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Japan | Economic and Financial Market Outlook

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JUN. 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)

Monetary Policy Outlook

	Real GDP (YoY, %)				
	Actual figures		Estimates		
	2024	2025	2026	2027	
US	2.8	2.1	2.1	1.9	
Japan	▲ 0.2	1.1	0.5 ← (0.8)	0.8	
Euro	0.9	1.4	0.9	1.4	

United States	<ul style="list-style-type: none"> A 0.25 percentage point interest rate cut will be implemented within the year, bringing the target range to 3.25–3.50%. Unless the labor market deteriorates, there is a possibility that no interest rate cut will be implemented.
Japan	<ul style="list-style-type: none"> Interest rates are expected to rise by 0.25 percentage points roughly every six months, capping at 1.5%. At the June monetary policy meeting, the Bank of Japan plans to conduct an interim assessment of its plan to reduce government bond purchases and discuss the pace of reductions starting in April 2027.
Eurozone	<ul style="list-style-type: none"> Interest rates are expected to rise in June due to anticipated increases in underlying inflationary pressures. The outlook thereafter will depend on the situation in the Middle East. Redeemed bonds will not be reinvested, and no active sales are planned

	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 2026/5/18	End of 2026	End of 2027	End of 2024	End of 2025	As of 2026/5/18	End of 2026	End of 2027
US *1	4.50	3.75	3.75	3.50 ← (3.25)	3.50 ← (3.25)	4.57	4.17	4.59	4.3 ← (4.1)	4.5 ← (4.3)
Japan	0.25	0.75	0.75	1.25	1.50	1.10	2.07	2.74	2.6 ← (2.2)	2.0
Euro *2	3.00	2.00	2.00	2.25 ← (2.00)	2.00	2.37	2.86	3.15	2.8 ← (2.4)	2.6 ← (2.2)

- US policy rate is the upper limit of the FF rate guidance target
- 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				Latest figures			Estimates		
		End of 2024	Annual Rate of Change	End of 2025	Annual Rate of Change	As of 2026/5/18	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%	7,403	+8%	7,900 ← (7,400)	+15%	8,600 ← (8,000)	+9%
	DJIA	42,544	+13%	48,063	+13%	49,686	+3%	54,000	+12%	58,000	+7%
Japan	TOPIX	2,785	+18%	3,409	+22%	3,827	+12%	4,200	+23%	4,600	+10%
	Nikkei 225 Index	39,895	+19%	50,339	+26%	60,816	+21%	67,000 ← (63,000)	+33%	73,000 ← (69,000)	+9%
Euro	STOXX600	508	+6%	592	+17%	610	+3%	650	+10%	690	+6%

		REIT									
		Actual figures				Latest figures			Estimates		
		End of 2024	Annual Rate of Change	End of 2025	Annual Rate of Change	As of 2026/5/18	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%	29,057	+14%	30,600	+20%	34,000	+11%
Japan	TSE REIT Index	1,653	-9%	2,014	+22%	1,814	-10%	2,000 ← (2,100)	-1%	2,150	+8%

		Exchange Rate (vs. JPY)									
		Actual figures				Latest figures			Estimates		
		End of 2024	Annual Rate of Change	End of 2025	Annual Rate of Change	As of 2026/5/18	YTD Rate of Change	End of 2026	Annual Rate of Change	End of 2027	Annual Rate of Change
USD		157.20	+11%	156.71	-0%	158.82	+1%	149	-5%	142	-5%
EUR		162.78	+5%	184.01	+13%	185.11	+1%	174	-5%	165	-5%

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



Economy

Economic Conditions Remained Generally Solid Prior to the Middle East Conflict

Real GDP for the January–March 2026 quarter grew at an annualized rate of +2.1% quarter-on-quarter (up from +0.8% in the previous quarter), marking an acceleration in growth. This was primarily due to a recovery in exports—such automobiles, which had been sluggish due to US tariff policies—and steady consumer spending driven by high wage raises. Furthermore, the impact of the Bank of Japan’s 0.75% interest rate hike in December has not yet materialized. On the other hand, with no notable progress in US-Iran peace negotiations, the forecast for real GDP growth in 2026 was revised down slightly to +0.5%, reflecting the potential downward pressure on the economy from persistently high crude oil prices and logistics disruptions caused by the de facto blockade of the Strait of Hormuz.

