



Outlook for Japanese Stock Market & Economy

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Sumitomo Mitsui DS Asset Management

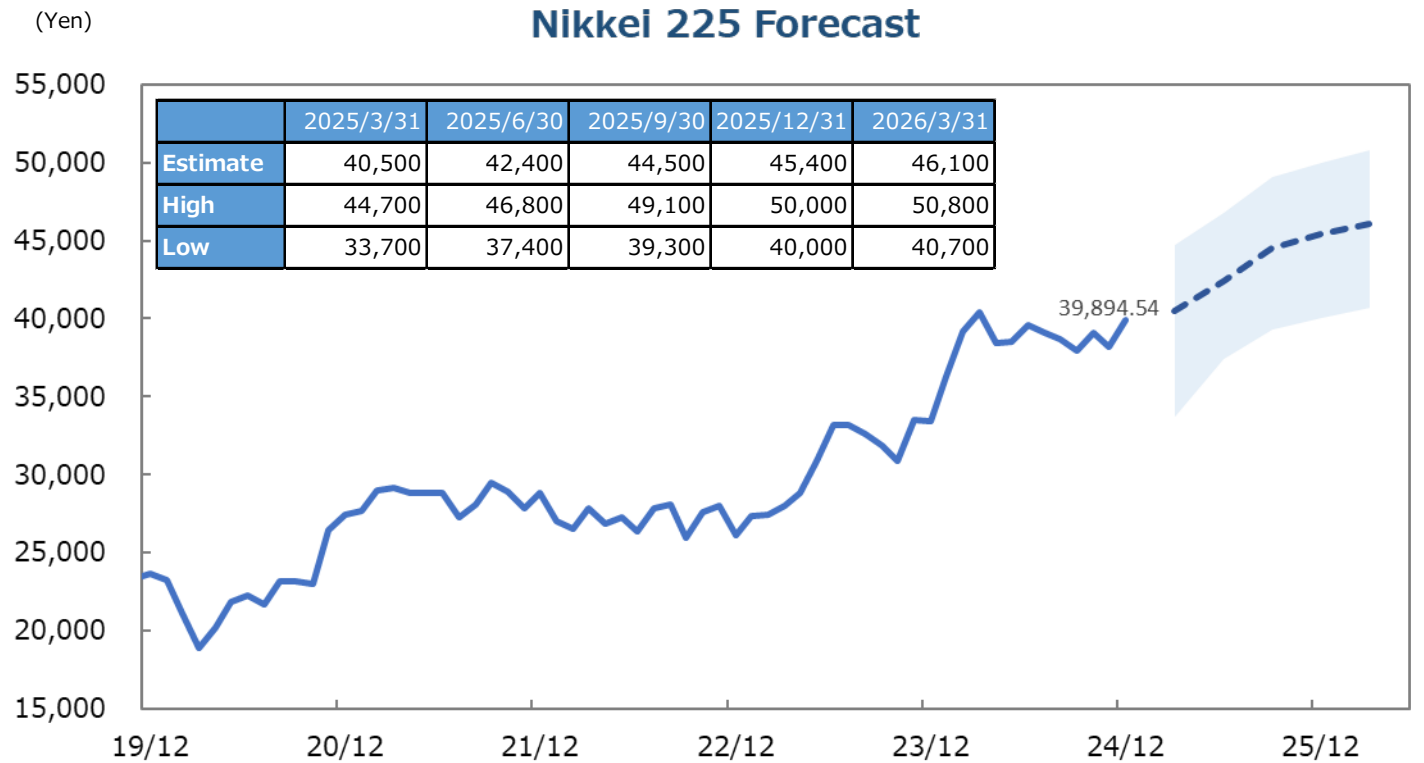


Outlook for Japanese Stock Market

Market Outlook

- We are bullish on the Japanese stock market in the mid-to-long term driven by steady growth of corporate earnings, the virtuous cycle of “wage increase and mild inflation”, and improvements in corporate governance.
- We expect the recent range trading will break upward once the future path of US monetary policy becomes clearer and market volatility settles.
- We expect the Nikkei 225 will reach to 45,400 and TOPIX to 3,190 by the end of 2025.
- Although foreign investors’ appetite for Japanese stocks appears sluggish, a massive amount of share buybacks, as much as 17 trillion yen in FY 2024, could protect the downside and boost the stock market going forward.

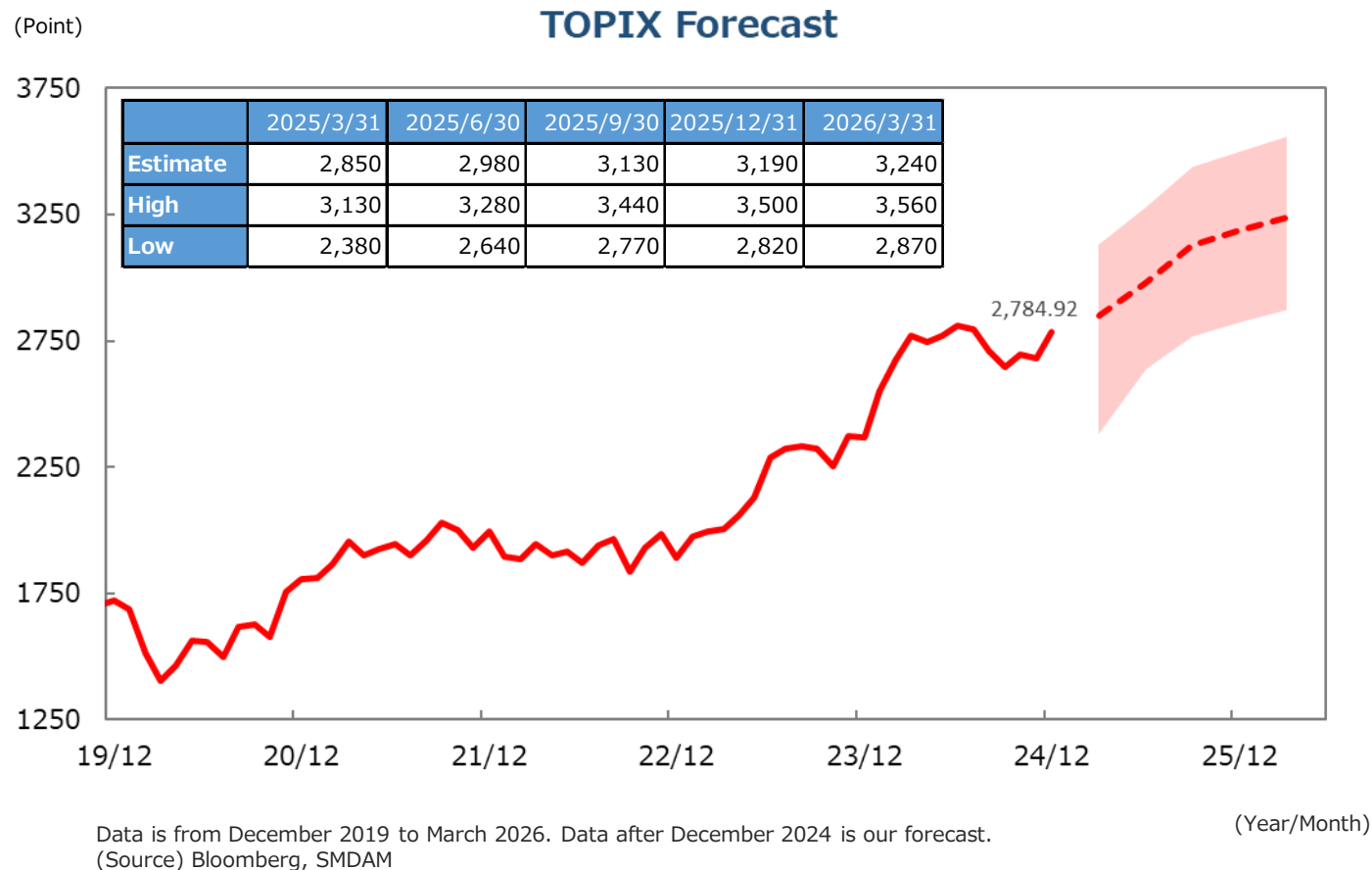
We are bullish on Japanese equity market



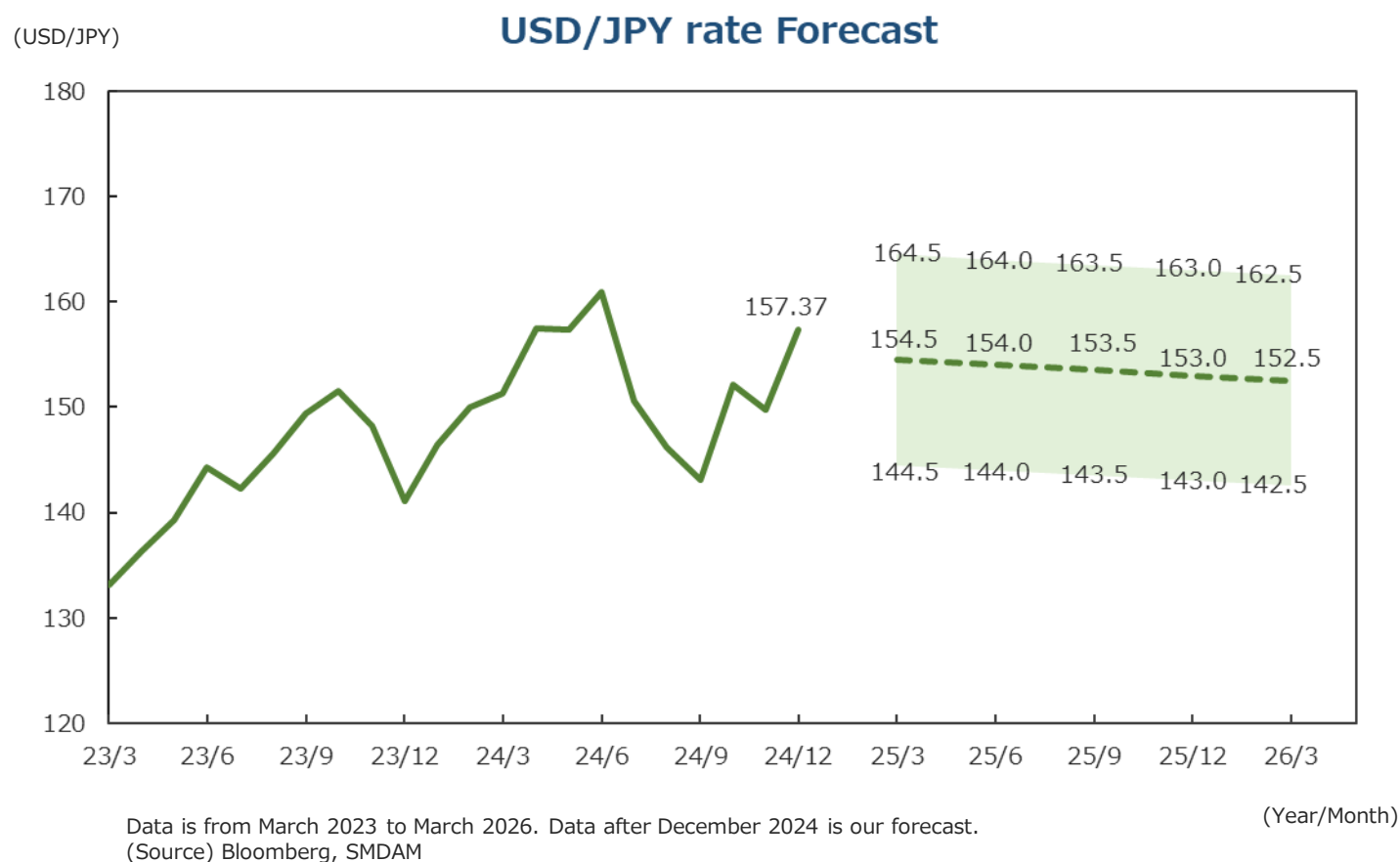
Data is from December 2019 to March 2026. Data after December 2024 is our forecast.
(Source) Bloomberg, SMDAM

(Year/Month)

We are bullish on Japanese equity market



Narrowing interest rate gap weighing on USD/JPY rate ahead



Upside / Downside risk scenarios

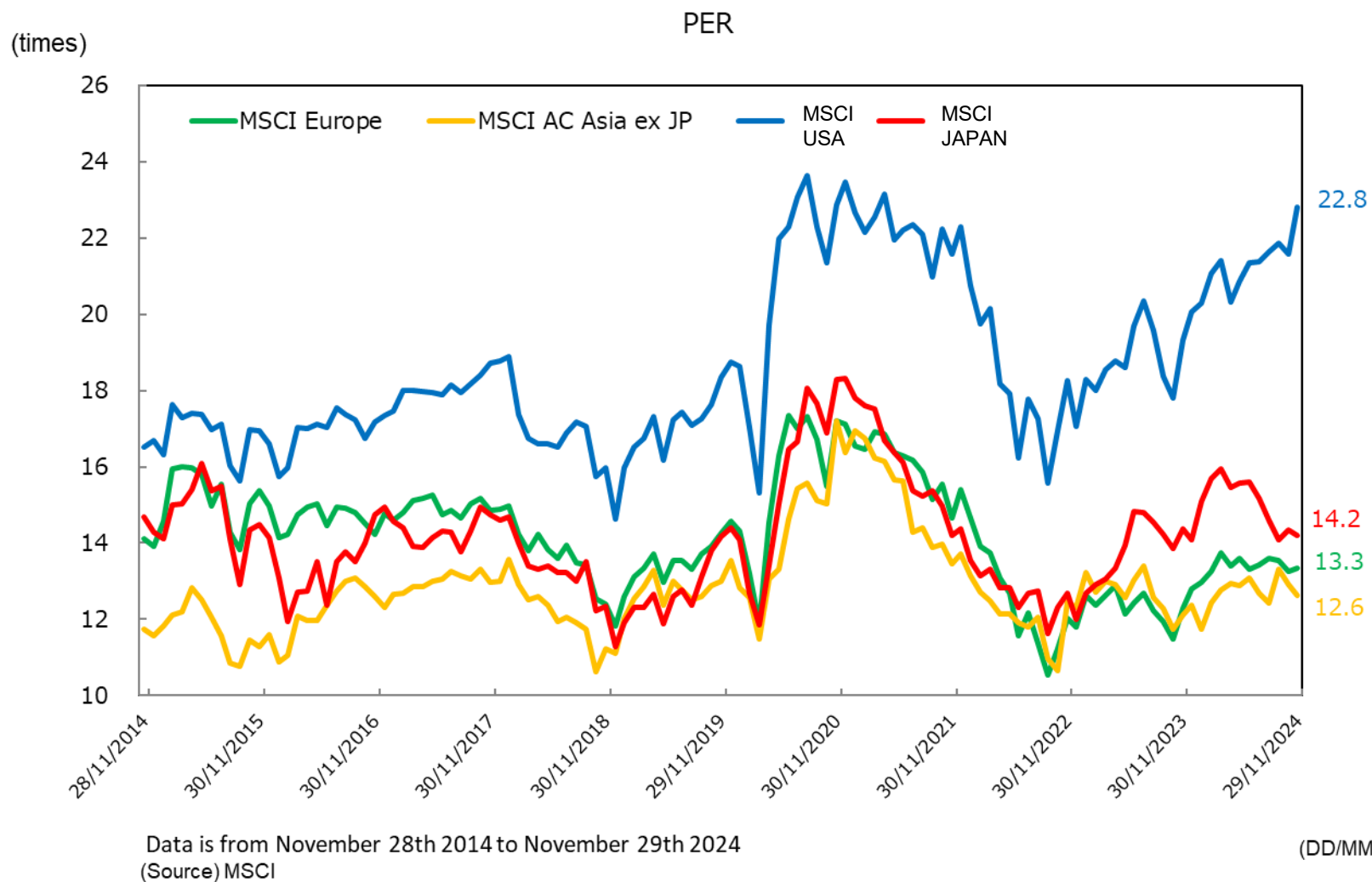
■ Upside Risks

- An increase in terminal rate of economic growth due to the end of deflation
- Further improvements of corporate governance, driven by Tokyo Stock Exchange

