



Outlook for Japanese Stock Market & Economy

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Sumitomo Mitsui DS Asset Management



Outlook for Japanese Stock Market

Market Outlook

- **Market Recovery Reflects Valuation Adjustments from the US Tariff Rollback**

Based on our share price valuation analysis, the recent market recovery is likely driven by valuation adjustments resulting from the partial rollback of US tariffs, which already appears to be largely priced in.

- **Projected Economic Recovery in Japan Potentially Supported by US and EU Fiscal Expansion**

The economic downturn is expected to bottom out in the third quarter of 2025. Thereafter, we anticipate that fiscal expansion measures by the US and the EU will bolster the Japanese economy and its corporate earnings.

- **Upward Revision of Nikkei 225 Target Prices Reflecting the US Tariff Rollback**

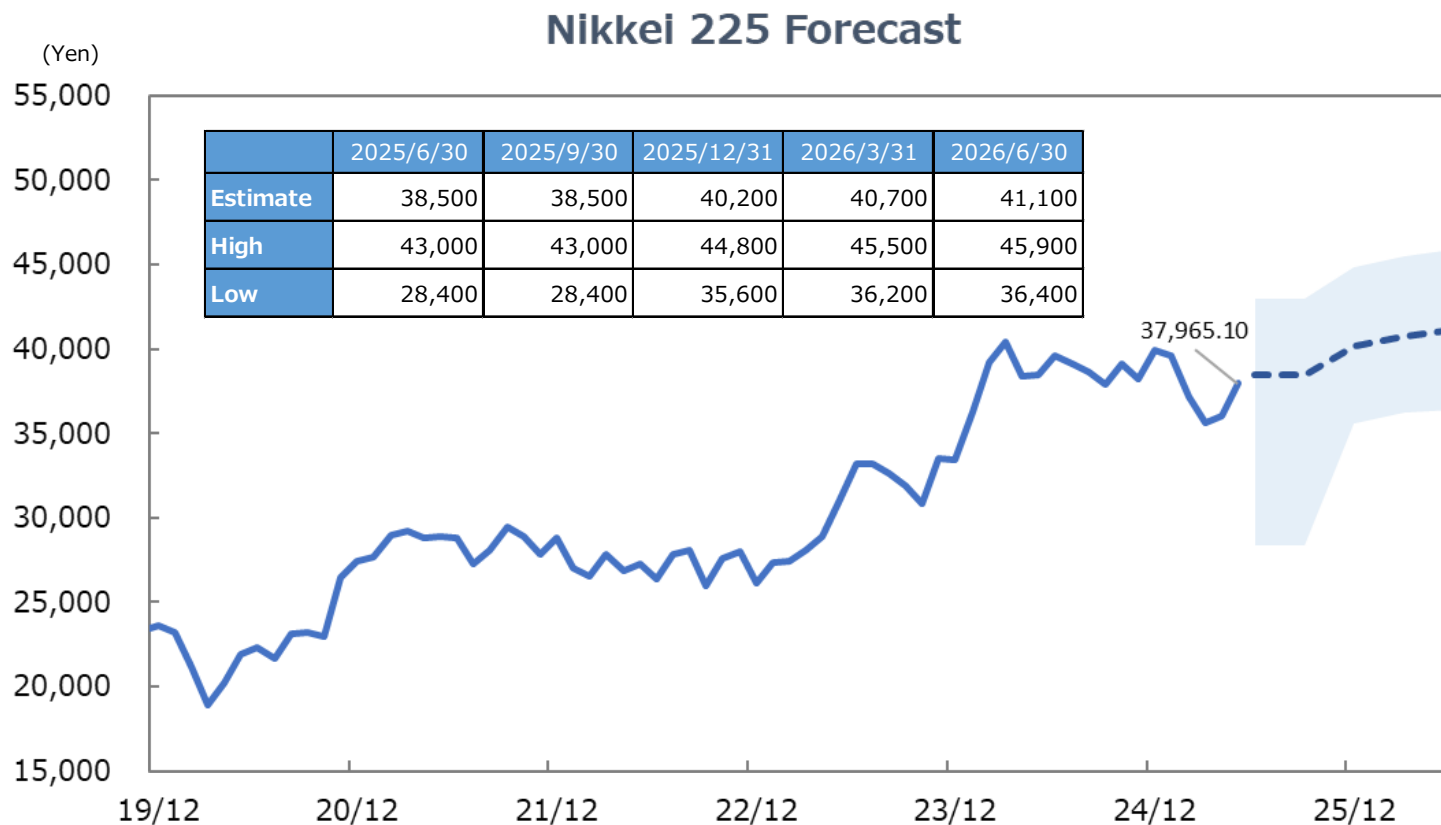
We have raised our target price for the Nikkei 225 from 39,600 to 40,200 as of December 2025, and from 40,100 to 40,700 as of March 2026, accounting for the US tariff rollback.