Downside Risks to the Economy Posed by Supply Constraints

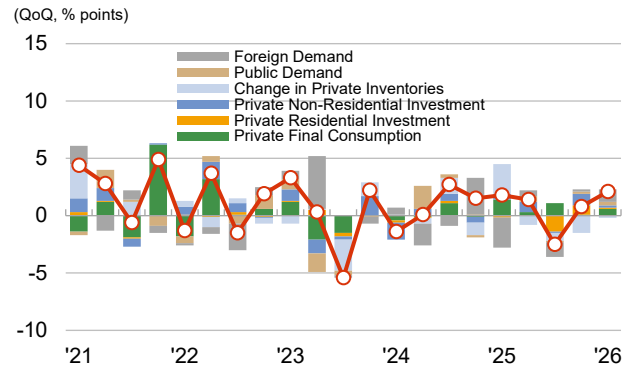
Since the escalation of tensions in the Middle East, sentiment indicators related to economic trends have been sluggish. Looking at the reasons cited in the Economic Watchers Survey for economic assessments, references to supply constraints—symbolized by shortages in the procurement of petrochemical products—are frequently observed. It is important to note that the impact of the Middle East situation extends beyond the deterioration of terms of trade driven by high crude oil prices to include a decline in capacity utilization in production activities. While the government’s release of oil reserves, alternative procurement, and drawdown of inventories are currently supporting raw material procurement, these measures are only temporary. If free navigation through the Strait of Hormuz is not restored for an extended period, supply constraints will become apparent and could suppress economic activity in terms of volume.

Upside Risks to Underlying Inflation Remain Elevated

Looking at the Index of Industrial Production by sector, industries such as petroleum and coal products and inorganic and organic chemicals have seen significant declines, likely due to supply constraints resulting from the de facto blockade of the Strait of Hormuz. While the impact is currently localized and limited, if supply chain disruptions worsen, they could act as a downward pressure on the economy through reduced production and potentially push down underlying inflation. However, the April Domestic Corporate Goods Price Index rose 4.9% year-on-year (up from 2.9% in March), indicating accelerating growth, and the impact is already spreading across a wide range of items. As companies adopt a more aggressive pricing stance than in the past, the upside risks to underlying inflation are considered to be greater.

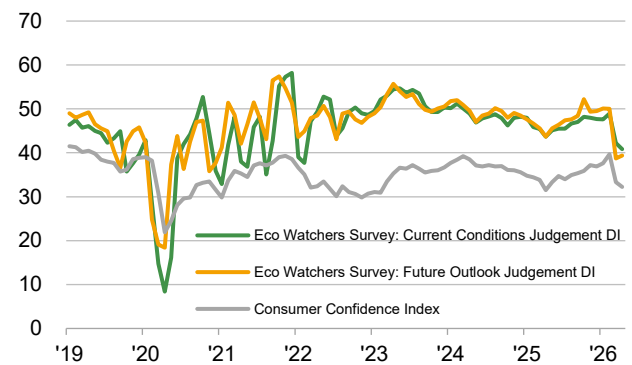
(Written by Satsuki Yuba, Research Department)

Real GDP and Contribution by Demand Item



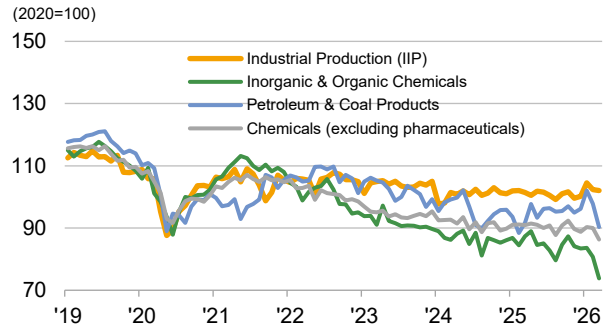
※ The latest figures are for the January-March period of 2026. Source: The Cabinet Office; Compiled by Daiwa Asset Management