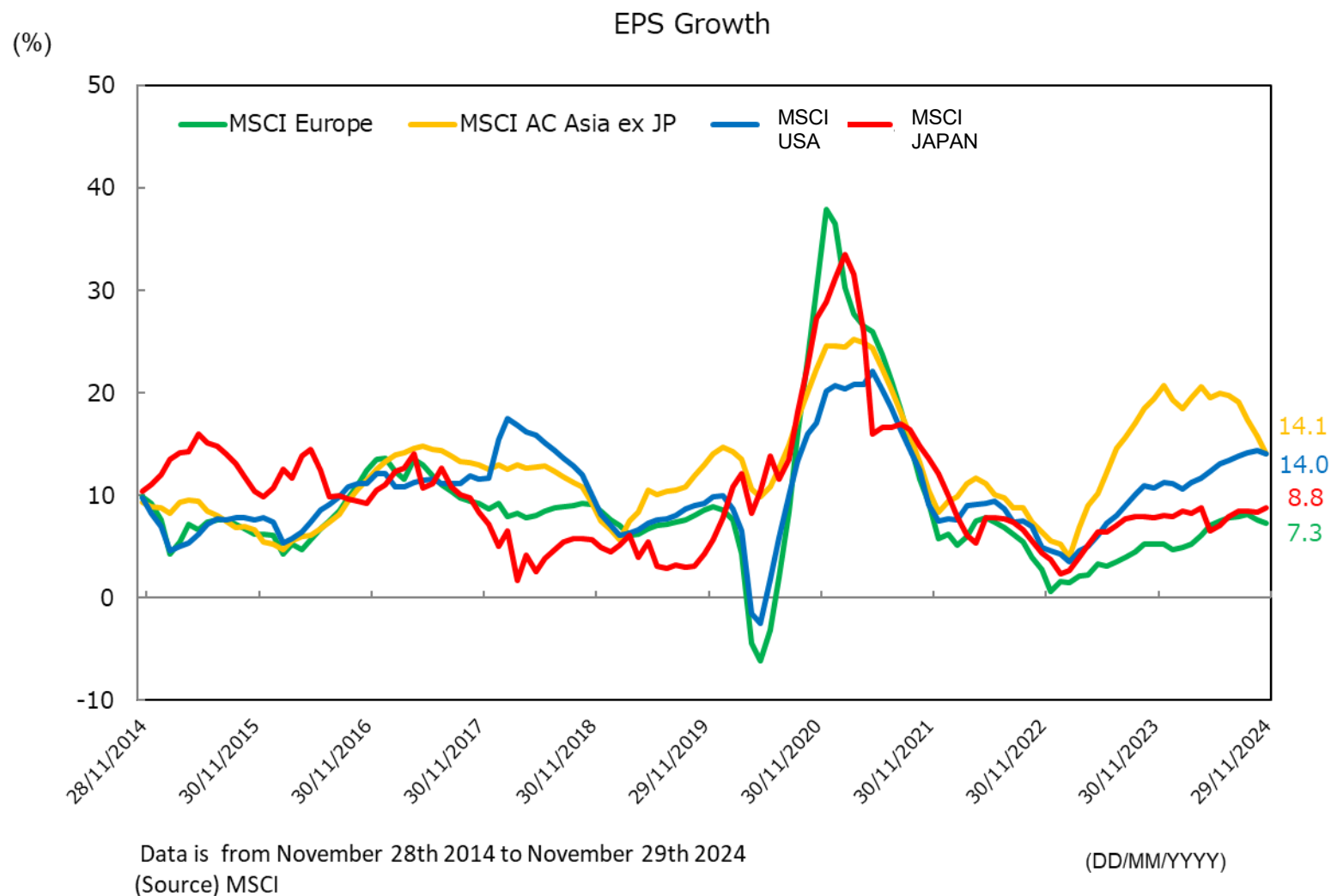
■ Downside Risks

- Tighter fiscal policy aimed at achieving a primary surplus
- Excessive and rapid appreciation of the JPY, which could impact corporate earnings
- Stagnation in the business cycle of manufacturing

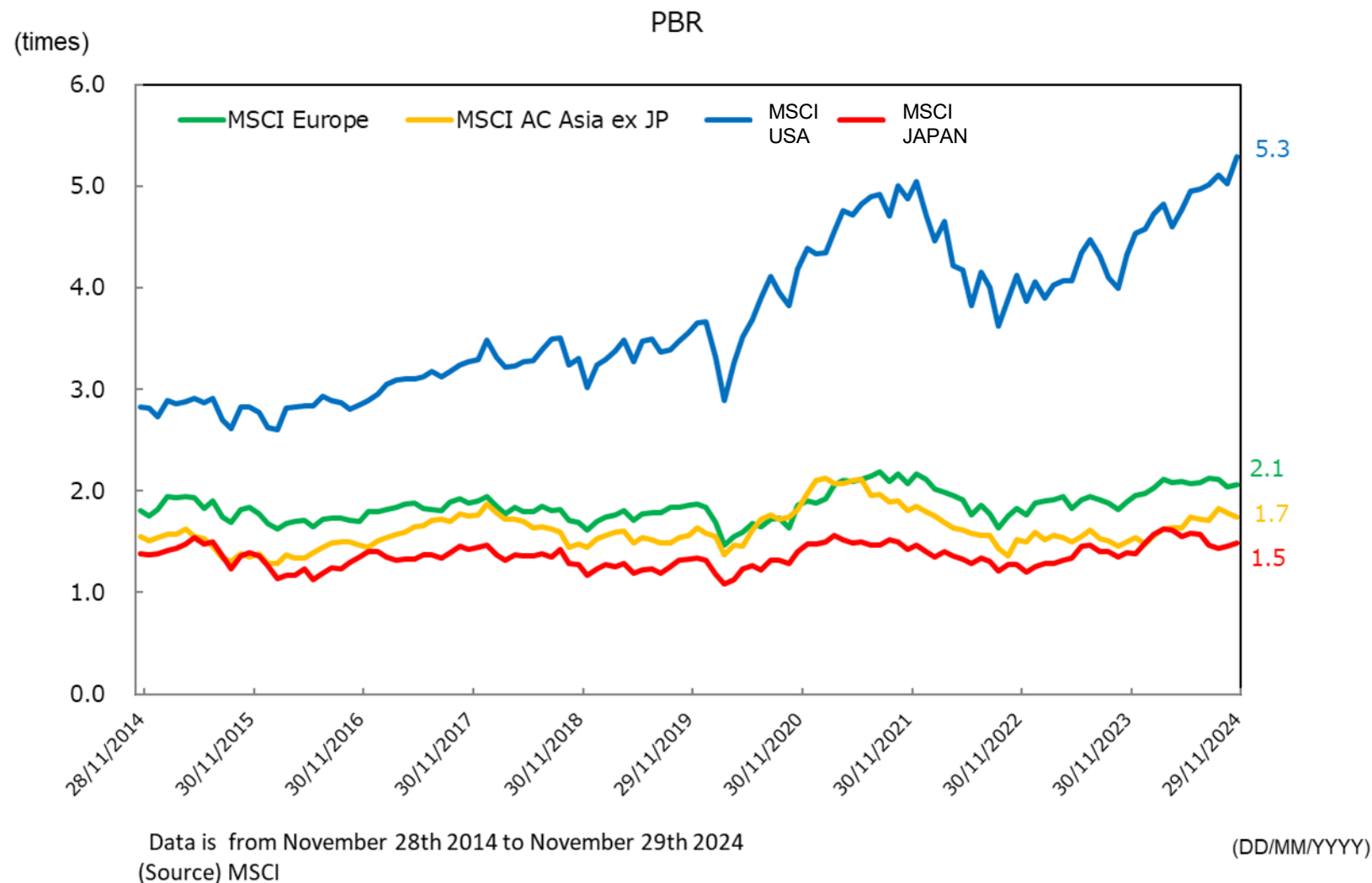
P/E ratio is just below 10 year average in Japan



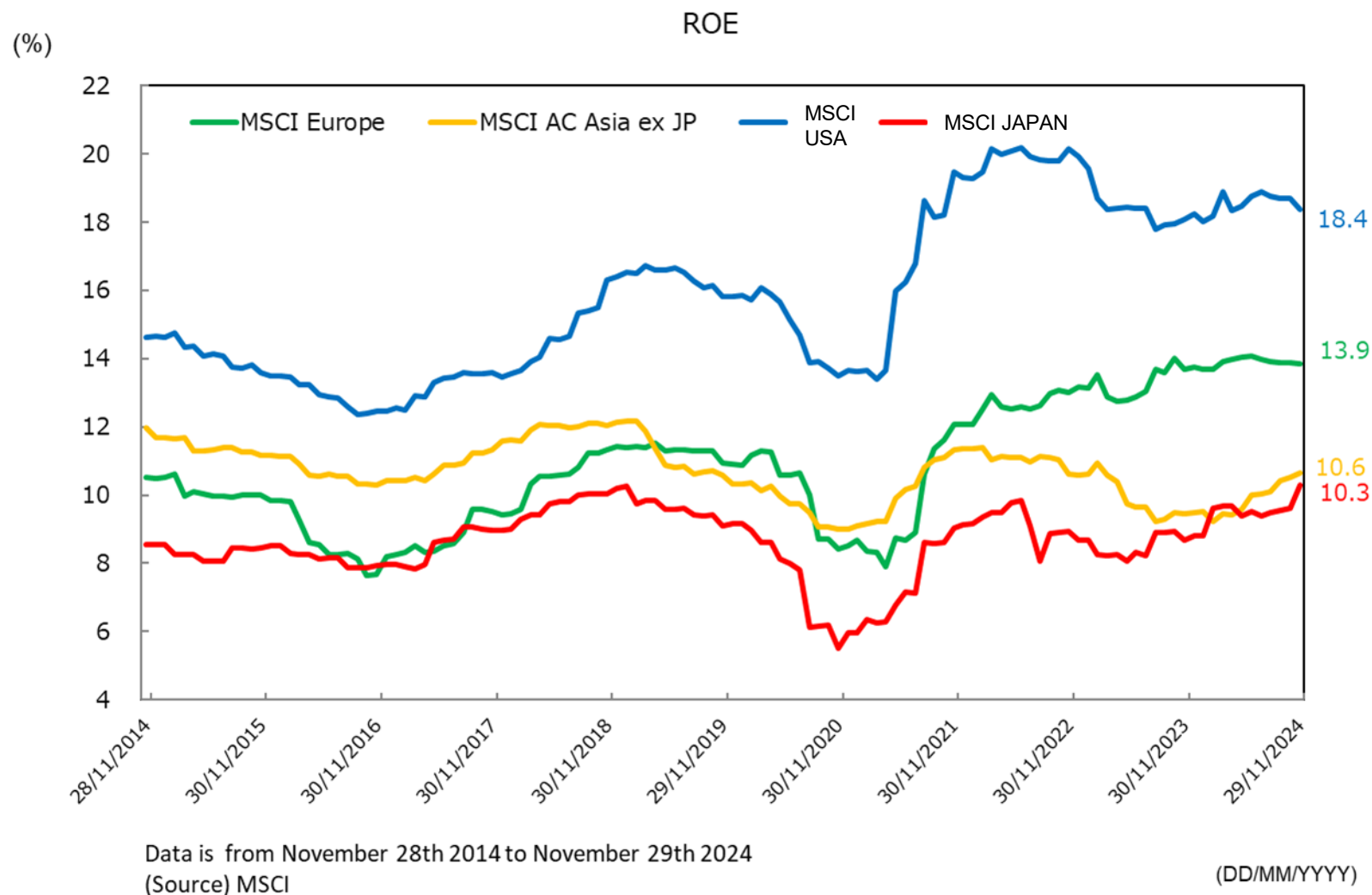
Earnings growth keeps steady momentum



Japan's P/B ratio lags behind global peers

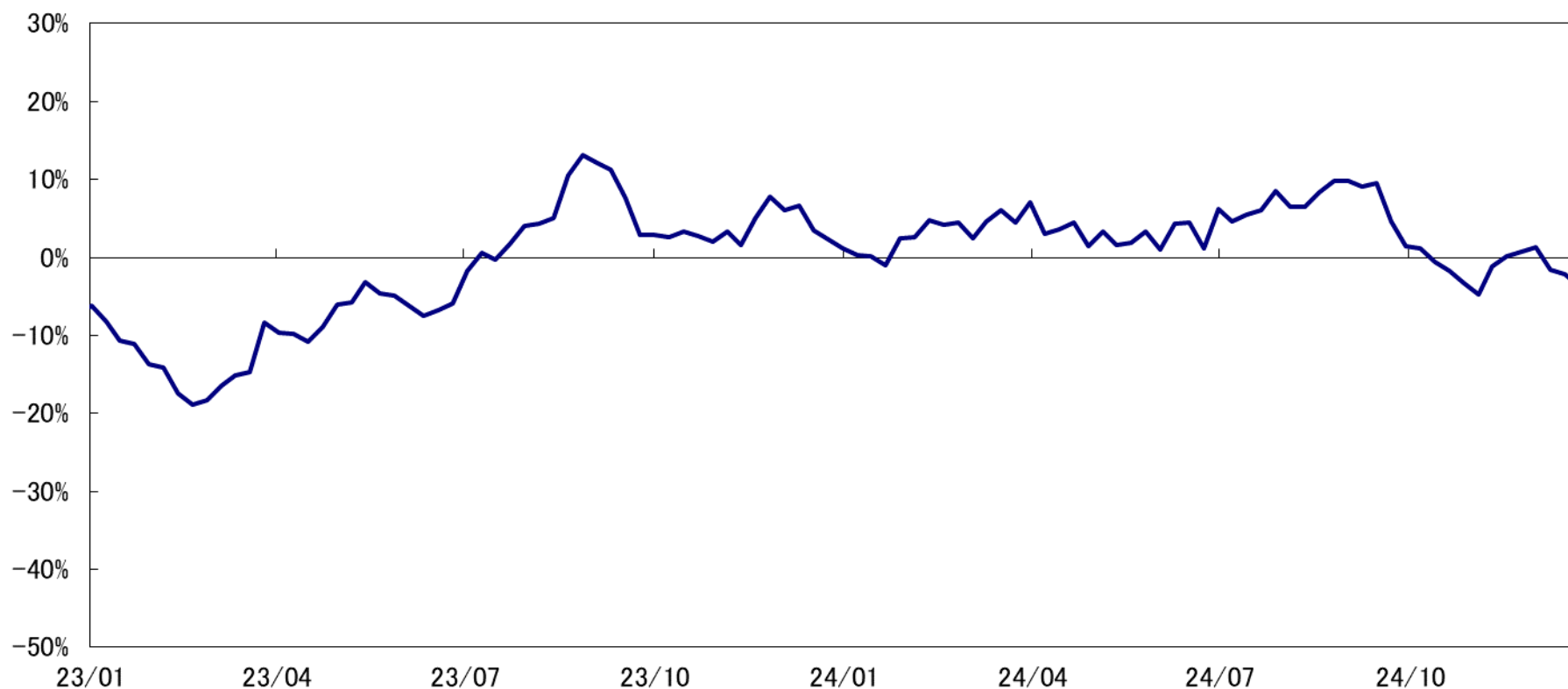


Earnings growth boost Japan's ROE



Uncertainty over global politics weighs on earnings forecasts

TOPIX Revision Index

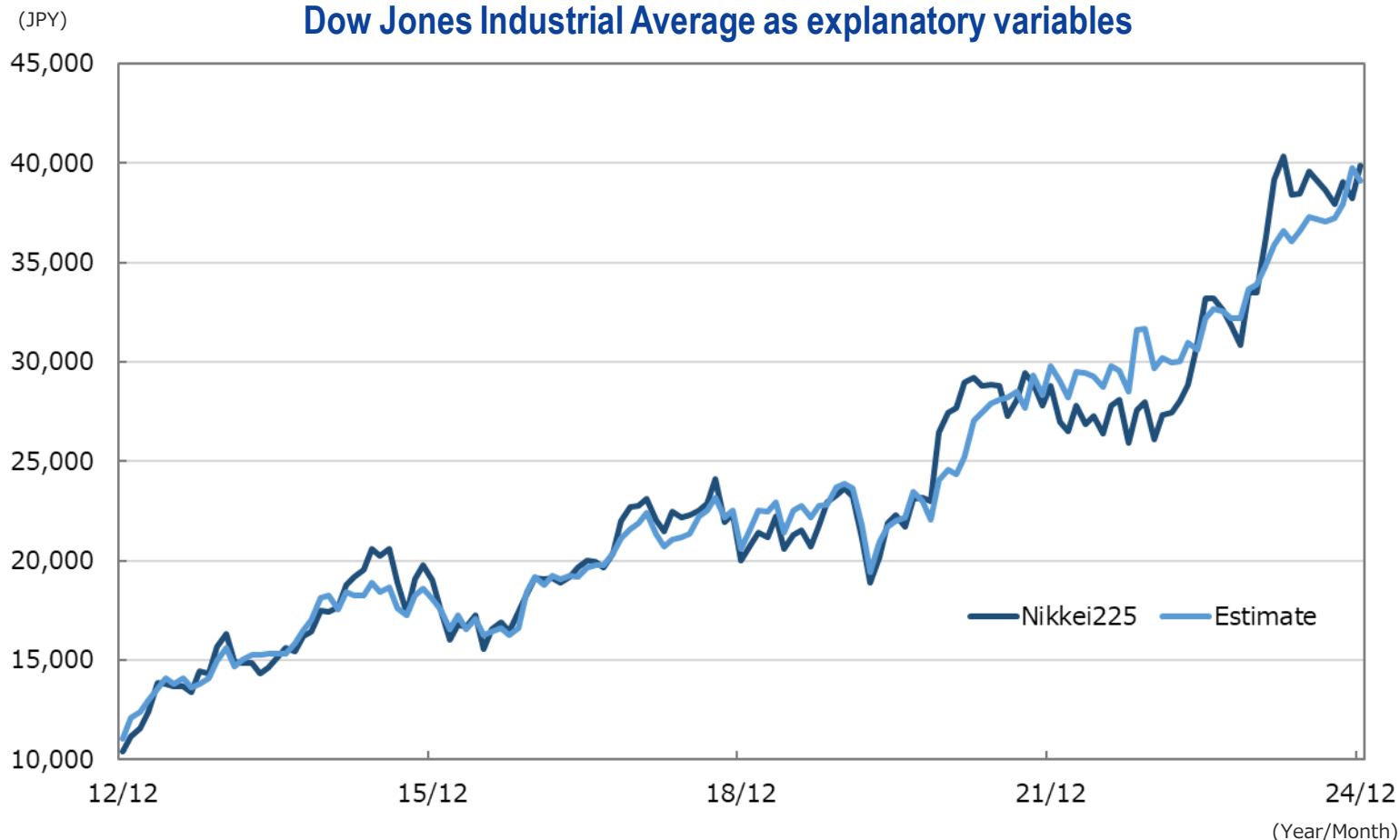


Data is from January 5th 2023 to December 26th 2024
(Source) Datastream, IBES

(YY/MM)

