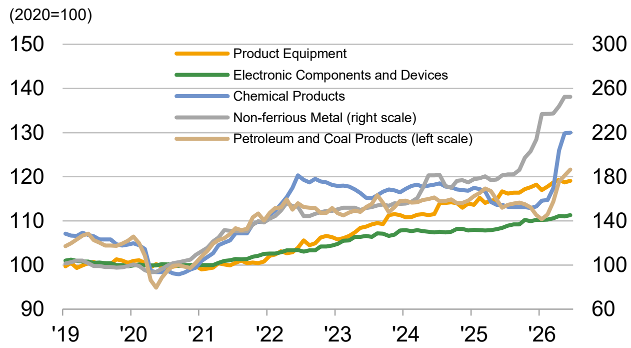
※Most recent figures are June 2026 survey
Source: Bank of Japan; Compiled by Daiwa Asset Management

Changes in the Business Conditions DI by Industry (Manufacturing Industry)



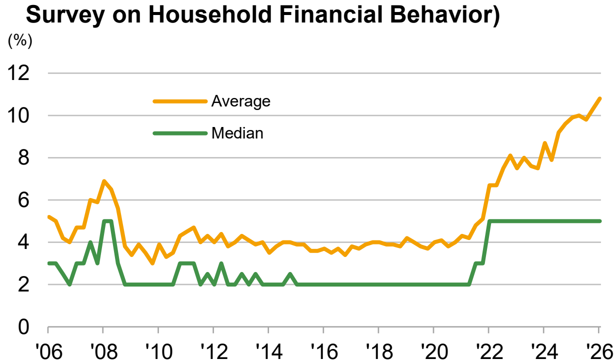
※ All company sizes. Difference between the June 2026 survey ("Actual") and the March 2026 survey ("Forecast")
Source: Bank of Japan; Compiled by Daiwa Asset Management

Domestic Corporate Goods Price Index (Major Items)



※ In Yen terms, excluding consumption tax; most recent figure is June 2026
Source: Bank of Japan; Compiled by Daiwa Asset Management

Price Outlook for the Next 5 Years (Public Opinion Survey on Household Financial Behavior)



※ The average annual change in prices five years from now compared to current levels
※ Most recent figure is June 2026 survey
Source: Bank of Japan; Compiled by Daiwa Asset Management

Equity

AI and Semiconductor Stocks Plunge

Since late June, selling pressure on AI- and semiconductor-related stocks has continued globally. Stock prices have risen sharply since April amid a highly concentrated market, making them vulnerable to profit-taking. In addition, concerns about the profitability and sustainability of AI infrastructure spending have led to a growing sense of caution toward AI-related themes. However, this has not resulted in a broad-based risk-off sentiment, and the TOPIX—which reflects the performance of a broad range of Japanese stocks—has remained resilient despite the sharp decline in the Nikkei 225.

Fundamentals Remain Strong

Even after the outbreak of the conflict in Iran, the domestic economy has remained robust, and efforts to secure alternative sources of crude oil and other commodities are progressing; consequently, the adverse effects of supply constraints have not yet materialized to a significant degree. Earnings momentum for Japanese companies remains strong; in addition to the accelerating earnings growth in the AI sector, earnings forecasts for non-AI-related sectors have also begun to experience upward revisions since May. While some negative factors are evident in the AI sector, we do not believe they warrant a change in our view of the fundamentals.

The Takaichi Administration's Growth Strategy Takes Shape

The Takaichi administration's growth strategy is taking shape, as evidenced by the announcement of a public-private investment roadmap totaling over 370 trillion Yen through fiscal year 2040, covering 17 strategic sectors. According to government estimates, if the investment yields the expected results, the potential growth rate will rise from 0.3% to 1.4% between 2036 and 2040, and could reach 1.8% if R&D investment and resource allocation become more efficient. On July 21, the Corporate Governance Code (2026 Revised Edition) was also finalized and announced.