- **Impact of Share Buybacks and Corporate Governance on Stock Market Dynamics**

Regarding demand and supply in the stock market, foreign investors' selling has been absorbed by share buybacks, driven by improving corporate governance.

Note: The forecasts are as of May 22nd, 2025.

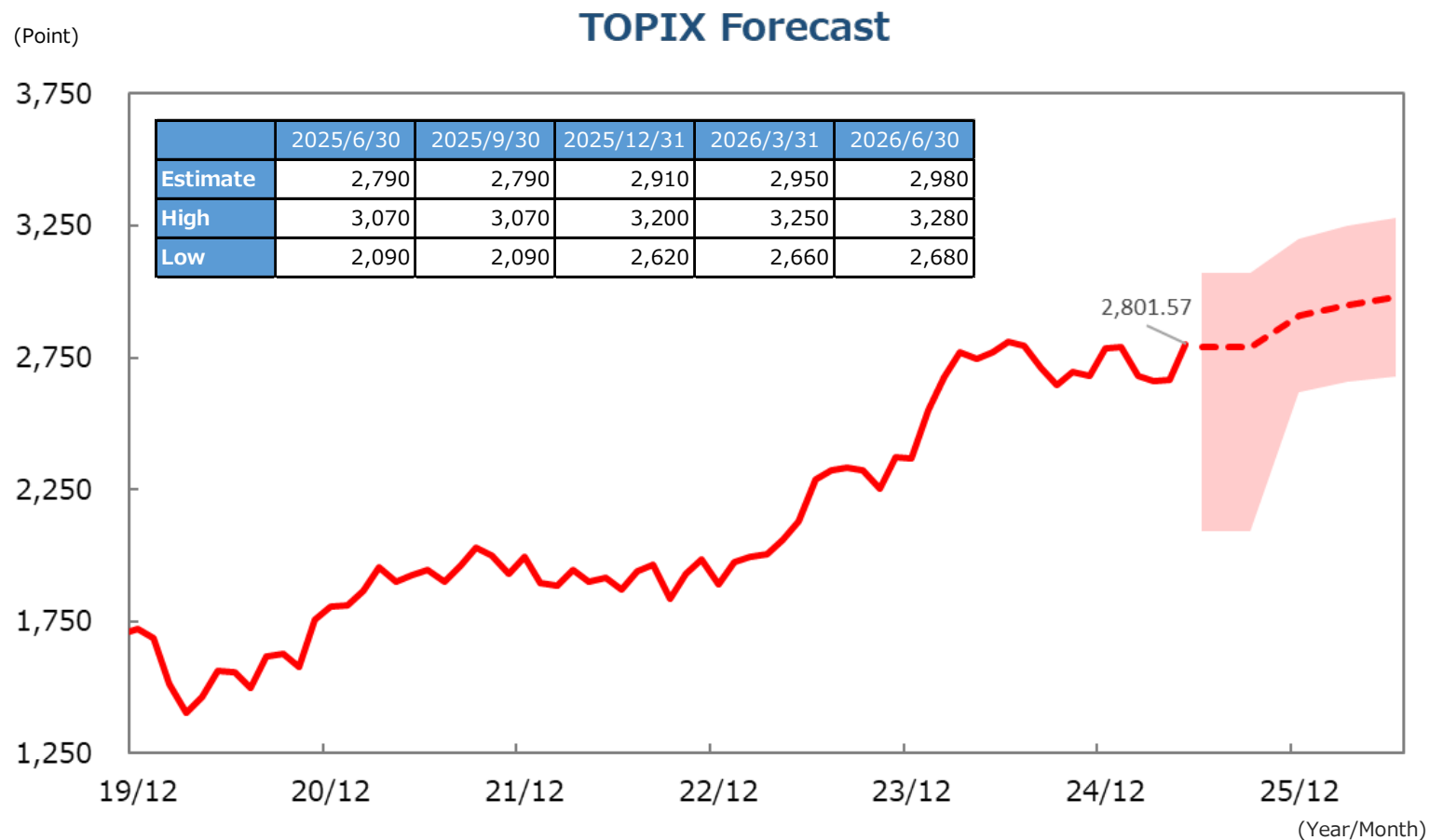
Japanese Equity to Resume Bullish Trend in Mid-to-Long Term