Weakening Yen and rally of US equity lift Nikkei 225

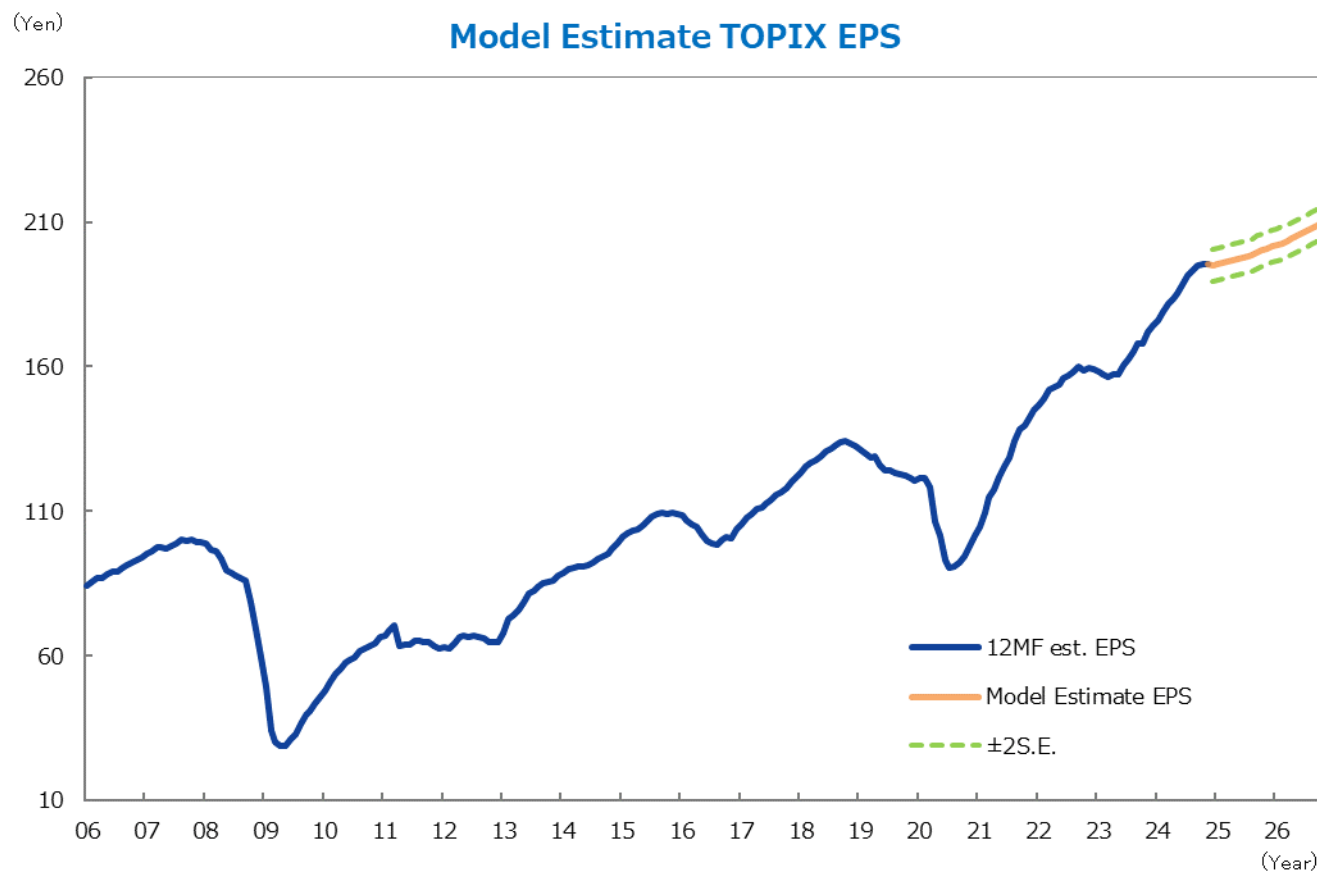
Multiple regression analysis of Nikkei 225 Index using US dollar / yen rate and Dow Jones Industrial Average as explanatory variables



Data is from December 2012 to December 2024.
(Source) SMDAM, Bloomberg

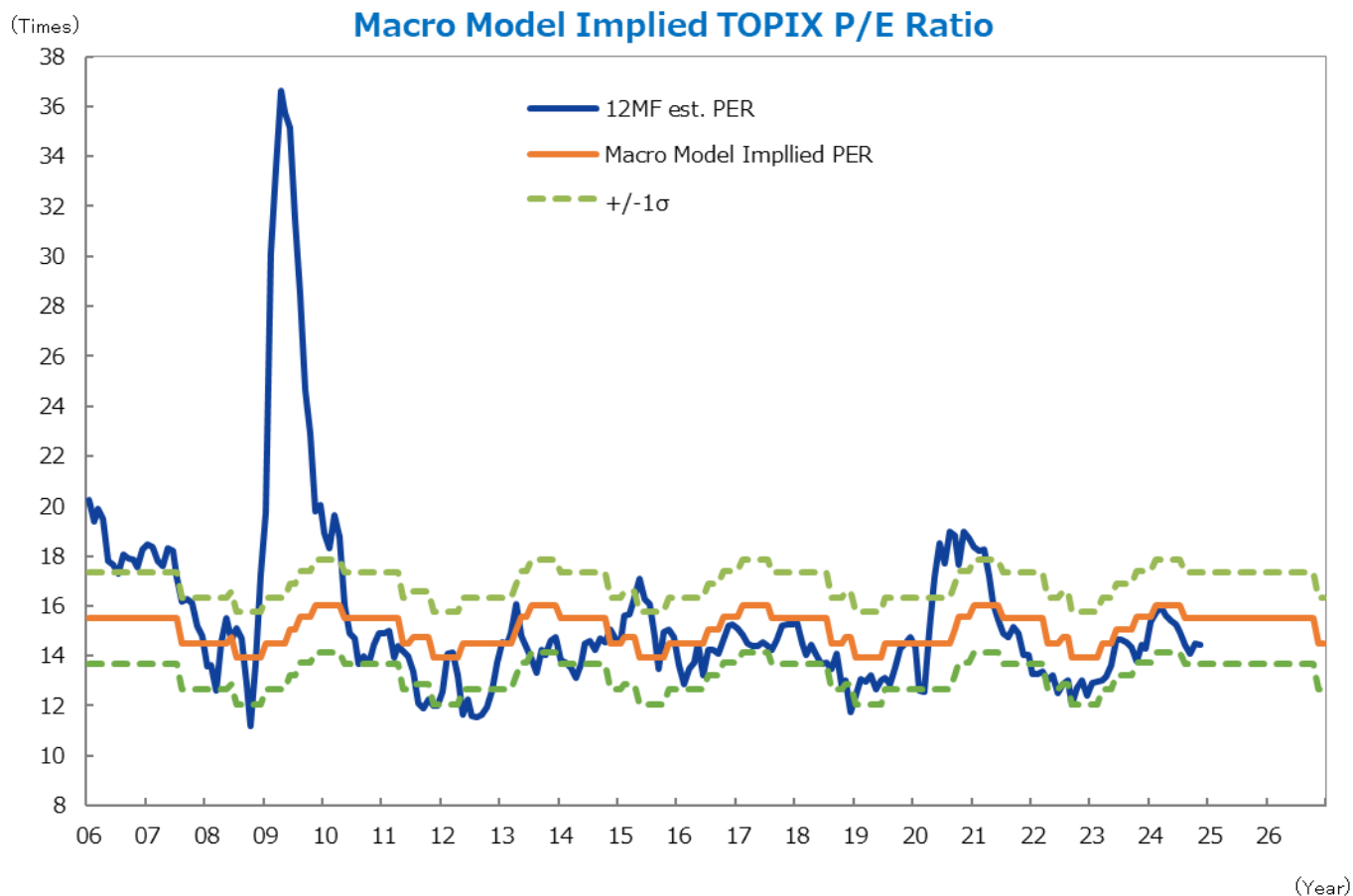


Quant model suggests that EPS to accelerate in the near future



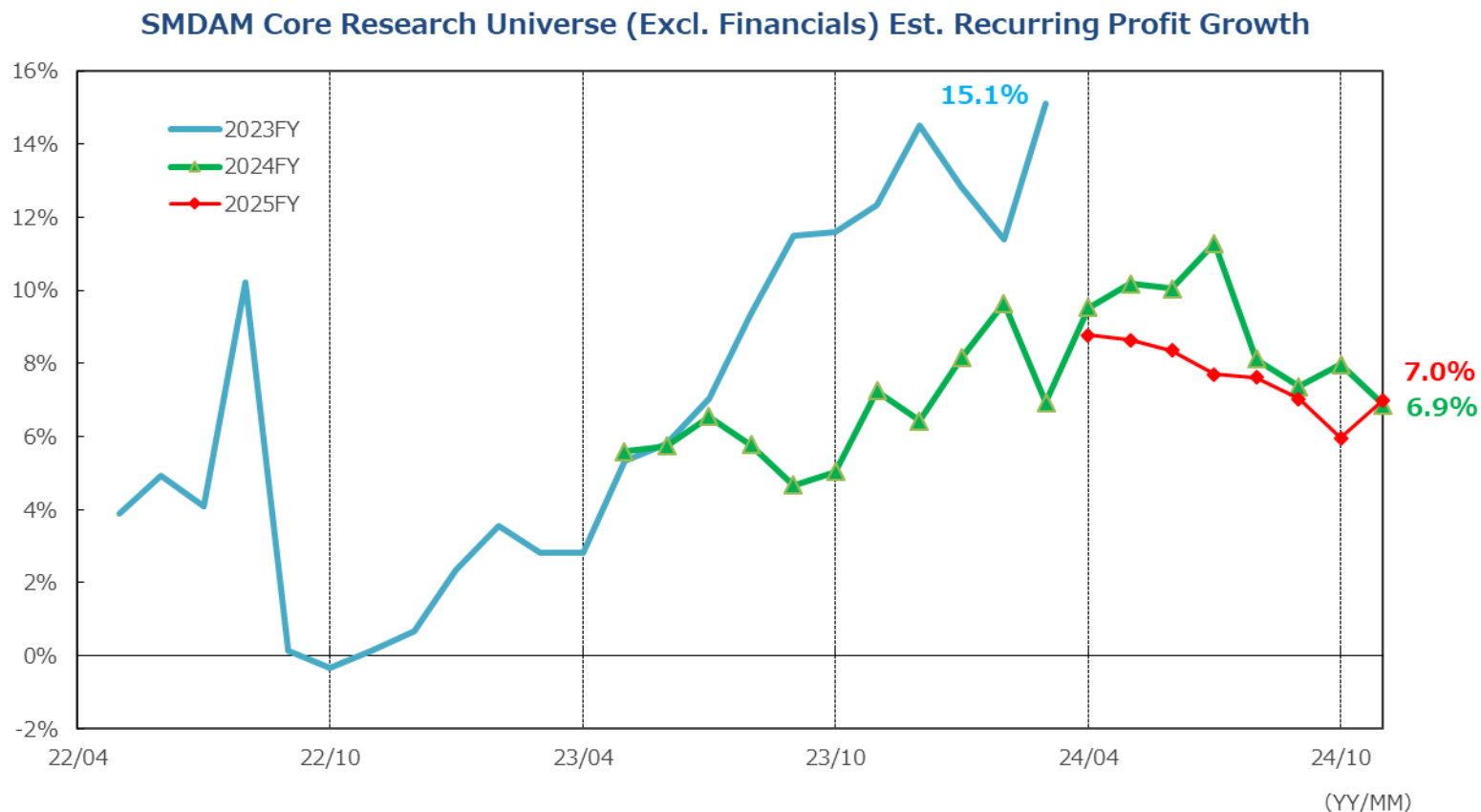
Note: Consensus data is from January 2006 to November 2024. Model estimate Data is from December 2024 to December 2026.
Source: SMDAM

TOPIX is currently traded with attractive P/E ratio



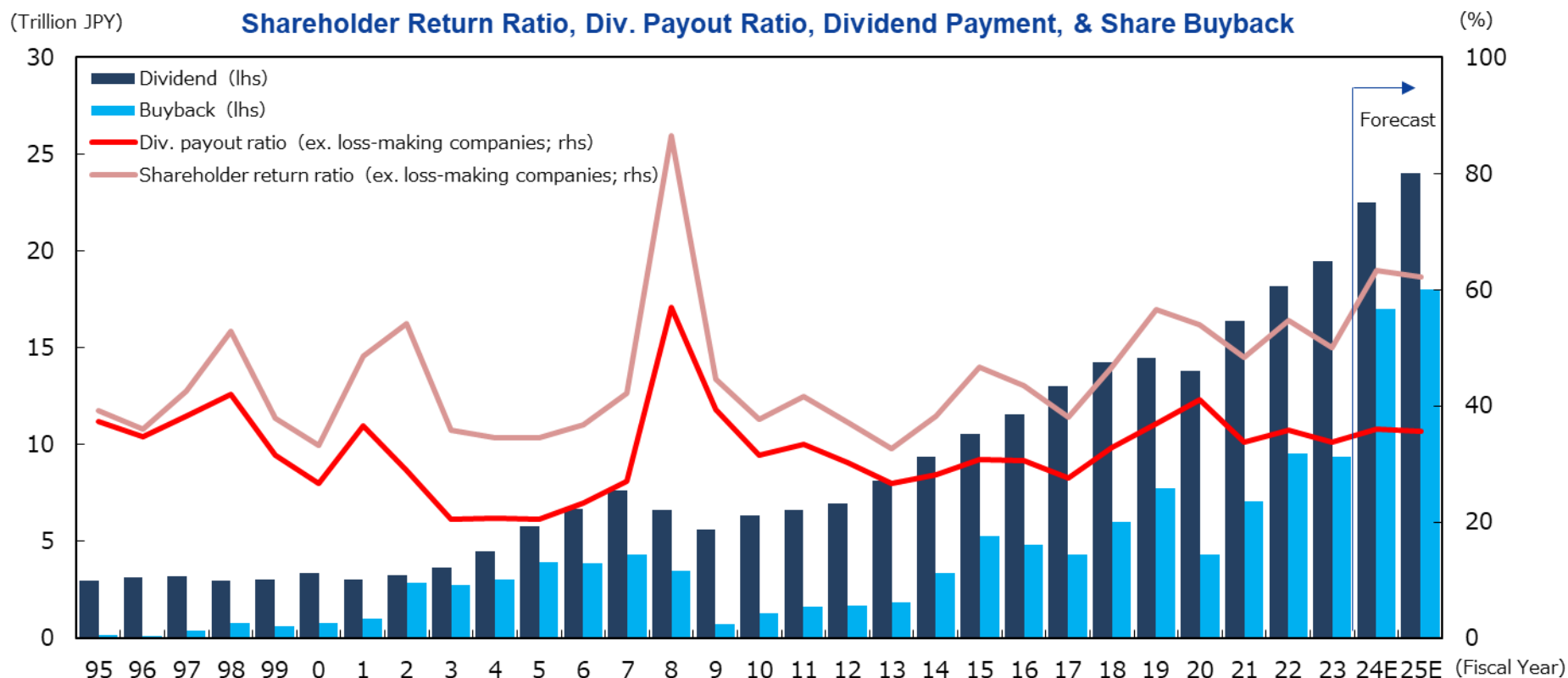
Note: Consensus data is from January 2006 to November 2024. Model estimate Data is from December 2024 to December 2026.
Source: SMDAM