Economic Sentiment Indicators



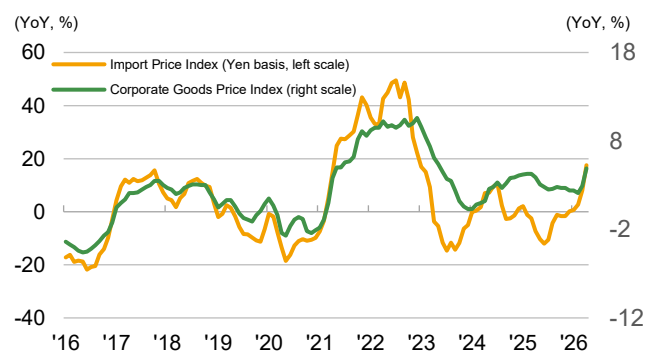
※ Latest figure as of April 2026 Source: Cabinet Office; Compiled by Daiwa Asset Management

Indices of Industrial Production



※ Latest figure as of March 2026 Source: Ministry of Economy, Trade and Industry; Compiled by Daiwa Asset Management

Domestic Corporate Goods Price Index and Import Price Index



※ Latest figure as of April 2026 Source: Bank of Japan; Compiled by Daiwa Asset Management



Equity

Accelerating Capital Concentration in AI and Semiconductors

The Nikkei 225 remained firm into May, reaching the 63,000-Yen level on May 13. Amid a global preference for AI-related stocks, capital inflows into AI and semiconductor-related names have accelerated in the Japanese equity market as well. On the other hand, the TOPIX has yet to recover from the high it reached at the end of February. With the de facto blockade of the Strait of Hormuz continuing, headwinds for corporate earnings persist, and market activity remains concentrated in a limited number of stocks.

FY2025 Full-Year Earnings Remain Solid

Financial results from companies with fiscal years ending in March have been solid, providing a tailwind for the stock market. Net profits for the January-March quarter delivered a positive surprise, with 57% of companies beating market consensus by 5% or more. Although companies' initial fiscal 2026 plans (recurring profit) were 10% below market consensus, this was only slightly lower than the historical average of 8%, and the figures were not as weak as feared, bringing a sense of relief to the market.

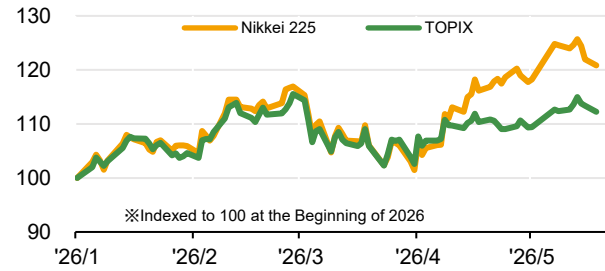
Risk If Middle East Tensions Fail to Ease

Although the financial results were solid, the de facto blockade of the Strait of Hormuz continues, and if the situation fails to improve, downward pressure on earnings will intensify. Currently, long-term interest rates are rising at an accelerating pace. How the stock market reacts to rising interest rates will depend on their level, speed, and the reasons behind the increase. If interest rates continue to rise due to factors such as inflation stemming from the situation in the Middle East, the stock market may react negatively to this, and it is necessary to closely monitor these developments.

Forecast for the Nikkei 225 Revised Higher

If improvements in the Middle East situation are delayed, Japanese stocks—which have been recovering on the back of market expectations—may stall. However, the medium- to long-term bull market, driven by structural changes and the government's growth strategy, is likely to continue. We anticipate further gains in Japanese stocks heading into year-end. We maintain our year-end 2026 and 2027 forecasts for the TOPIX at 4,200 and 4,600, respectively. However, reflecting our positive outlook on AI and semiconductors, we have raised the Nikkei-to-TOPIX ratio and increased our year-end 2026 and 2027 forecasts for the Nikkei 225 to 67,000 and 73,000 Yen, respectively.