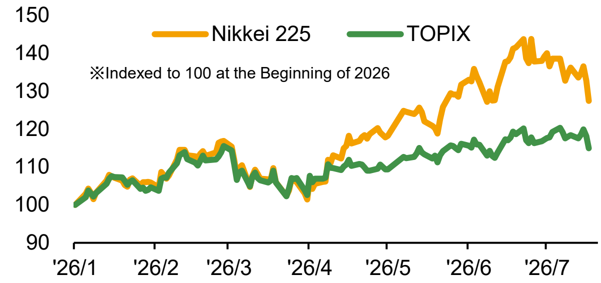
(%)

Focus on the Q1 FY2026 financial results

Companies with a March fiscal year-end are now in full swing with their first-quarter (April–June) financial results for fiscal year 2026. The consensus forecast projects robust growth, with net income for TOPIX-listed companies expected to rise 19% year-on-year. For the full fiscal year 2025, companies reported solid financial results and outlooks despite the deteriorating situation in the Middle East, which served as a tailwind for Japanese stocks. In this earnings season as well, the market will be assessing the impact of the Middle East situation on corporate earnings. Attention is also focused on whether AI and semiconductor-related companies can meet high market expectations amid continued volatility in their stock prices.

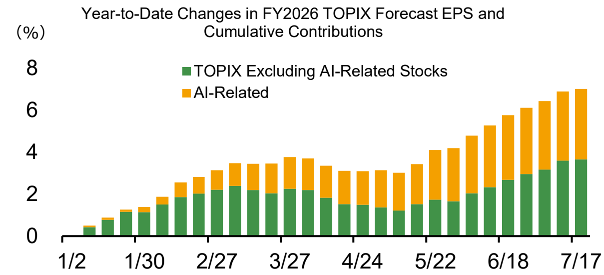
(Written by Kazunori Tatebe, Research Department)

AI and Semiconductor Sell-Off Drags Down the Nikkei 225



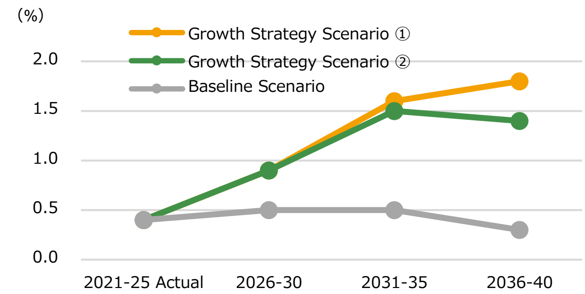
※ Latest figures as of July 17, 2026
Source: Bloomberg; Compiled by Daiwa Asset Management

Earnings Outlook Continues to Improve



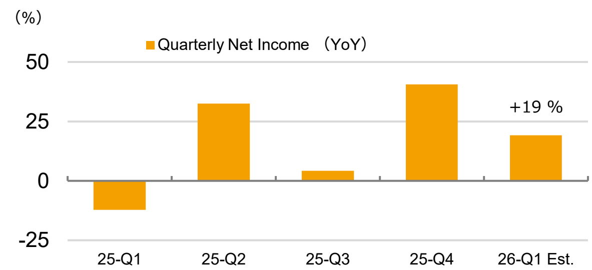
※ Latest figure as of July 17, 2026
Source: FactSet; Compiled by Daiwa Asset Management

Government Estimates Growth Strategy Will Lift Potential Growth to the Upper 1% Range



※ Note: ① takes into account not only investment returns but also R&D investment and the efficiency of resource allocation
② considers only the investment effect
Projections on the Medium- to Long-Term Economic and Fiscal Outlook Under Japan's Growth Strategy (June 24, 2026)
Source: Cabinet Office; Compiled by Daiwa Asset Management

Q1 Financial Results: Will They Further Boost Earning Expectations?