SMDAM analysts see a cruising speed of earnings growth ahead



Note: Data is as of 10th December 2024, SMDAM Core Universe (Excl. Financials) consists of 398 Japanese companies covered by SMDAM in-house analysts.
Source: SMDAM

Streak of record-breaking dividends and share buybacks



Note: Data is from FY1995 to FY2025. FY2024 and FY2025 are forecasts by Daiwa Securities.
 Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

Seesaw of value and growth in the short term

Performance Comparison of Russell/Nomura Style Indices

Index	Returns(%)						
	3 Month	6 Month	YTD	1 Year	2 year	3 Year	5 Year
RN Japan Equity	3.87	-0.26	15.12	16.75	40.81	36.98	57.66
Total Value	4.62	-1.27	19.02	20.65	53.23	63.77	70.78
Top Cap Value	8.08	-1.93	26.20	27.92	63.55	78.07	100.79
Large Cap Value	4.73	-1.91	19.76	21.25	54.58	66.41	75.39
Mid Cap Value	1.53	-1.86	13.82	15.12	44.94	53.72	46.99
Small Cap Value	3.78	1.50	15.42	17.67	46.81	52.30	50.84
Micro Cap Value	3.40	-0.53	13.23	15.94	43.11	46.88	44.18
Total Growth	3.30	0.82	11.88	13.50	29.76	15.01	44.02
Top Cap Growth	5.08	-0.80	14.76	16.57	36.64	18.26	54.95
Large Cap Growth	3.28	0.41	12.56	14.13	31.88	16.09	48.15
Mid Cap Growth	-0.07	2.95	8.51	9.69	23.45	12.06	36.59
Small Cap Growth	3.30	4.39	5.92	7.84	13.40	6.51	13.05
Micro Cap Growth	-1.65	-2.54	-1.11	0.98	4.00	-2.39	5.74
Top Cap Total	6.17	-1.31	18.92	20.70	47.76	41.49	73.00
Large Cap Total	3.88	-0.72	15.67	17.21	42.13	37.57	61.41
Mid Cap Total	0.72	0.13	11.26	12.50	34.29	32.16	46.03
Small Cap Total	3.57	2.54	11.61	13.71	32.98	33.13	36.03
Micro Cap Total	1.75	-1.17	8.23	10.72	29.00	28.89	31.62

Note : As of 19th December 2024
(Source) Bloomberg





Outlook for Japanese Economy



Current status & Outlook of Japanese economy

[Current Status]

- **The economy is recovering.** Real GDP in Q3 of 2024 was revised upward, showing growth for the second consecutive quarter. While the economic figures for Q4 are off to a strong start in capital goods and total supply, consumer data showed some weakness, possibly due to the subdued demand for seasonal goods caused by the extreme heat. Export is slowing but remain resilient. The Bank of Japan's December "Tankan survey" indicates business conditions were generally flat, while CAPEX remain solid. Although the victory of Donald Trump in the US presidential election has raised uncertainty over the US economic policies, the impact on domestic business sentiment has been limited so far.
- **Inflation is in upward trend.** Nationwide core CPI rose by +2.3% YOY in October, down from +2.4% in September, while the Tokyo Metropolitan Area core CPI rose by +2.2% YOY in November, up from +1.8% in October. The rise in Tokyo Metropolitan Area core CPI was mainly driven by energy prices, following the reduction of government emergency measures to cope with the extreme heat. Additionally, rising service prices and cost-push pressure from the depreciation of the JPY also contributed.

[Outlook]

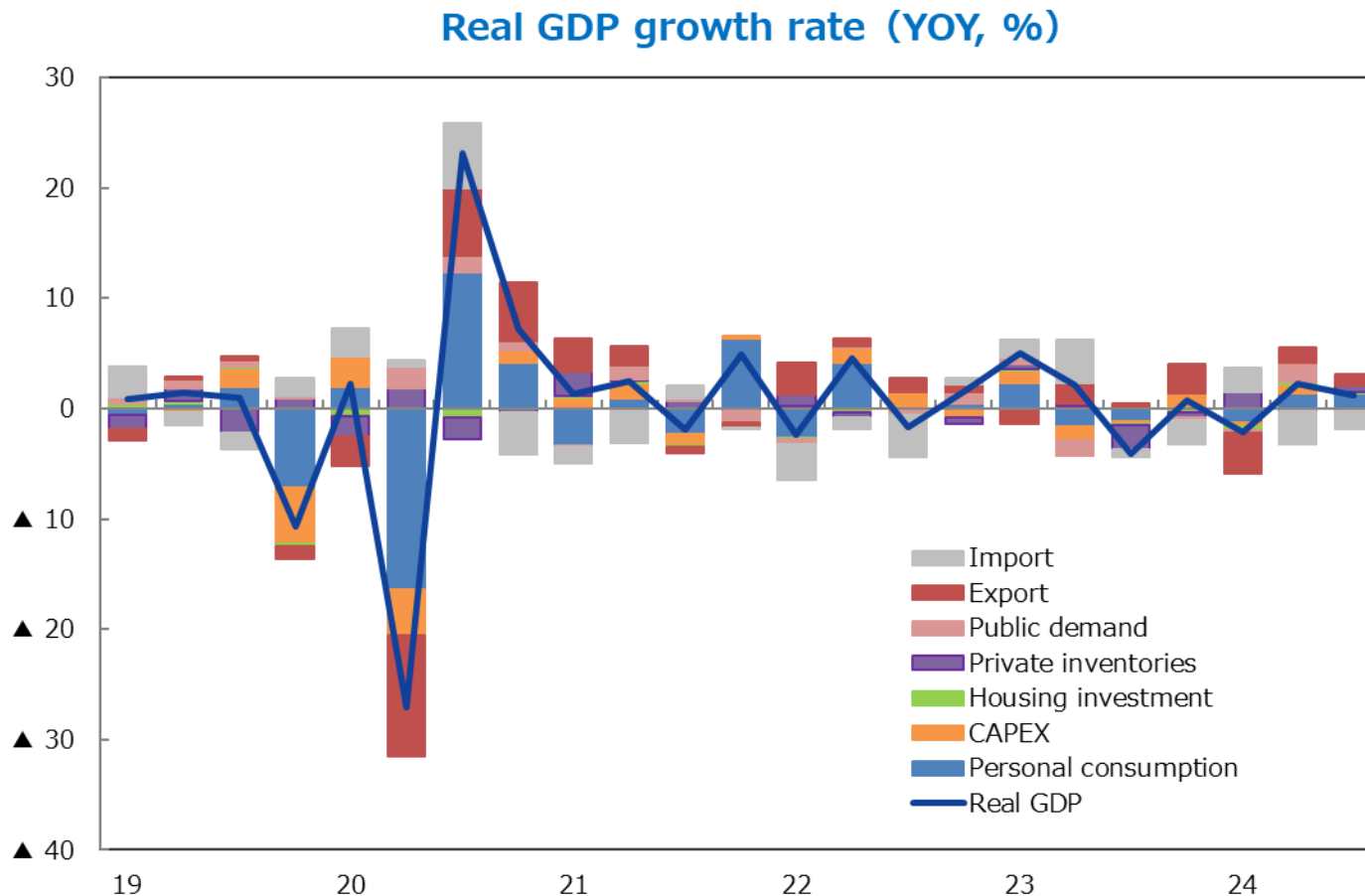
- ① **While we have raised our real GDP growth forecast for FY 2024 from +0.3% to +0.5% and that for FY 2026 from +0.8% to +0.9%, we have maintained our estimate for FY 2025 at +1.2%.** The upward revision for FY 2024 reflects actual data for July to September 2024, while the revision for FY 2026 is mainly due to the assumption of elimination of provisional gasoline tax. We assume the increase in the minimum taxable income will begin in 2025, with the expected amount being half of what the Democratic Party for the People is advocating for. We expect the Japanese economy to return to a moderate growth path, supported by wage increases, steady appetite for CAPEX (such as labor saving, digitalization, greening, urban development, and construction of semiconductor factories), economic measures including tax reduction, and the resilience of overseas economies.
- ② **While we have maintained core CPI forecast for FY 2024 at +2.6% and that for FY 2025 at +2.1%, we have lowered that for FY 2026 from +1.9% to +1.5%.** The downward revision for FY 2026 reflects the assumption of elimination of provisional gasoline tax. We expect cost-push pressure from import prices will decrease, while inflation will be stable due to rising service prices driven by wage hikes. We forecast core CPI to maintain a momentum of around +2.0% YOY, with high volatility due to the impact of economic measures. The BOJ Core CPI (excluding food and energy) is to stay at around +2% as it is not affected by subsidies for utility bills and change in gasoline tax.
- ③ **We expect the government to adopt accommodative fiscal policies.** Prime Minister Ishiba has confirmed that he will continue his predecessor's policies and focus on combating deflation over the next three years. In November, the Cabinet approved a comprehensive economic measure aimed at "ensuring people's safety and security and sustainable growth." Regarding tax cuts, an agreement has been reached between the ruling party and the opposition Democratic Party for the People to raise the minimum taxable income from the current 1.03 million yen starting in 2025 and to abolish the provisional gasoline tax.
- ④ **We have maintained our forecast for the Bank of Japan's monetary policy.** We expect the BOJ to raise its policy rate to 0.50% in January 2025, 0.75% in July 2025, 1.00% in January 2026, and 1.25% in January 2027. We anticipate the BOJ will coordinate carefully with the government before each rate hike, conducting comprehensive research on the domestic economy, inflation, and overseas economies (particularly the United States) as part of the "Outlook Report" in January 2025. Following that, gradual interest rate hikes towards the lower bound of a neutral economic interest rate level (1% to 2.5%) will continue at a pace of once every six months until the rate reaches 1%. Beyond that point, the pace of rate hikes will slow down to once a year. There is a risk of a delay of rate hike in case of the US raises tariffs. If the Japanese economy is negatively impacted by the US tariff increase without a corresponding depreciation of the yen, it is possible that the BOJ will delay the rate hike and keep the policy unchanged for a while.

Forecast for the Japanese economy

Forecast of annual Real GDP growth and its breakdown						
Fiscal Year	FY21	FY22	FY23	FY24 Est	FY25 Est	FY26 Est
Real GDP	3.0%	1.4%	0.7%	0.5%	1.2%	0.9%
Private final consumption expenditure	1.8%	2.6%	-0.4%	0.6%	1.4%	1.0%
Private housing investment	0.3%	-2.6%	0.8%	-1.5%	-0.8%	-1.1%
Private-sector capital investment	3.2%	3.6%	-0.1%	2.5%	1.8%	1.6%
Private inventory investment	0.5%	0.0%	-0.3%	0.1%	0.0%	0.0%
Public fixed capital formation	-6.4%	-5.5%	-0.3%	1.0%	0.1%	0.7%
Net export contribution	0.8%	-0.5%	1.4%	-0.6%	0.0%	0.1%
Exports of goods and services	12.5%	4.9%	2.8%	1.2%	3.3%	3.3%
Imports of goods and services	7.3%	7.3%	-3.3%	4.4%	3.2%	2.9%
Nominal GDP	2.9%	2.3%	4.9%	3.0%	3.0%	2.3%
GDP deflator	-0.1%	0.9%	4.2%	2.6%	1.8%	1.4%
Industrial Production Index	5.6%	-0.3%	-1.9%	-0.5%	2.6%	1.6%
Consumer Price Index (Core)	0.1%	3.0%	2.8%	2.6%	2.1%	1.5%
Consumer Price Index (BOJ Core)	-0.8%	2.2%	3.9%	2.2%	2.0%	2.0%
Domestic corporate goods price index	7.1%	9.6%	2.4%	2.7%	1.1%	1.1%
Employee compensation	2.1%	2.5%	1.9%	3.8%	3.5%	3.4%
Unemployment rate	2.8%	2.6%	2.6%	2.5%	2.3%	2.2%
Monetary Policy interest rate (Short term)	-0.10%	-0.10%	0-0.1%	0.50%	1.00%	1.25%

Note: Rate of increase over the previous year. Net exports are based on the degree of contribution, and the consumer price index (Core) excludes the effects of the consumption tax and free education.
Source: Sumitomo Mitsui DS Asset Management based on data from the Cabinet Office, the Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry

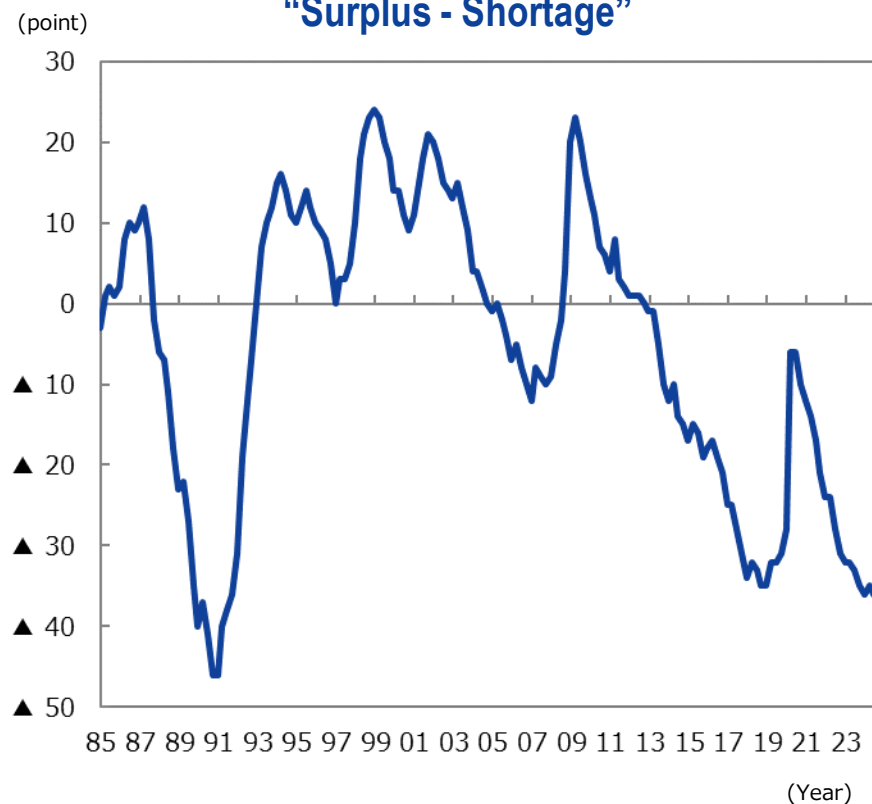
Japanese economy returns to a growth trend