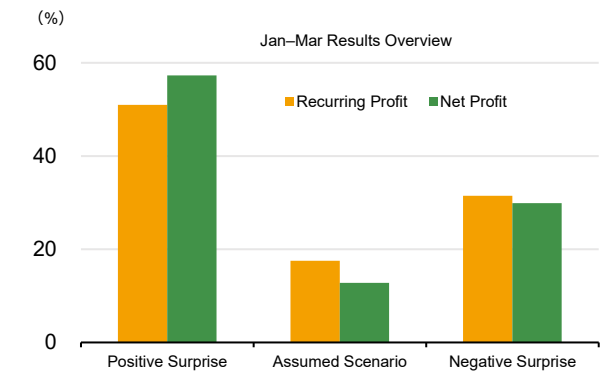
Nikkei Significantly Outperforms TOPIX



※Latest figure as of May 18, 2026

Source: Bloomberg; Compiled by Daiwa Asset Management

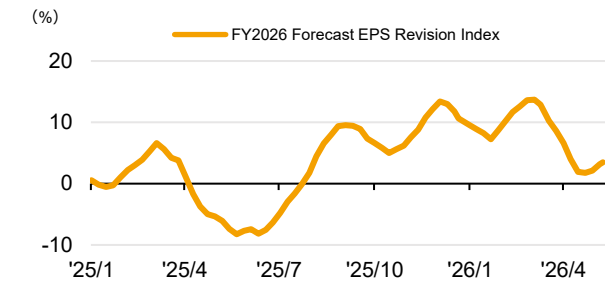
Jan-Mar Results Came in Above Expectations



※ Results are classified as "surprises" if they deviate by 5% or more from analyst estimates; companies comprising the TOPIX 500 that reported their March financial results by May 18

Source: FactSet; Compiled by Daiwa Asset Management

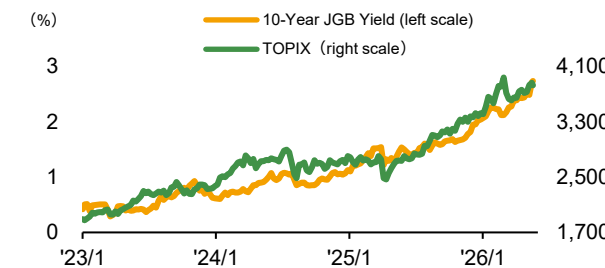
Revision Index Rebounds Following Solid Earnings



※Latest figure as of May 18, 2026

Source: FactSet; Compiled by Daiwa Asset Management

Can Stock Prices Continue to Rise as Interest Rates Increase?



※Latest figure as of May 18, 2026

Source: FactSet; Compiled by Daiwa Asset Management

(Written by Kazunori Tatebe, Research Department)



Interest Rates

Long-Term Interest Rate Forecast for End-2026 Revised Higher

Despite the rate hikes to date, financial conditions remain in a state of monetary easing, and no clear economic slowdown is evident. Concerns about being “behind the curve” have intensified further in light of the situation in the Middle East, and June is widely seen as the most likely timing for the next rate hike. We are making an upward revision to our long-term interest rate outlook. In addition to the structural shift toward an inflationary economy, inflation expectations in Japan are easily influenced by actual price trends, which tends to put upward pressure on market interest rates. Under these conditions, the market is likely to anticipate that the ultimate target for interest rate hikes will exceed our assumption of 1.5% for the time being. Considering the spread over the one-month rate two years forward, which is currently hovering around 2%, long-term interest rates appear to have a fair value of around 2.6%. However, it is important to note that, against the backdrop of rising holdings by foreign investors, JGBs have become more susceptible to shifts in global risk appetite. Particularly in the long- and ultra-long-term segments, rising overseas interest rates tend to spill over into the domestic market, making it likely that rates will trade above this level.

(Written by: Satsuki Yuba, Research Department)

J-REIT

Investment Rating Raised to “Slightly Bullish”

Since mid-April, the J-REIT market has declined due to concerns over rising domestic long-term interest rates. The TSE REIT Index closed at 1,814 on May 18, its lowest level since July 2025.