※ Consensus forecasts are for companies in the TOPIX index that report their financial results for the March fiscal year, as of July 17, 2026
Source: FactSet; Compiled by Daiwa Asset Management

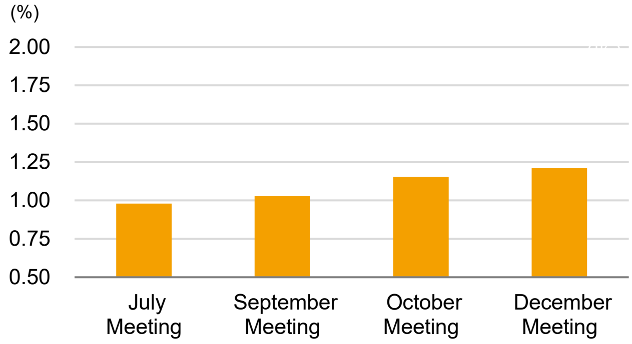
Interest Rates

Two-Sided Risks Surrounding the Timing of the Next BOJ Rate Hike

Based on economic and inflation developments, we believe that the market's expectation of additional BOJ rate hikes at roughly six-month intervals is reasonable, and we anticipate the next rate hike at the December Monetary Policy Meeting. However, while upside inflation risks raise the possibility of an earlier rate hike, the government's stance—as reflected in the draft Basic Policy on Economic and Fiscal Management and Reform and interpreted by some as signaling caution toward further rate hikes—also warrants attention to the risk of a delay. In other words, risks exist on both sides regarding the timing of the next policy move. As such, assessing the BOJ's future policy path requires not only monitoring economic and inflation developments but also taking political factors into account. Following the so-called "Honebuto Shock," revisions to the wording of the draft policy document, proposals to review the asset allocation of the Government Pension Investment Fund (GPIF), and discussions on including Japanese government bonds among eligible NISA investment products have helped ease the sharp rise in long-term interest rates. Nevertheless, concerns over fiscal expansion and inflation are likely to persist, particularly as the issue of funding measures for proposed consumption tax cuts and other initiatives remains unresolved. Accordingly, we expect long-term interest rates to remain elevated relative to our year-end 2026 forecast of 2.6% for the time being.

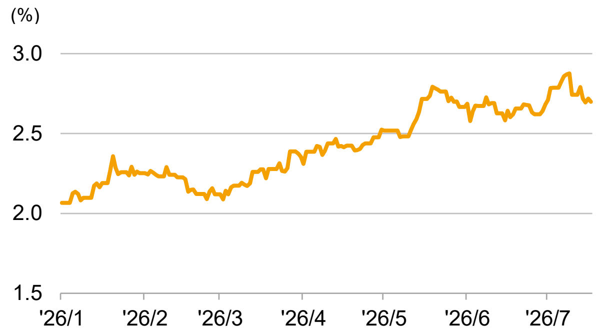
(Written by: Satsuki Yuba, Research Department)

Policy Rate Level Implied by the Market



※ As of July 17, 2026
Source: Bloomberg; Compiled by Daiwa Asset Management

10-Year Government Bond Yield



※ Most recent figure as of July 17, 2026
Source: Bloomberg; Compiled by Daiwa Asset Management

J-REIT

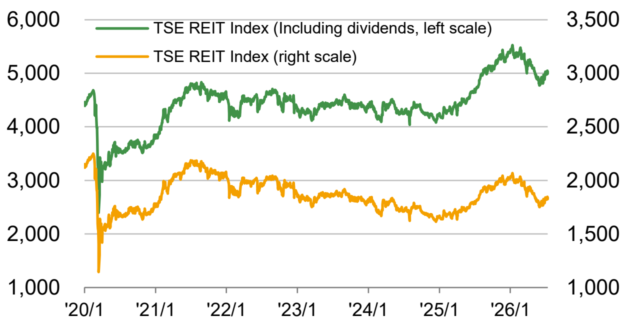
Gradual Upside Supported by Attractive Valuations

The J-REIT market has rebounded from the lows it hit in early June. The Tokyo Stock Exchange REIT Index recovered from a closing price of 1,752 on June 5 to 1,838 on July 17. Even as domestic long-term interest rates temporarily rose to around 2.9%, the J-REIT market maintained an upward trend. The correction in AI and semiconductor-related stocks and the rebound in the J-REIT market occurred almost simultaneously, suggesting that capital flows into and out of these sectors are also affecting the J-REIT market.