Note: Data is from Q1 2019 to Q3 2024.
Source: Cabinet office, SMDAM

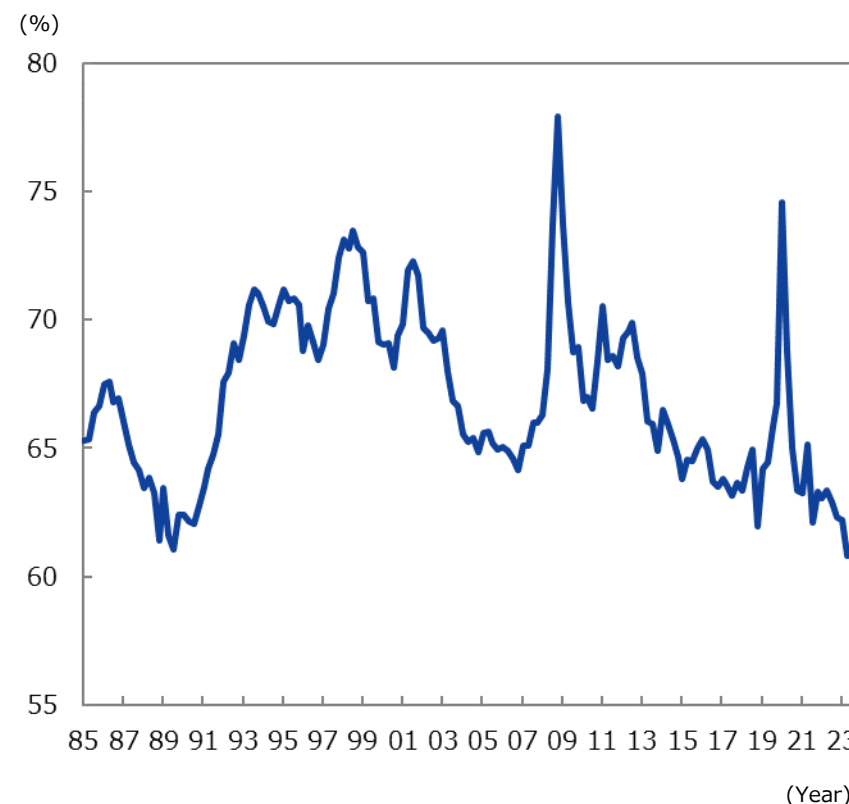
Conundrum of Japanese labor market

Employment Sufficiency Index "Surplus - Shortage"



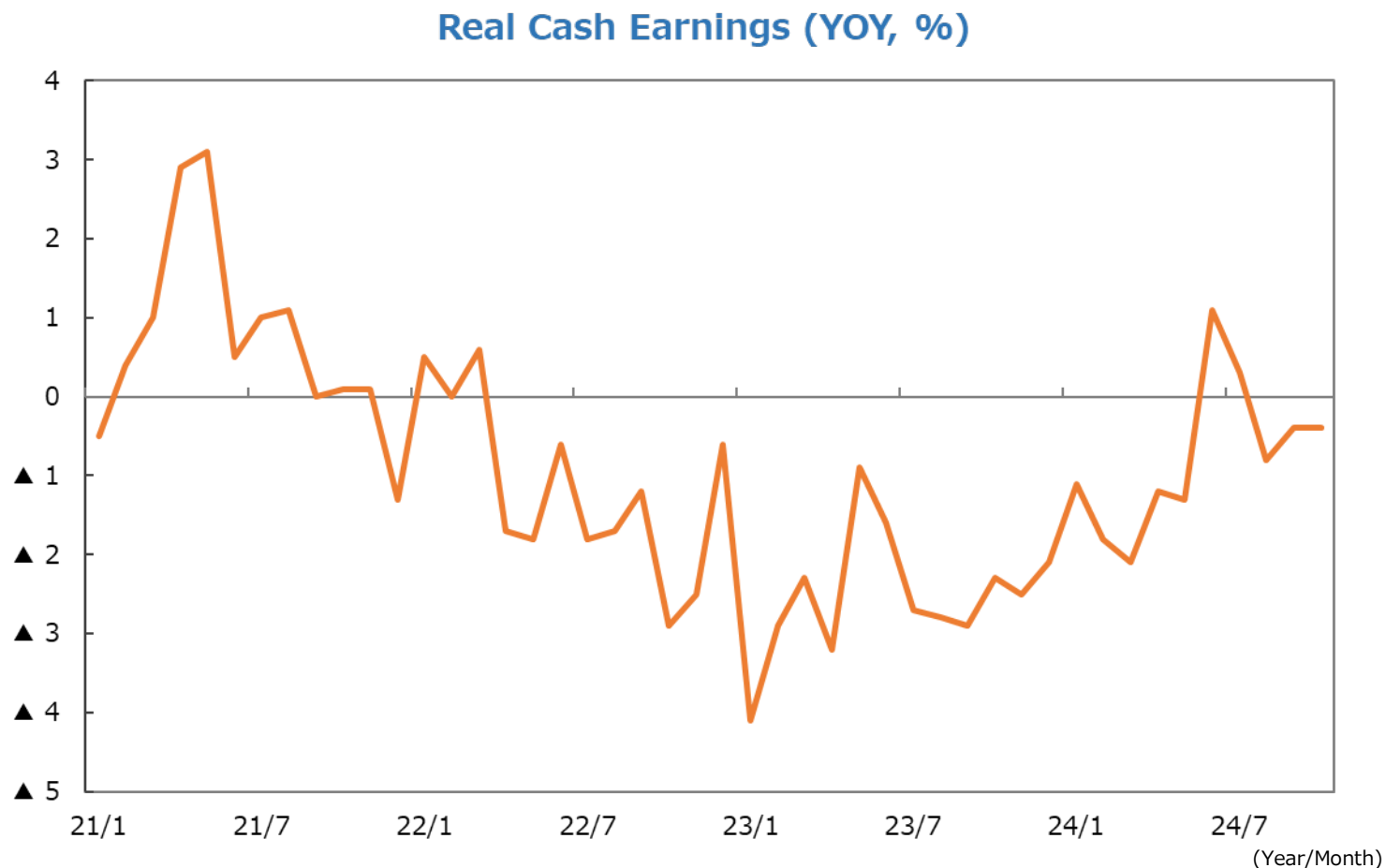
Note: Data is from April 1985 to December 2024.
Source: The bank of Japan, SMDAM

Labor Share of Added Value



Note: Data is from April 1985 to April 2024.
Source: Ministry of finance, SMDAM

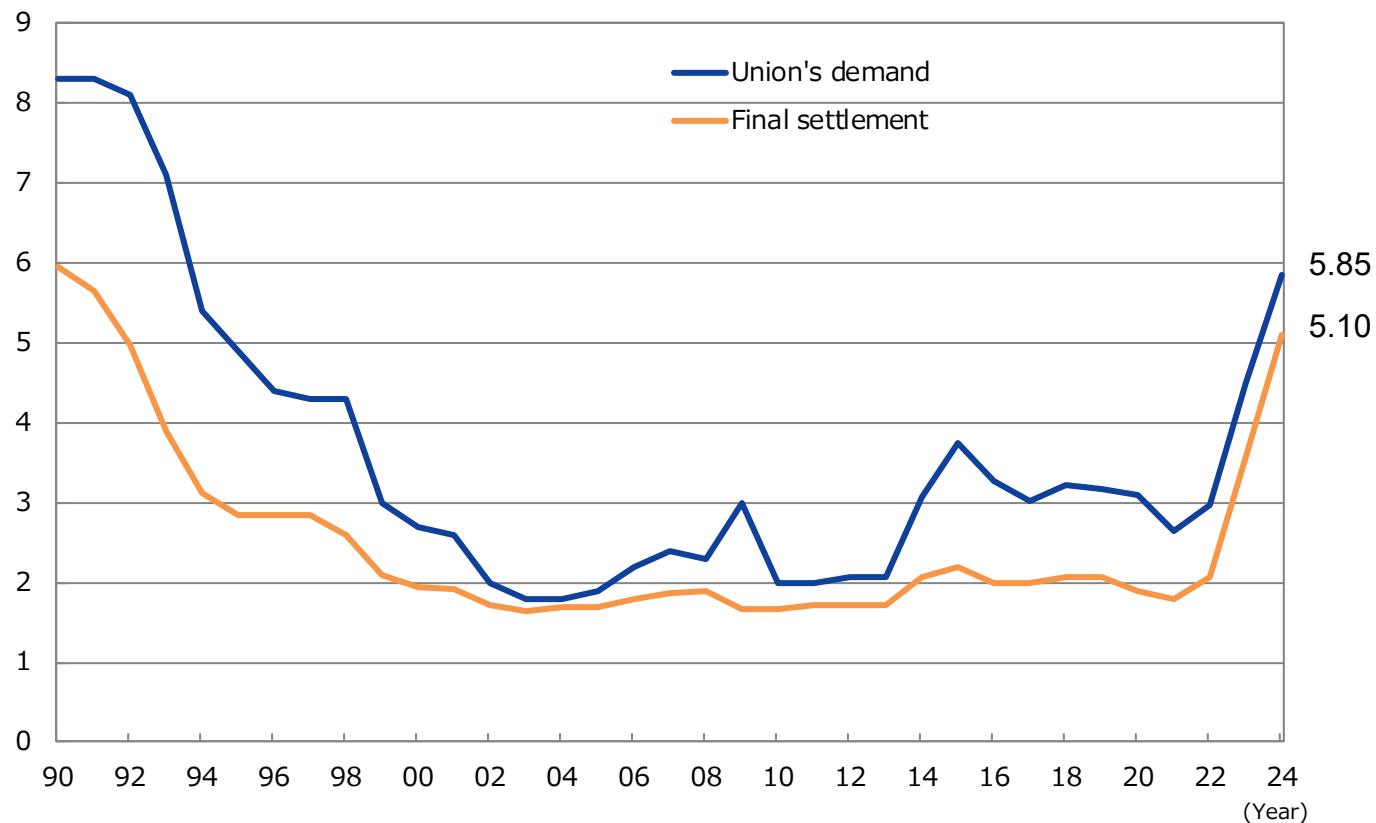
Inflation erodes purchasing power of consumers



Note: Data is from January 2021 to October 2024.
Source: Japanese Trade Union Confederation, SMDAM

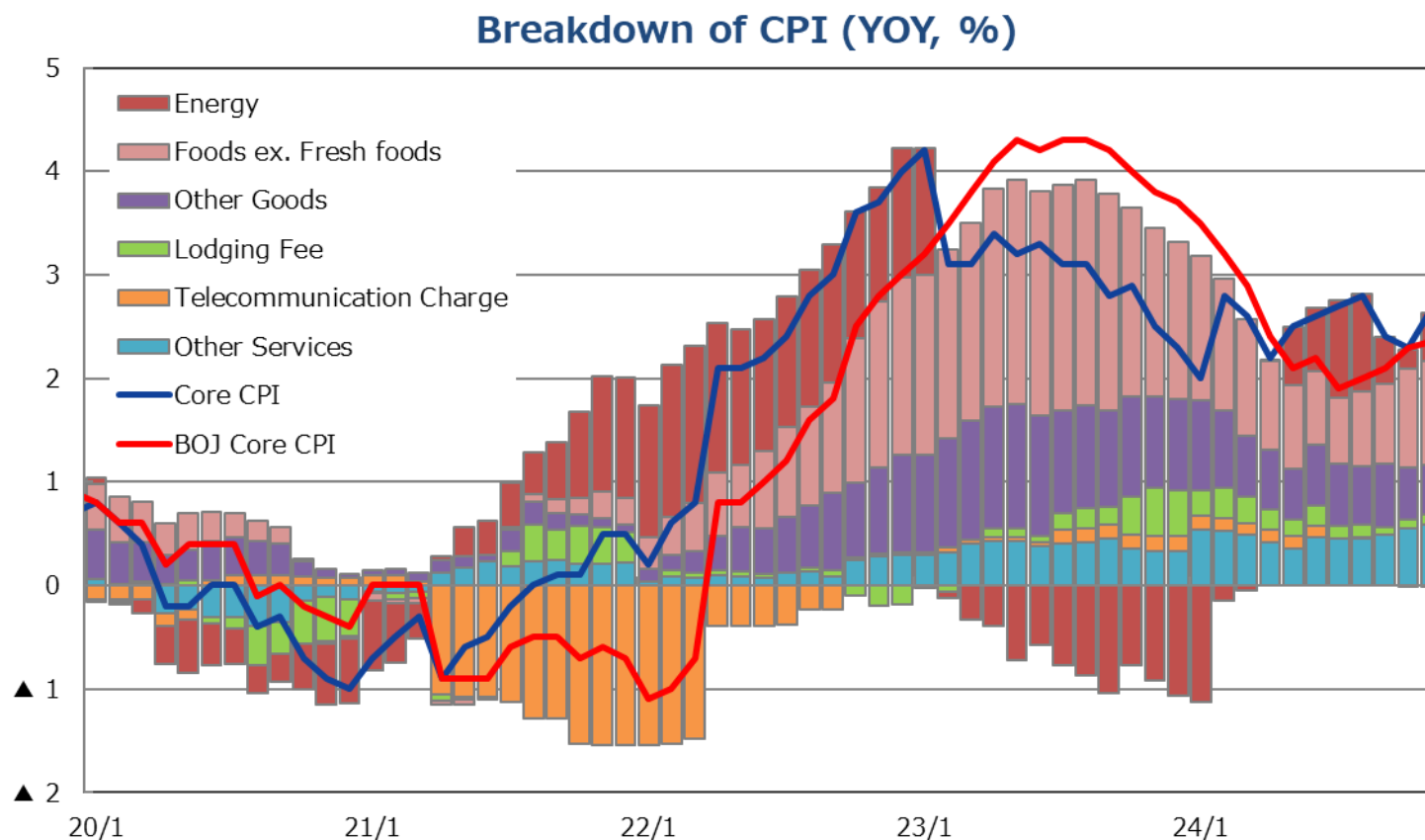
Highest wage increase in 33 years

Wage increase (YOY, %)



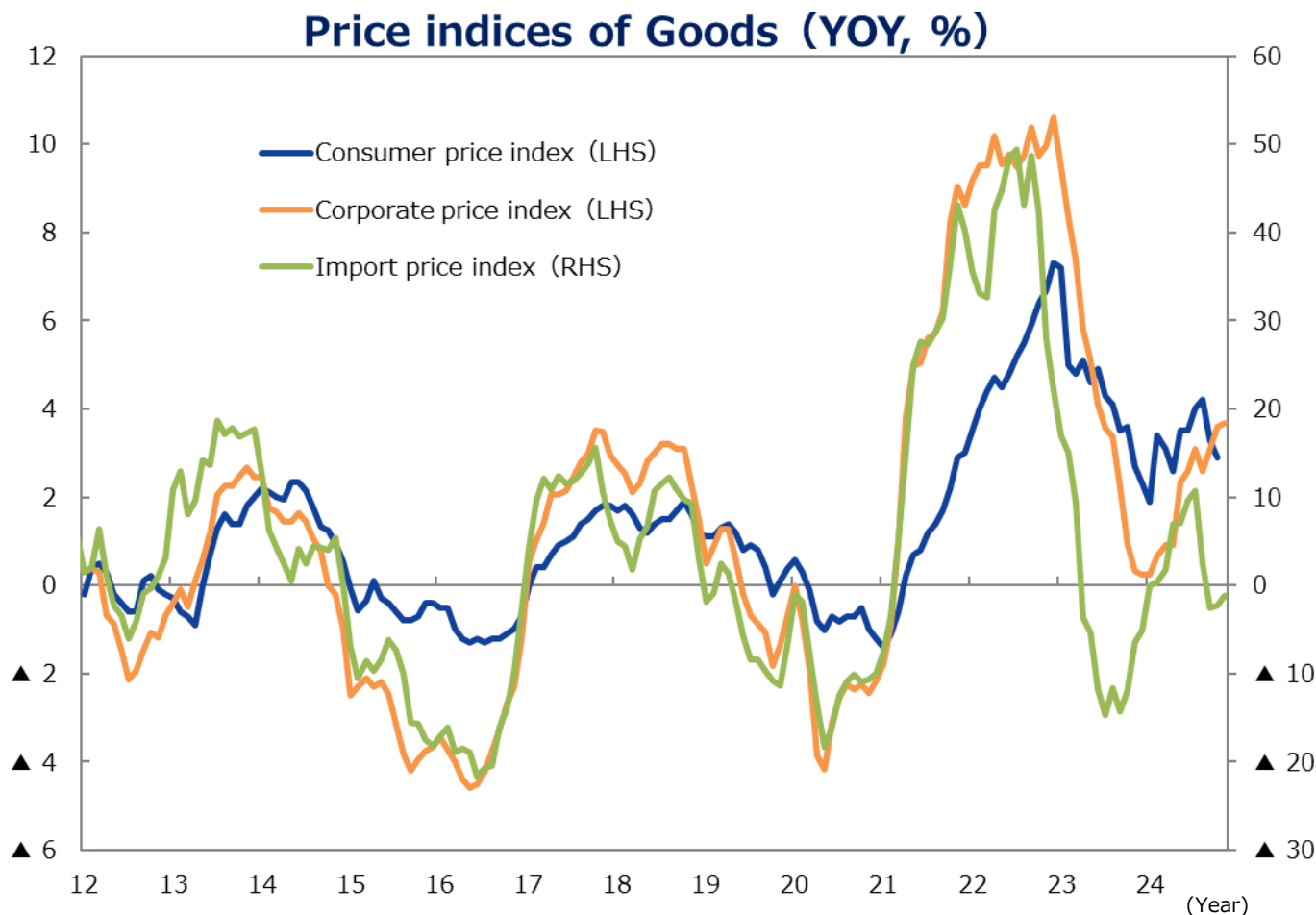
Note: Data is from FY 1990 to FY 2024.
Source: Japanese Trade Union Confederation, SMDAM