In light of the improved valuations resulting from the index decline, we have upgraded our investment rating from “Neutral” to “Slightly Bullish”. Current dividend yields exceed 5%, and preliminary calculations indicate that the NAV multiple for the J-REIT market as a whole has fallen to the low 0.8x range. While rising interest rates increasing J-REIT borrowing costs is a negative factor, we expect dividend increases to continue due to steady rent hikes, the utilization of capital gains and retained earnings, and expanded shareholder returns. If the index continues to stagnate, a full-scale resumption of buybacks is anticipated, and the index is expected to show resilience. The upgrade was driven by factors such as a 5% income yield without foreign exchange risk and the potential for a capital gain if domestic long-term interest rates stabilize. On the other hand, based on an upward revision to the outlook for domestic long-term interest rates, the forecast for the TSE REIT Index at the end of 2026 was revised downward from 2,100 to 2,000.

(Written by Kazuhiko Arai, Global Investment Department)

10-Year Breakeven Inflation Rate



※ Latest figure as of May 18, 2026

Source: Bloomberg; Compiled by Daiwa Asset Management

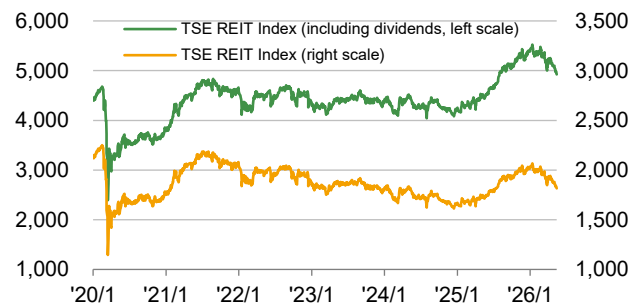
10-Year Government Bond Yield



※ Latest figure as of May 18, 2026

Source: Bloomberg; Compiled by Daiwa Asset Management

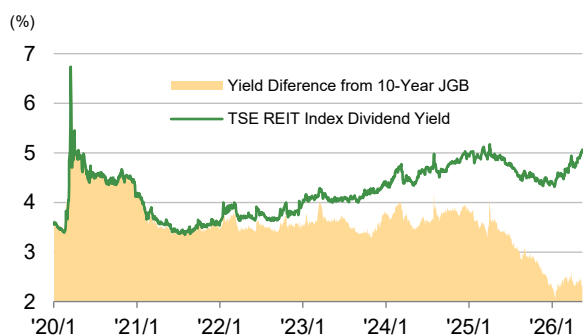
Trend of the Tokyo Stock Exchange REIT Index



※ Latest figure as of May 18, 2026

Source: Bloomberg; Compiled by Daiwa Asset Management

Trend of the Dividend Yield for the TSE REIT Index



※ Dividend yield is based on trailing 12-month actuals

※ Latest figure as of May 18, 2026

Source: Bloomberg; Compiled by Daiwa Asset Management

US Dollar

Yen Weakness and Dollar Strength Pause on FX Intervention

Over the past month, both the Yen and the US Dollar have appreciated against other currencies, leading to a pause in Yen weakness and Dollar strength. Currency intervention by Japanese monetary authorities—buying Yen and selling US Dollars—led to a strong Yen and a weaker US Dollar, offsetting the Dollar’s strength driven by high crude oil prices and rising US interest rates. Prior to the currency intervention, the Yen had weakened and the US Dollar had strengthened to the 160-Yen-per-Dollar range due to deteriorating Japanese terms of trade caused by high crude oil prices and rising US interest rates. The environment surrounding foreign exchange rates has not changed in a way that would naturally promote a strong Yen and a weaker US Dollar.

Widening US-Japan Real Rate Differential Supports Dollar Strength

Over the past month, the real interest rate differential between Japan and the US widened, contributing to the strength of the US Dollar. This was because, against the backdrop of persistently high crude oil prices, expectations for both inflation and interest rate hikes rose in the US, leading to higher real interest rates, whereas in Japan, while inflation expectations rose, expectations for interest rate hikes did not, resulting in lower real interest rates. This is likely due to the differing degrees of hawkishness among central banks regarding inflation. However, we expect that as crude oil prices turn lower, US real interest rates will decline relatively, leading to a weaker US Dollar and a strong Yen.