The J-REIT market's dividend yield stands at around 5%, and the NAV multiple is in the 0.85x range (based on our preliminary calculations). Although the market has been on an upward trend for the past month or so, we view this as a phase in which the perception of undervaluation is being resolved and maintain our "slightly bullish" investment rating. Rent increases are accelerating, particularly for office and rental housing properties. Although borrowing costs are rising due to higher interest rates, the positive earnings outlook remains unchanged. In the short term, the market is likely to continue being influenced by trends in AI and semiconductor-related stocks as well as domestic long-term interest rates; however, reflecting strong fundamentals, we anticipate a gradual rise in the J-REIT market.

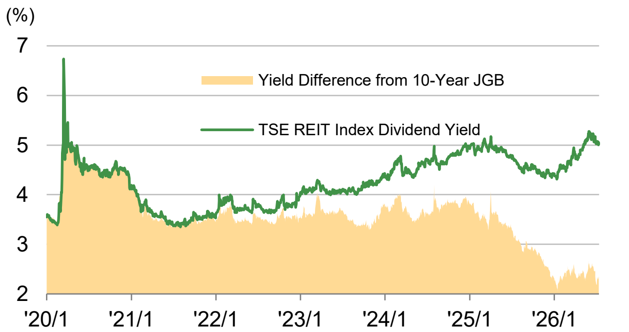
(Written by Kazuhiko Arai, Global Asset Management Department)

Trend of the Tokyo Stock Exchange REIT Index



※ Latest figure as of July 17, 2026
Source: Bloomberg; Compiled by Daiwa Asset Management

Trend of the Dividend Yield for the TSE REIT Index



※ Dividend yield is based on actual performance over the past 12 months
※ Most recent figure as of July 17, 2026
Source: Bloomberg; Compiled by Daiwa Asset Management

US Dollar

USD/JPY Trends Higher

Over the past month, the US Dollar has shown little movement against other currencies, while the Yen has weakened slightly, resulting in further USD/JPY appreciation. The US Dollar's strength and the weak Yen were driven by the US economy's solid performance amid inflation pressure and a rebound in crude oil prices due to the deteriorating situation in the Middle East. Risk-off sentiment amid rising US interest rates also contributed to the US Dollar's strength. However, since risk-off sentiment tends to lead to lower interest rates, we believe that a US Dollar rally driven by the simultaneous occurrence of rising US interest rates and risk-off sentiment is unlikely to be sustainable.

US Dollar Strength Despite Relative Decline in US Real Interest Rates

Compared to one month ago, inflation expectations have declined in both Japan and the US, and real interest rates have risen; however, the increase in real interest rates was greater in Japan, causing the real interest rate differential between the two countries to narrow. Nevertheless, risk-off sentiment amid rising US interest rates drove the Dollar higher, resulting in a stronger Dollar and a weak Yen, despite the relative decline in US real interest rates. Going forward, if crude oil prices continue to fall, US real interest rates will decline in absolute terms, and we expect this to lead to a shift toward a weaker US Dollar and a strong Yen.