End of utility bill subsidies and foods lifts CPI



Note: Data is from January 2020 to November 2024.
Source: MIAC, SMDAM

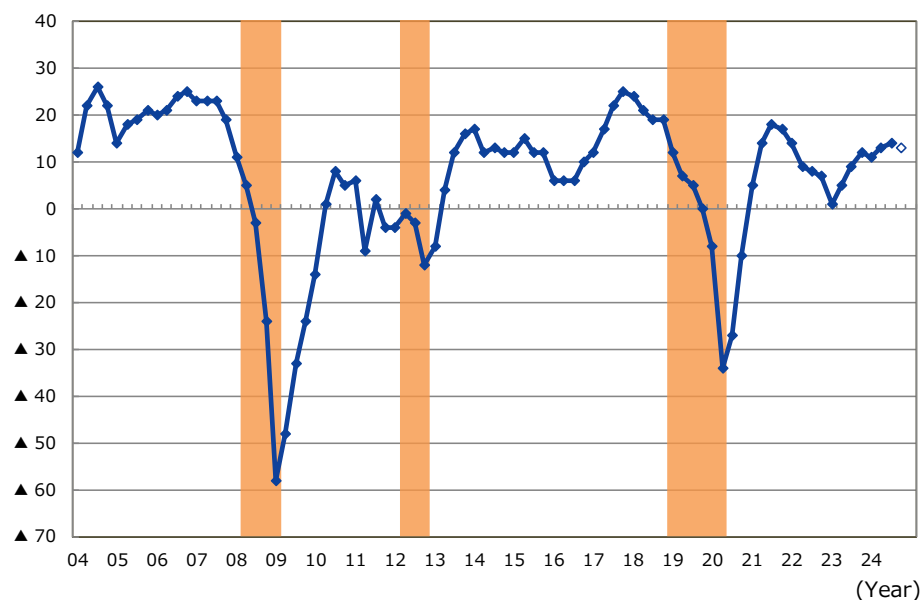
Corporate price rising despite weaker import prices



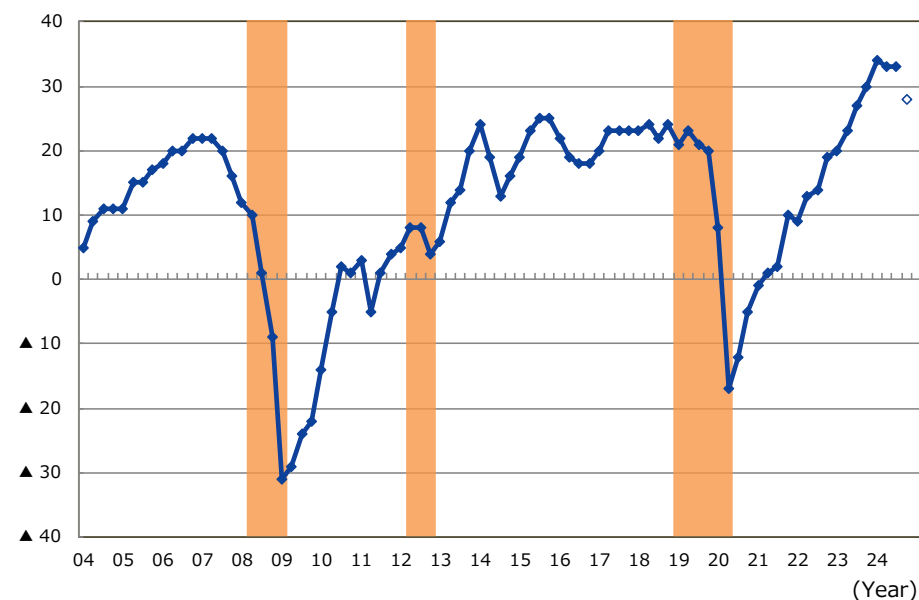
Note: Data is from January 2012 to November 2024.
Source: MIAC, Bloomberg, SMDAM

Improvement in business sentiment appears to have stalled

BOJ business condition DI Large manufacturers (%)



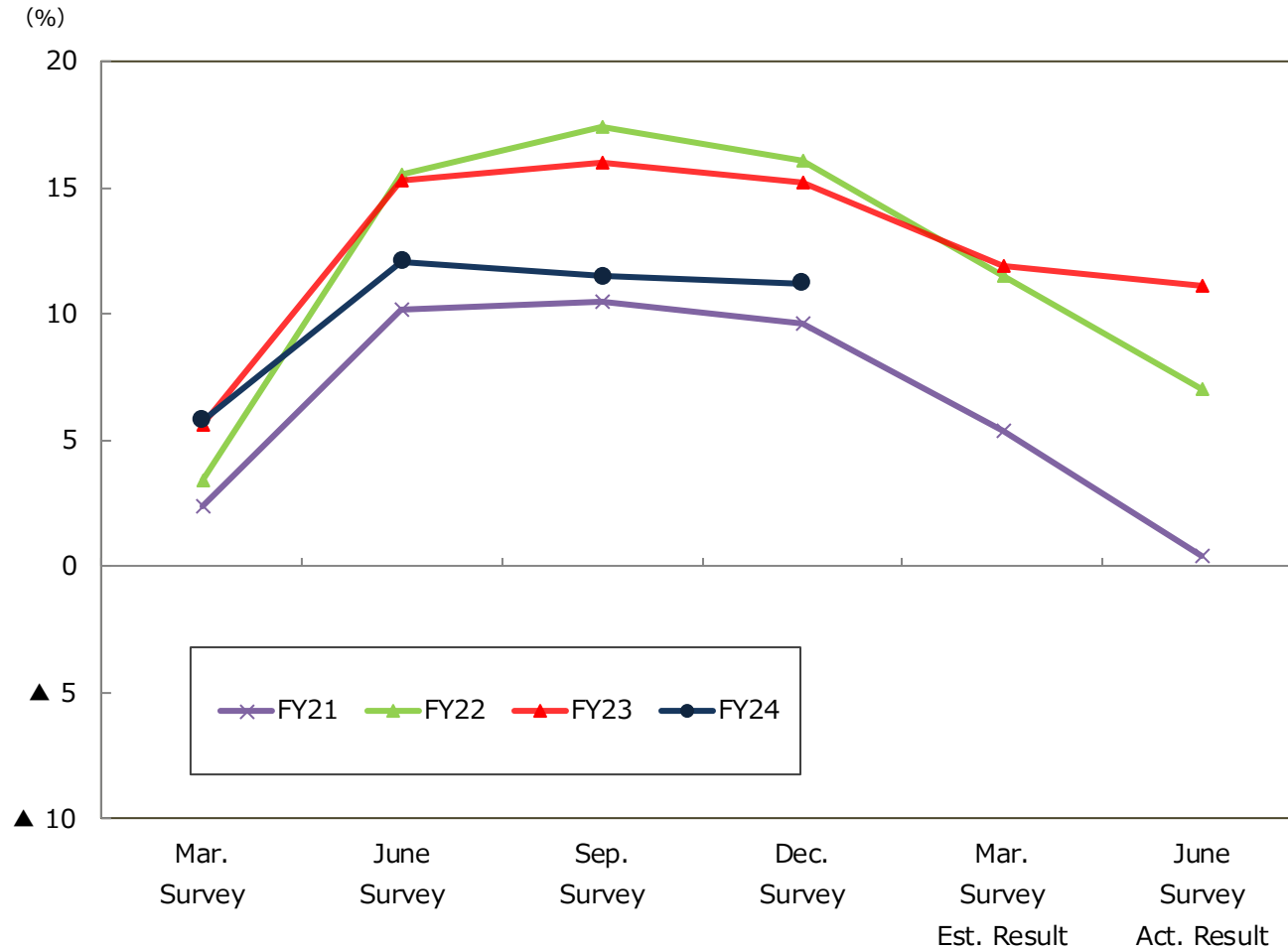
BOJ business condition DI Large non-manufacturers (%)



Note: Data is from Q1 2004 to Q4 2024. The orange shadow represents periods of economic recession.
Source: The Bank of Japan, SMDAM

Appetite for CAPEX keeps momentum so far

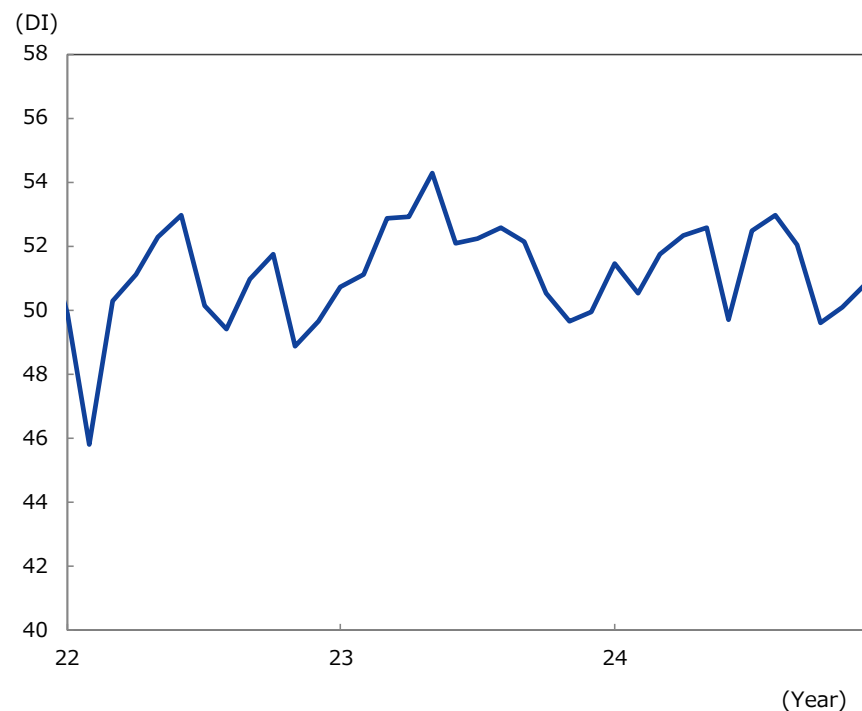
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



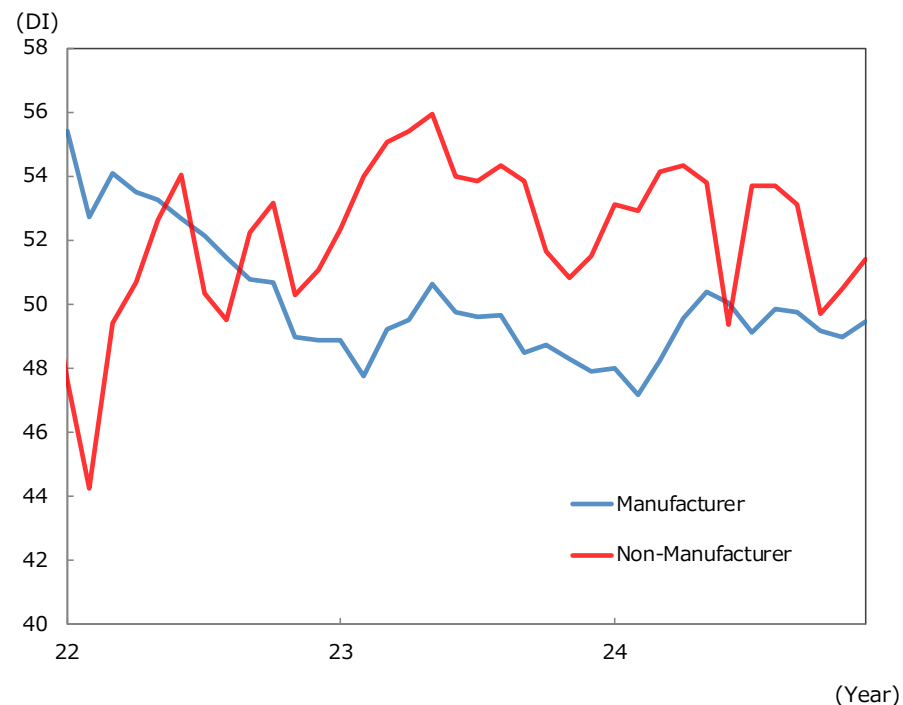
Note: Data is from Q1 FY2021 to Q4 FY2024.
Source: The Bank of Japan, SMDAM