Japan, US May Align to Curb Yen Weakness and Dollar Strength

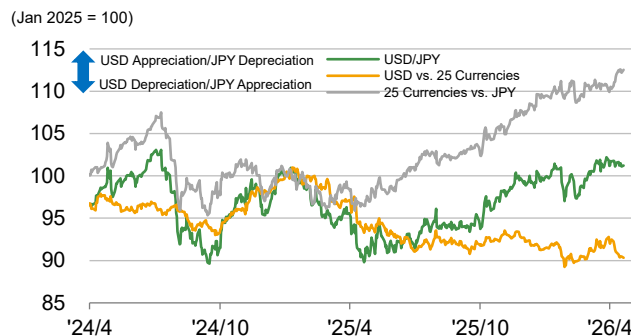
Japan’s real effective exchange rate (narrow definition, based on 27 countries and regions) hit its weakest level against the Dollar in March 2026 since August 1967. In terms of the real effective exchange rate (broad definition), the Yen is about 35% weaker than the 20-year average, while the Dollar is about 15% stronger than the average, making Yen weakness and Dollar strength particularly prominent among major currencies. To curb inflation and rising interest rates in Japan and the decline in US export competitiveness, Japanese and US authorities are coordinating efforts to curb weak Yen and strong Dollar conditions. There may therefore be substantial scope for yen-buying, dollar-selling intervention.

Expected Shift to Lower Oil Prices to Support Yen, Weigh on Dollar

Commodity prices, including crude oil, remain elevated, and the deterioration of Japan’s terms of trade due to high commodity prices, along with a decline in relative real interest rates, is contributing to weak Yen. However, we believe there is a high probability that the US and Iran will reach an agreement—even if only temporary—to end hostilities and reopen the Strait of Hormuz in the near future, leading to a decline in crude oil prices. Consequently, an improvement in Japan’s terms of trade and a rise in relative real interest rates are likely to drive a strong Yen and a decline in the US Dollar. We expect a strong Yen driven by falling crude oil prices and lower overseas interest rates to prevail over risk-on Yen weakness, leading to a decline in cross-Yen pairs across the board.

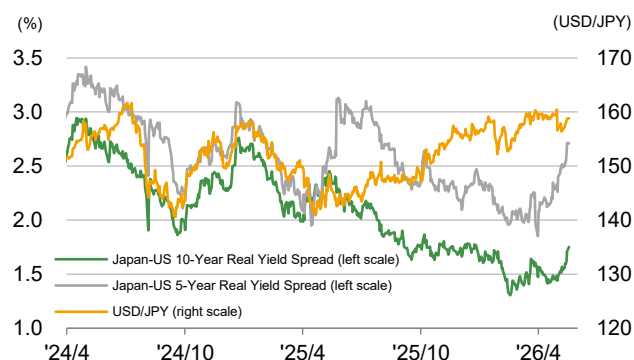
(Written by Yuji Kameoka, Research Department)

Exchange Rates of USD/JPY and Other Currencies



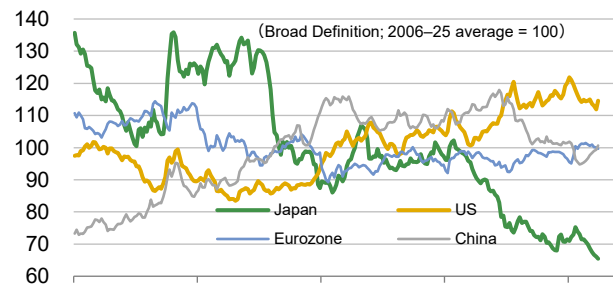
※Weighted average of exchange rates for 25 currencies based on April 2025 trading volumes
 ※The latest figure as of May 18, 2026
 Source: BIS and LSEG; Compiled by Daiwa Asset Management