Japan and the US Coordinate to Rein In Yen Weakness and Dollar Strength

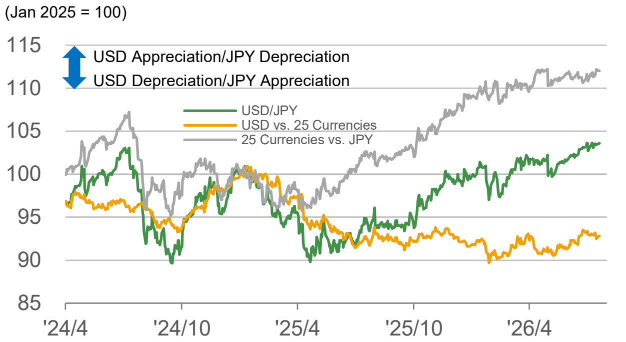
Japan's real effective exchange rate (narrow definition, based on 27 countries and regions) hit its weakest level against the Dollar since August 1965 in April 2026. In May, compared to the average over the past 20 years, Japan's real effective exchange rate (broad definition) showed the Yen was 35% weaker, while the US Dollar was 14% stronger. It appears that the Yen continued to weaken and the US Dollar continued to strengthen in June as well. To curb inflation and rising interest rates in Japan and the decline in US export competitiveness, Japanese and US authorities are taking a coordinated stance to curb the weak Yen and strong US Dollar, and the possibility of intervention through Yen buying and US Dollar selling remains.

Rebounding Oil Prices Support Yen Weakness and Dollar Strength

With the resumption of hostilities between the US and Iran, shipping traffic through the Strait of Hormuz has decreased, causing crude oil prices to rebound amid supply concerns. Commodity prices are at higher levels than they were at the end of February when the war began, creating conditions conducive to a weak Yen and a stronger US Dollar due to Japan's deteriorating terms of trade and relatively higher overseas interest rates. However, concerns over declining demand are likely to act as a restraining factor on high crude oil prices and Yen depreciation. In the medium term, we expect the US and Iran to reach an agreement to end hostilities, leading to a recovery in Middle Eastern oil supply and a decline in crude oil prices, which in turn will drive the Yen higher and the US Dollar lower.

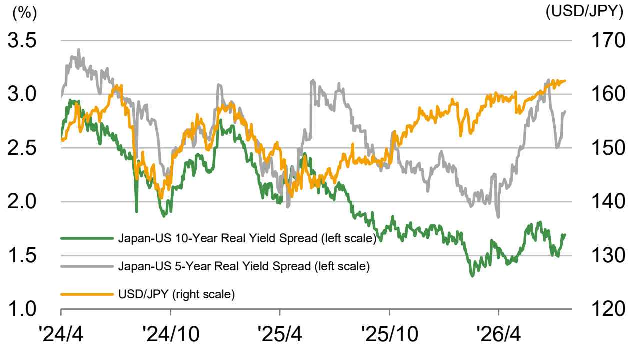
(Written by: Yuji Kameoka, Research Department)

Exchange Rates of USD/JPY and Other Currencies



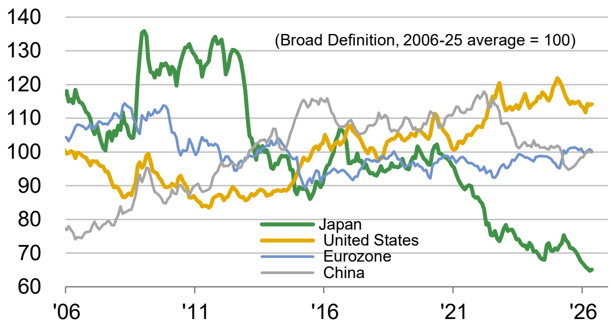
※Weighted average of exchange rates for 25 currencies based on April 2025 trading volumes
※The latest figure as of July 20, 2026
Source: BIS and LSEG; Compiled by Daiwa Asset Management