Business sentiment rebound gradually

Composite PMI



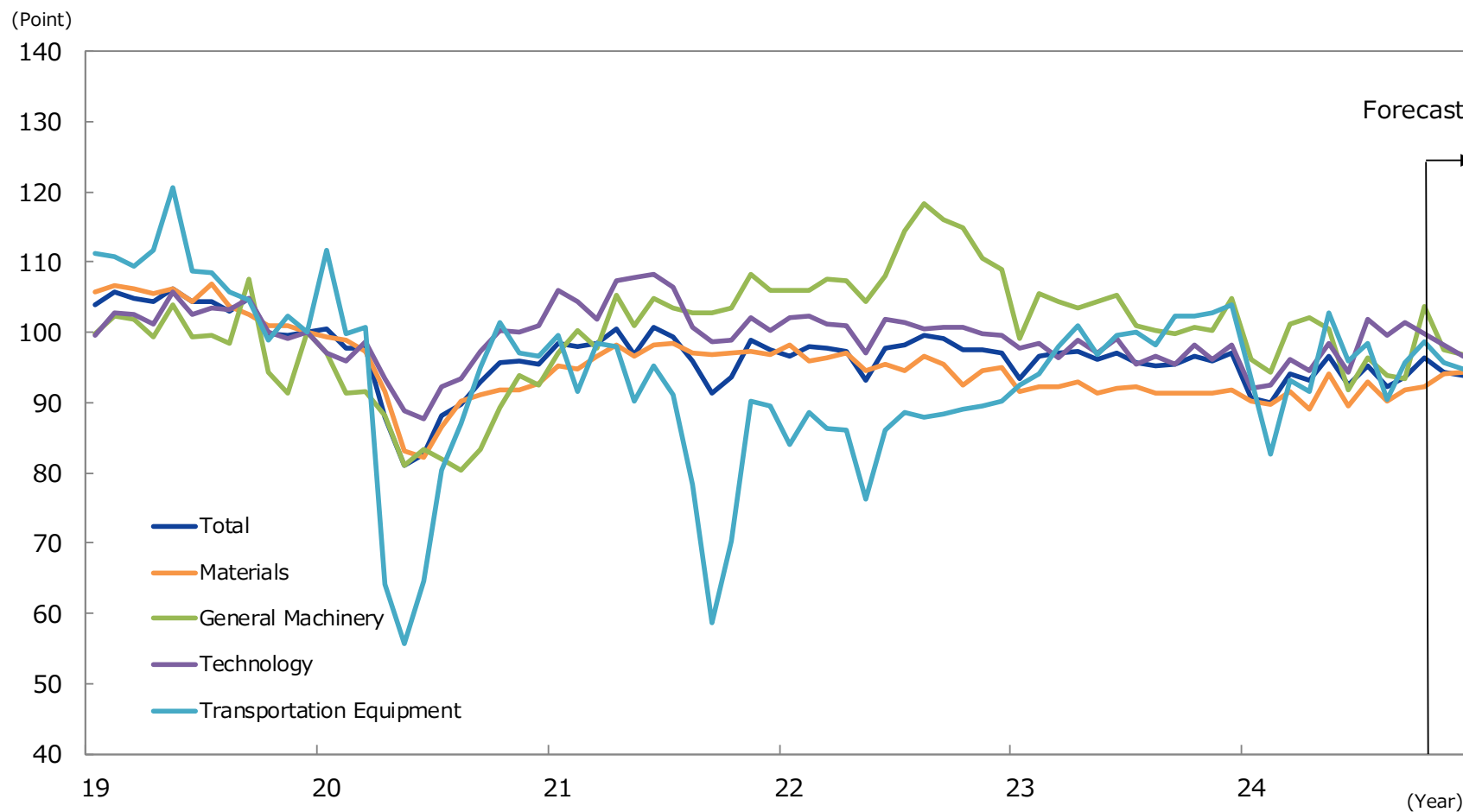
PMI, Manufacturer & Non-Manufacturer



Note: Data is from January 2022 to December 2024.
Source: Bloomberg, SMDAM

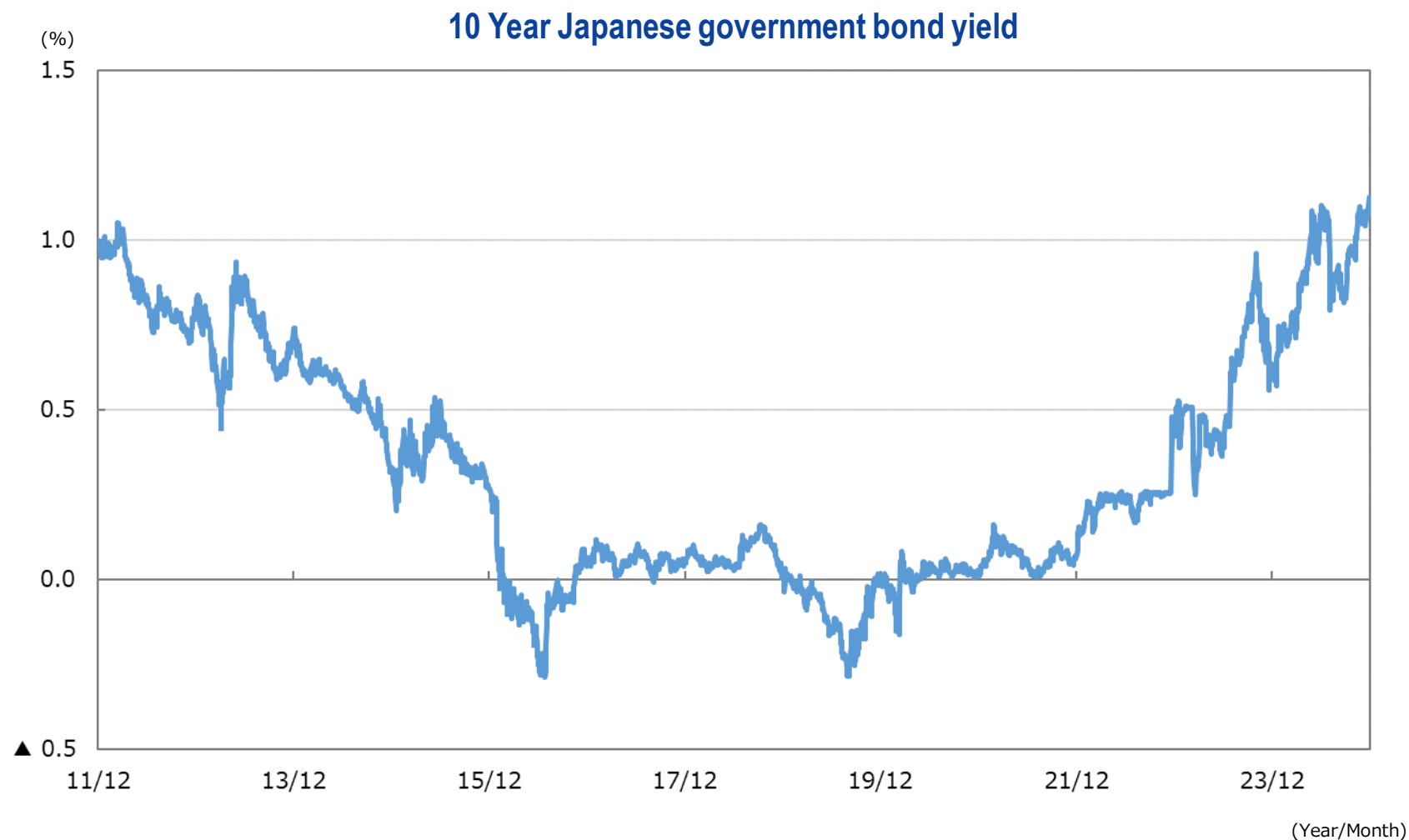
Industrial production is flat and mixed

Industrial Production (Dec. 2019=100)



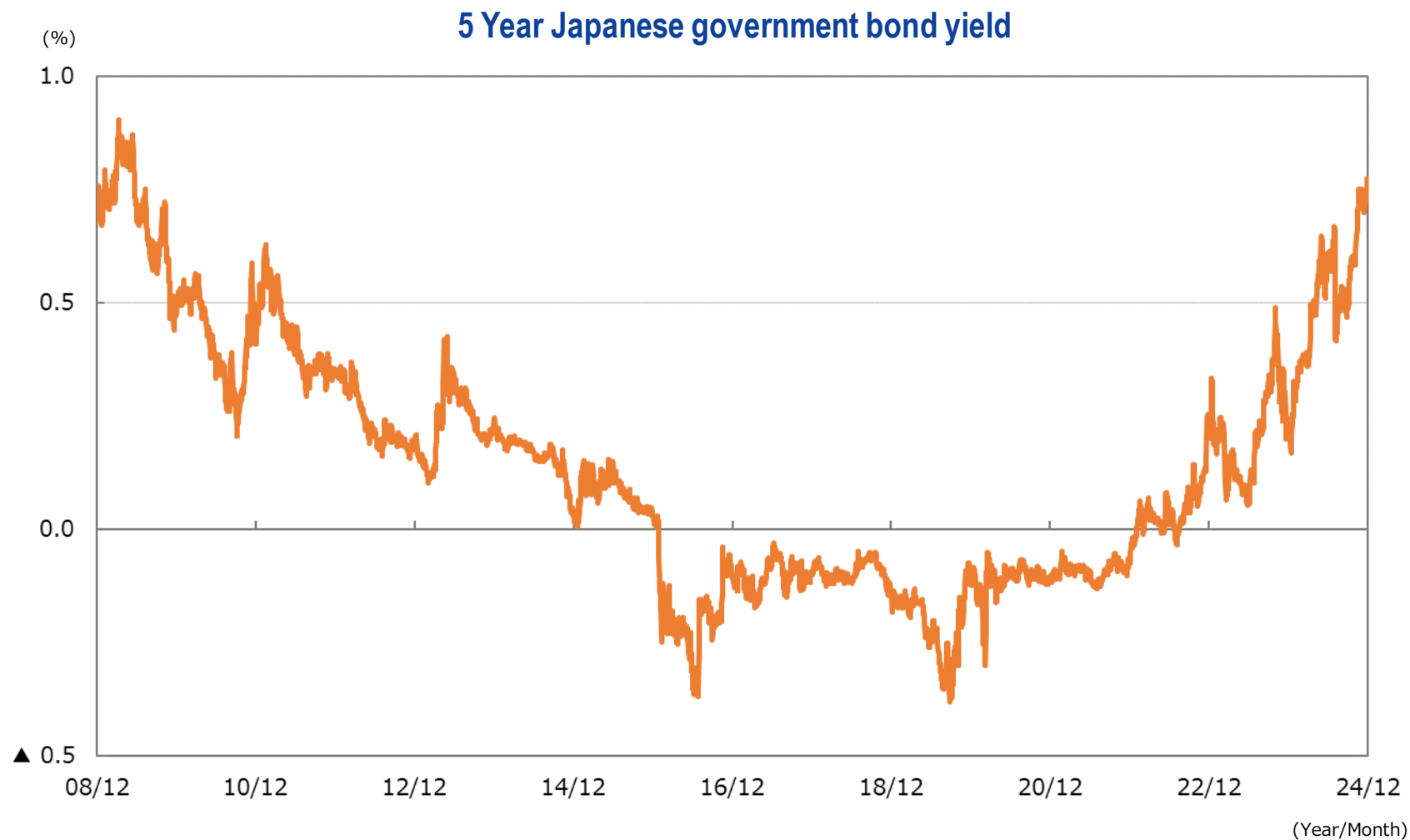
Note: Data is from January 2019 to December 2024. Data after October 2024 is forecasts.
Source: METI, SMDAM

Growing expectation for further monetary tightening



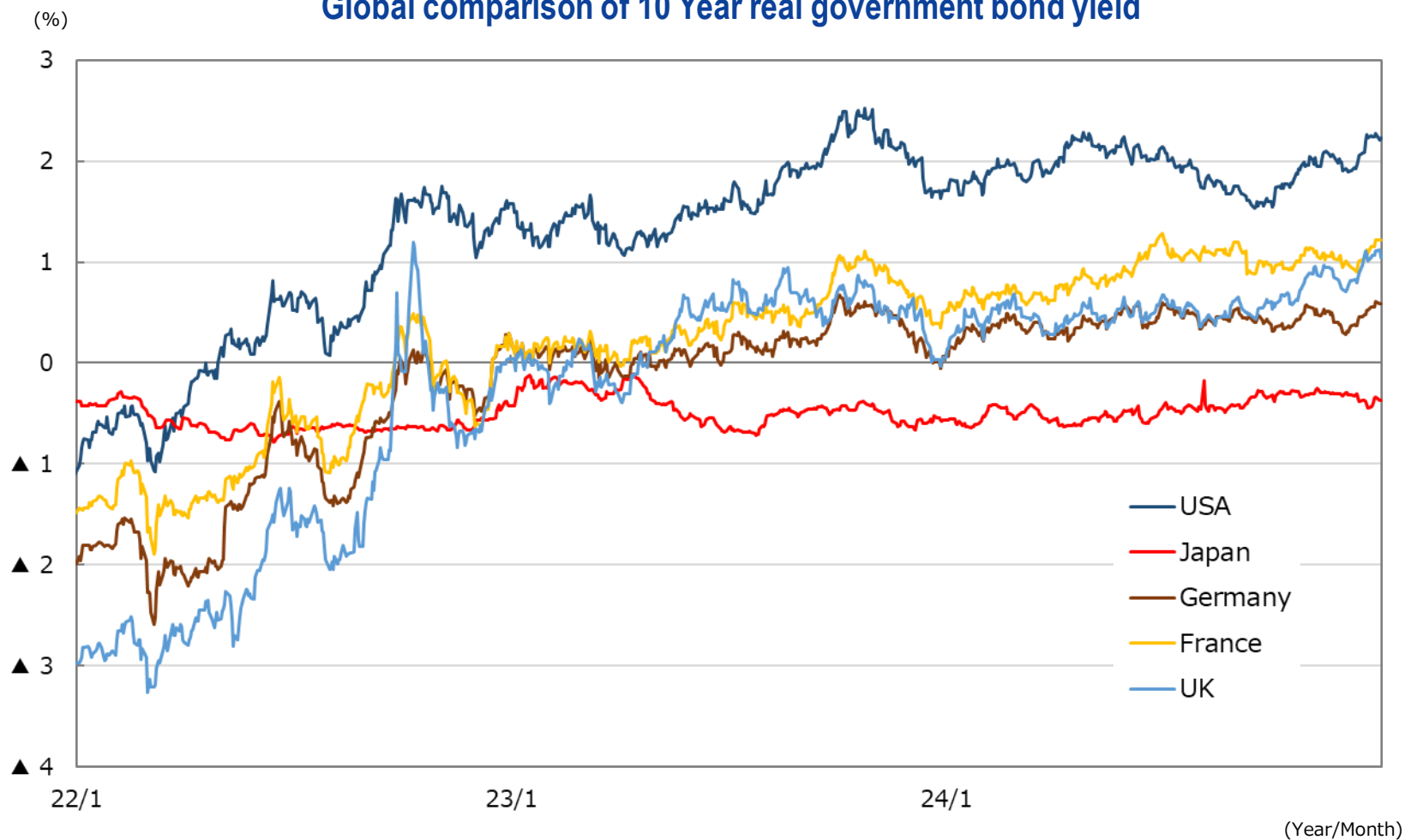
Note: Data is from 31st December 2011 to 31st December 2024.
Source: Bloomberg

Growing expectation for further monetary tightening



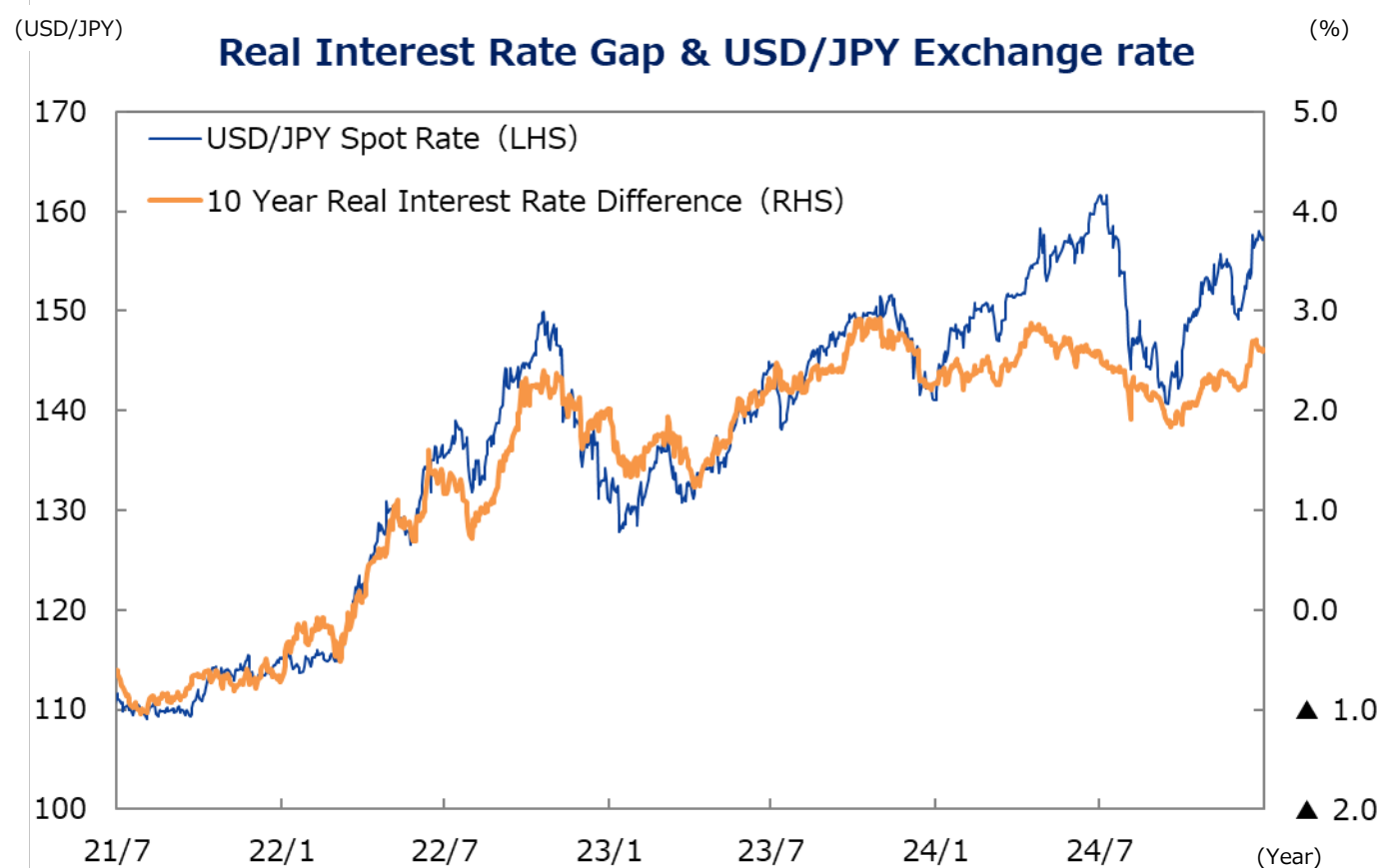
Why is Japan interest rate going to be raised further?