Data is from December 2019 to June 2026. Data after May 2025 is our forecast.
Note: The forecasts are as of May 22nd, 2025.
(Source) Bloomberg, SMDAM

(Year/Month)

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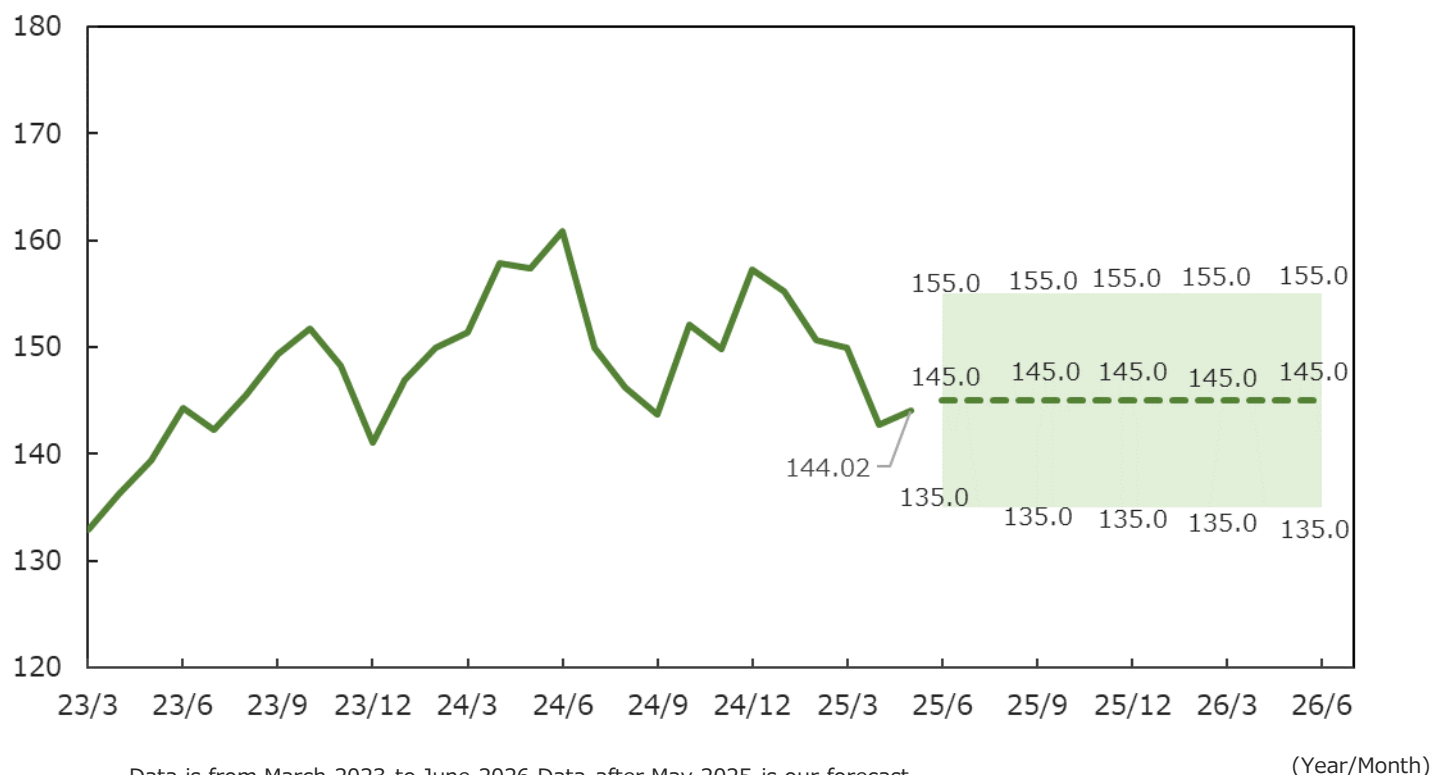
Note: The forecasts are as of May 22nd, 2025.