Japan-US Real Interest Rate Differential and USD/JPY



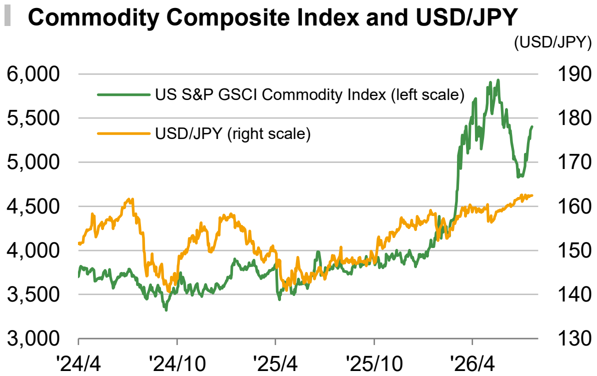
※The latest figure as of July 20, 2026
Source: LSEG; Compiled by Daiwa Asset Management

Real Effective Exchange Rate of Japan, US, Eurozone and China



※ Broad definition includes 64 countries and regions, including emerging markets
※ Latest figure as of May 2026
Source: BIS; Compiled by Daiwa Asset Management

Commodity Composite Index and USD/JPY



※The latest figure as of July 20, 2026
Source: LSEG; Compiled by Daiwa Asset Management

Euro

EUR/JPY Shifts from Stability to Decline

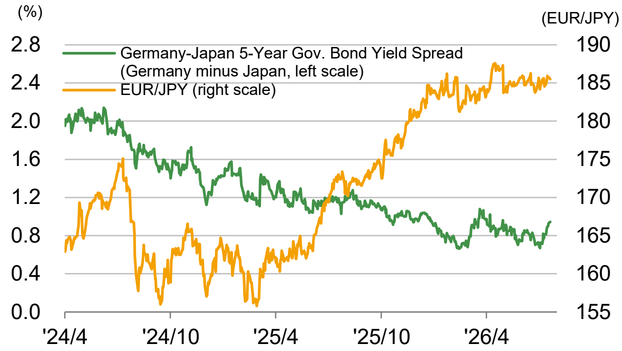
As crude oil prices rebounded, German interest rates rose relative to Japanese rates. However, even though interest rates are exerting downward pressure on the Yen and upward pressure on the Euro, this is being offset by risk-off sentiment driving the Yen higher and the Euro lower, keeping the EUR/JPY pair stable. In the medium term, amid a trend of falling crude oil prices, we expect the narrowing of the German-Japanese interest rate spread to lead to a weaker Euro and a strong Yen. We do not anticipate a significant strengthening of the Euro or weakening of the Yen driven by risk-on sentiment.

EUR/USD Expected to Remain Stable

The Euro weakened against the US Dollar. Although German interest rates rose relative to US rates following a rebound in crude oil prices, risk-off sentiment drove the Euro lower and the US Dollar higher. In the near term, the possibility remains that the EUR/USD pair will weaken. However, in the medium term, while improved terms of trade in the Eurozone due to lower crude oil prices will support a stronger Euro and weaker US Dollar, the relative decline in German interest rates and rise in US interest rates will pressure the Euro lower and the US Dollar higher; consequently, we expect the EUR/USD Dollar pair to trade stably.

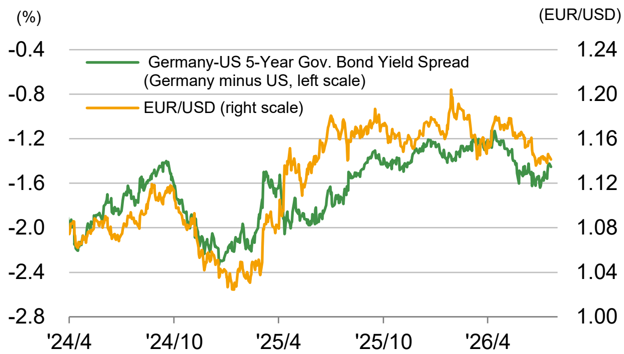
(Written by: Yuji Kameoka, Research Department)

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



※The latest figure as of July 20, 2026
Source: LSEG; Compiled by Daiwa Asset Management

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



※The latest figure as of July 20, 2026
Source: LSEG; Compiled by Daiwa Asset Management

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