Japan-US Real Interest Rate Differential and USD/JPY



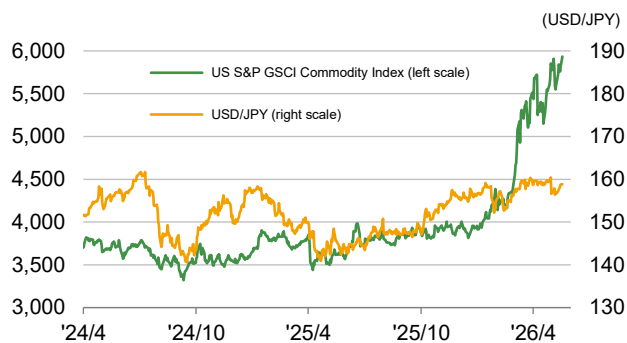
※The latest figure as of May 18, 2026
 Source: LSEG; Compiled by Daiwa Asset Management

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



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

Commodity Composite Index and USD/JPY



※The latest figure as of May 18, 2026
 Source: LSEG; Compiled by Daiwa Asset Management



Euro

FX Intervention Halts Euro Strength, Yen Weakness

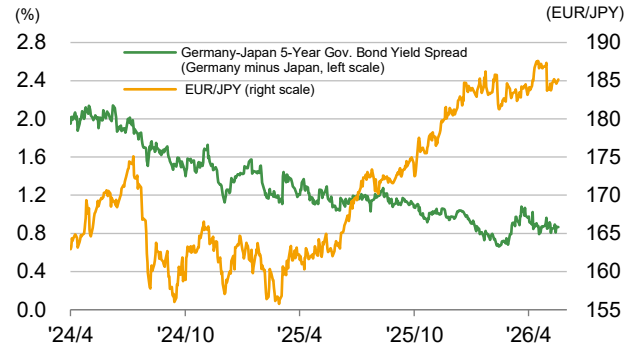
Intervention by Japanese monetary authorities to buy Yen and sell US Dollars has exerted upward pressure on the Yen, temporarily halting the Euro's appreciation against the Yen. Nevertheless, risk-on sentiment continues to exert downward pressure on the Yen, keeping EUR/JPY relatively firm. However, German interest rates have been declining on a relative basis, and this trend is expected to strengthen should crude oil prices turn lower. In the medium term, we anticipate a weakening of the Euro and a strengthening of the Yen as the German-Japanese interest rate spread narrows and risk-on sentiment wanes.

Euro-US Dollar Stabilizing

While risk-on sentiment has driven the Euro higher and the Dollar lower, the relative decline in German interest rates (coupled with rising US rates) has pushed the Euro lower and the Dollar higher, resulting in limited movement in the EUR/USD pair. Going forward, if crude oil prices turn lower, improved terms of trade in the Eurozone and risk-on sentiment will likely drive the Euro higher and the Dollar lower, while fading expectations of an ECB rate hike (due to lower German rates relative to the US) will likely push the Euro lower and the Dollar higher. We expect the EUR/USD pair to continue trading stably near current levels.

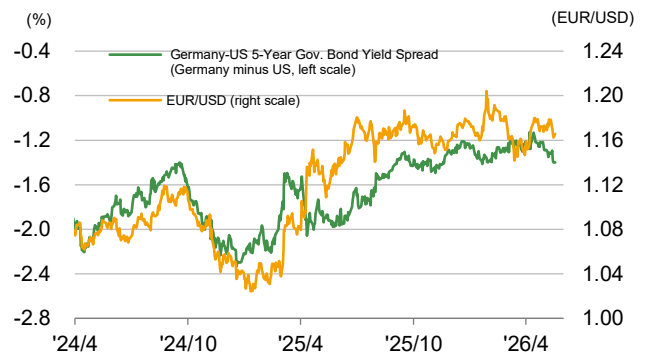
(Written by Yuji Kameoka, Research Department)

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



※The latest figure as of May 18, 2026
Source: LSEG; Compiled by Daiwa Asset Management

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



※The latest figure as of May 18, 2026
Source: LSEG; Compiled by Daiwa Asset Management

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