(Source) Bloomberg, SMDAM

USD/JPY Rate Will be Supported by the Recovery in Confidence

(USD/JPY)

USD/JPY rate Forecast



Data is from March 2023 to June 2026. Data after May 2025 is our forecast.
Note: The forecasts are as of May 22nd, 2025.
(Source) Bloomberg, SMDAM

Upside / Downside Risk Scenarios

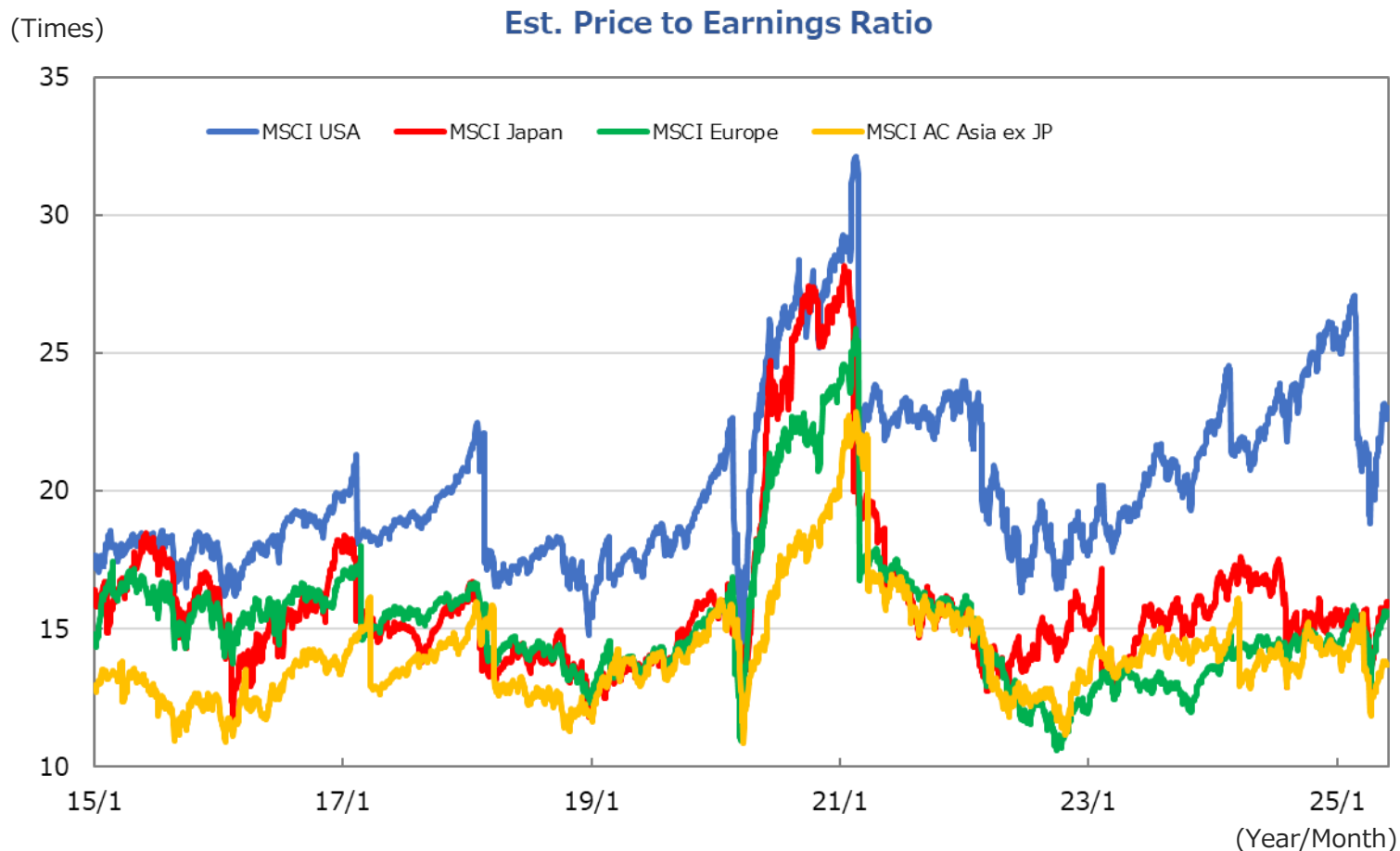
■ Upside Risks

- Receding concern over Trump tariffs
- Further improvement of corporate governance due to the increase in hostile tender offer bids (TOBs)