Global comparison of 10 Year real government bond yield



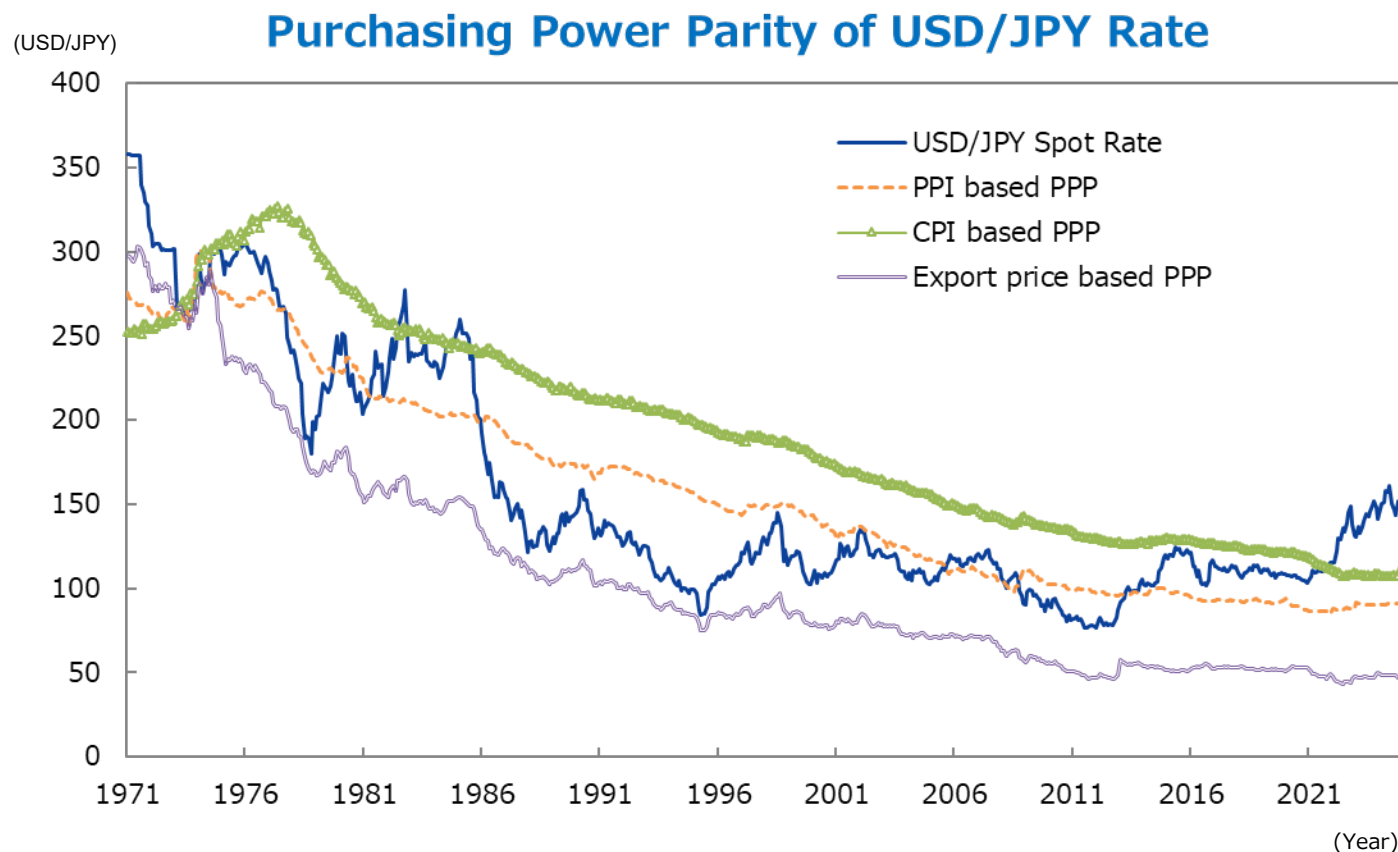
Note: Data is from 1st January 2011 to 31st December 2024.
Source: Bloomberg

Divergence between FOREX and interest rate gap again

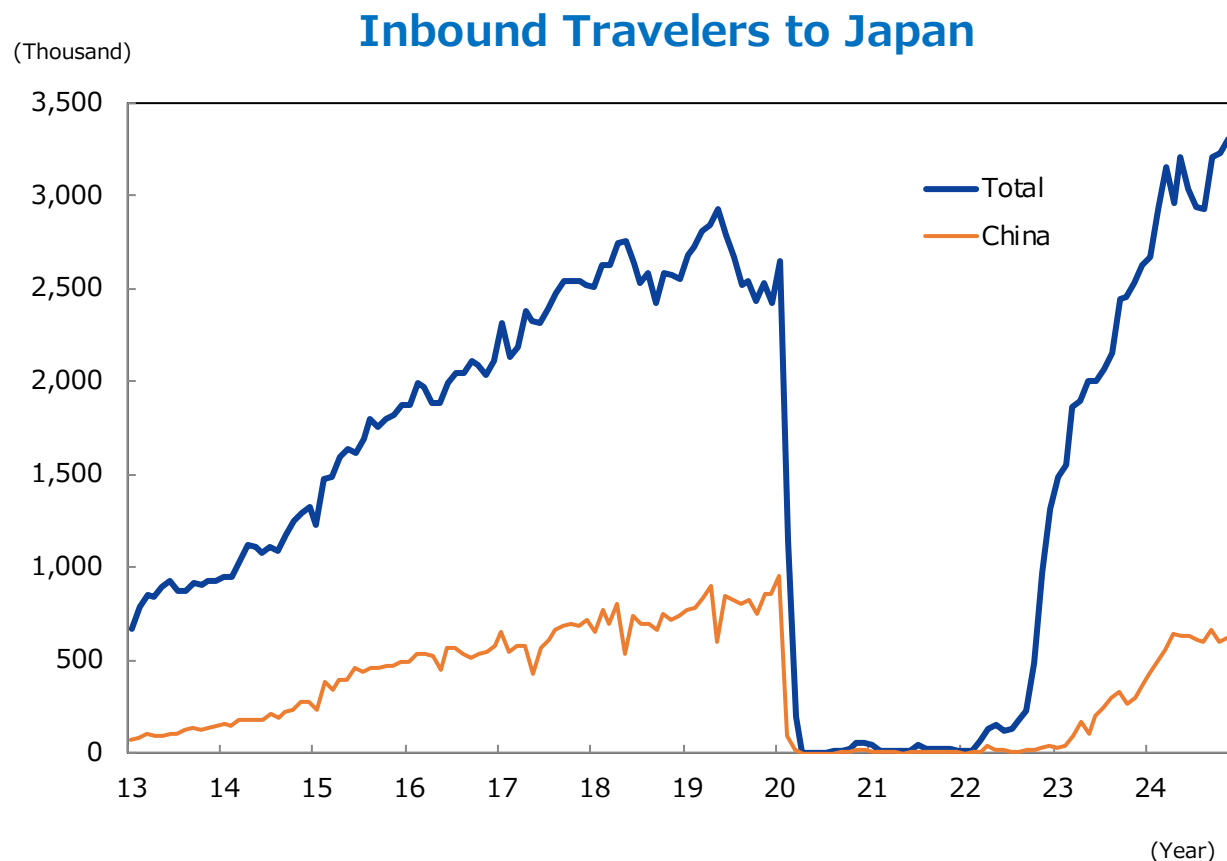


Note: Real interest rates are 10 year government bond yields. Data is from 1st July 2021 to 31st December 2024.
Source: Bloomberg, SMDAM

USD/JPY rate stays far above purchasing power parity



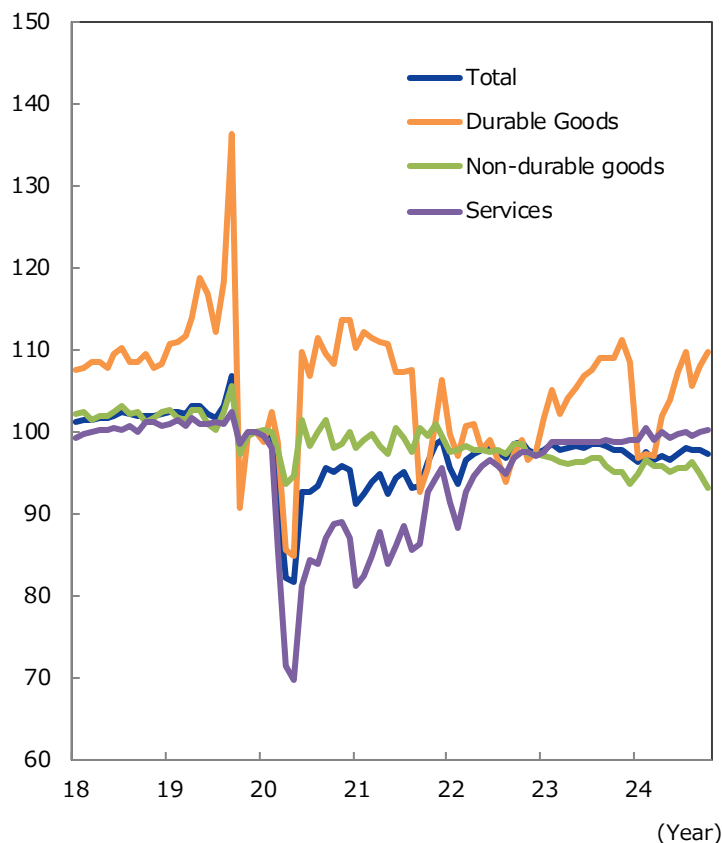
Inbound travel keeps momentum despite weak flow from China



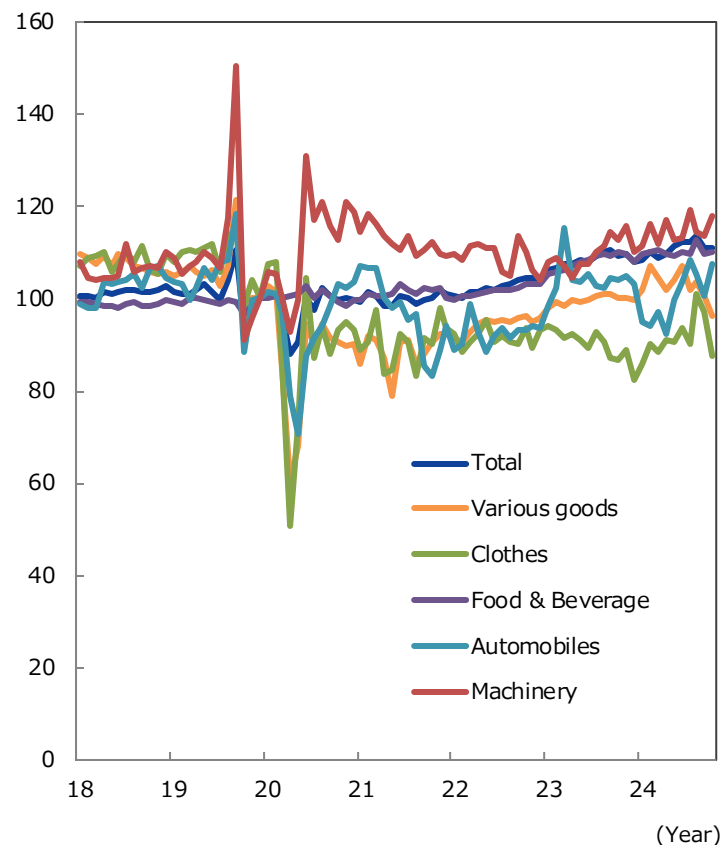
Note: Data is from January 2013 to November 2024. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Consumers buying durables, while hesitate to spend for clothes

Consumer Activity Index (Dec. 2019 = 100)



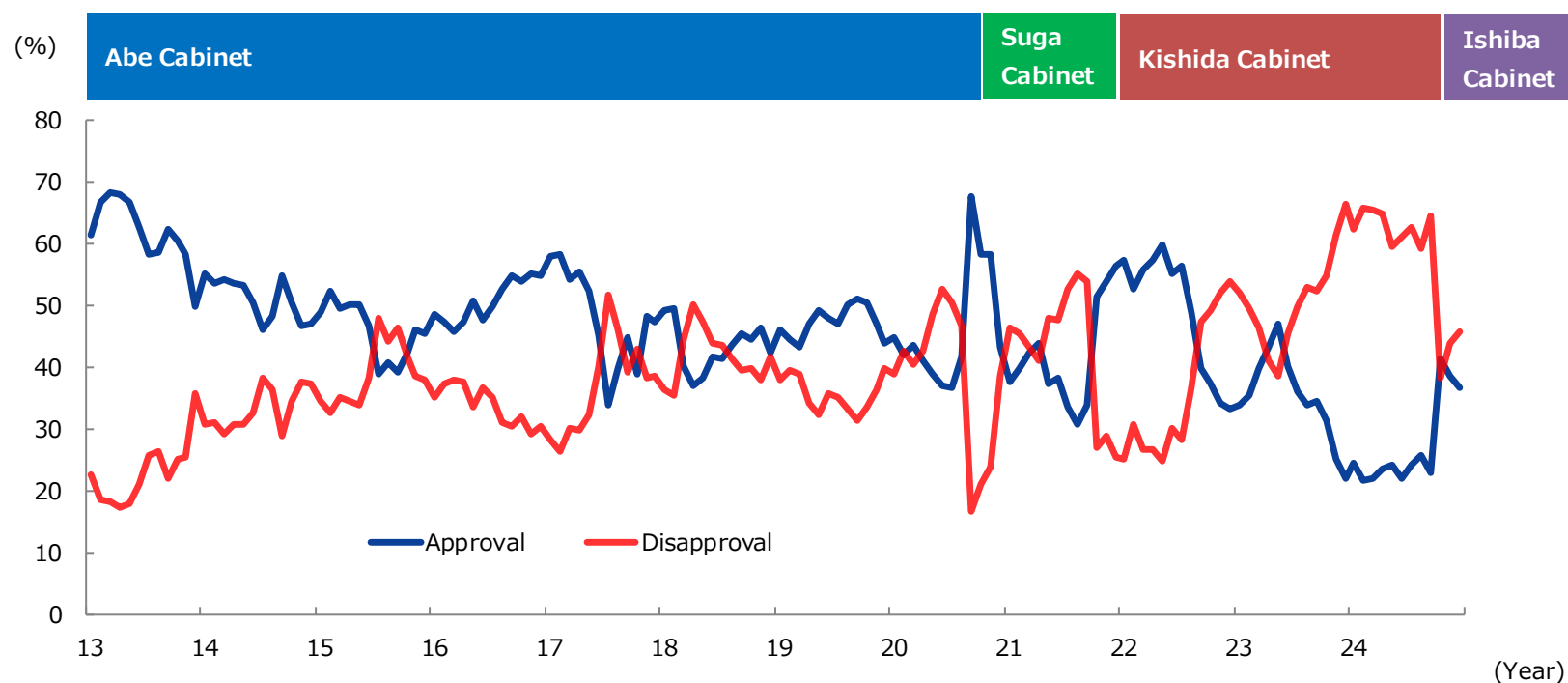
Retail Sales (Dec. 2019 = 100)



Note: Data is from January 2018 to October 2024.
Source; Bank of Japan, METI, and SMDAM

New PM Ishiba failed to boost popularity of ruling party

Cabinet approval rate



Note: Data is from January 2013 to December 2024.
Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Schedule of major events

Year	Month	Date	Event
2025	January	23-24	Ordinary Diet Session Monetary Policy Meeting
	February	17	Release of 2024 Q4 GDP
	March	11 18-19 25	Revision of 2024 Q4 GDP Monetary Policy Meeting Release of the results of spring negotiations of Trade Union Confederation Expiration of the term of the Bank of Japan's Adachi Policy Board member Enactment of the FY 2025 budget and tax-related bills
	April	13 30-5/1	Start of Osaka Expo Monetary Policy Meeting
	May		Release of 2025 Q1 GDP
	June	16-17 30	Revision of 2025 Q1 GDP Monetary Policy Meeting Cabinet's decisions on "Big-boned policy" End of the ordinary Diet session Expiration of the term of the Bank of Japan's Nakamura Policy Board member
	July	28	Final results of spring negotiations of Trade Union Confederation Election of the House of Councillors
	August		Release of 2025 Q2 GDP
	Septemebr	18-19	Revision of 2025 Q2 GDP Monetary Policy Meeting
	October	29-30 30	Monetary Policy Meeting Expiration of the term of the House of Representatives
	November		Release of 2025 Q3 GDP
	December	18-19	Revision of 2025 Q3 GDP Monetary Policy Meeting Cabinet approval of the initial budget for FY 2025 and the outline for tax reform

(Source) Compiled by Sumitomo Mitsui DS Asset Management Co., Ltd.

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