■ Downside Risks

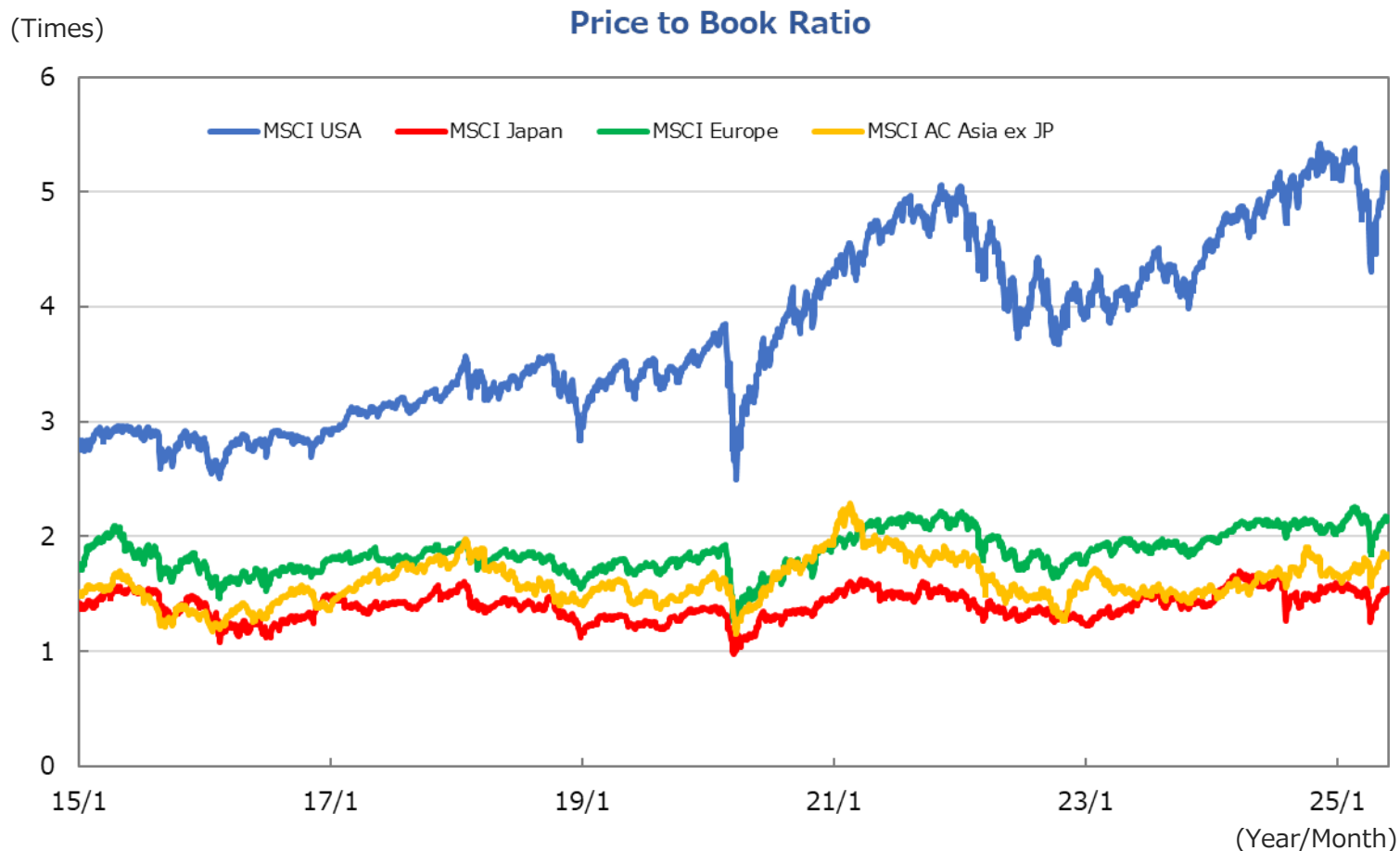
- Escalation of the trade war between the US and China
- Rising yen fueled by slowing US economy and aggressive easing by the FED
- Sharp contraction of artificial intelligence (AI) and big tech stocks' valuation
- Sharp increase of Japanese government bond (JGB) yield owing to expansion in military spending
- Foreign investors' sell-off due to the ruling party's defeat in the summer election

P/E Ratio has Recovered to the Levels of Last November



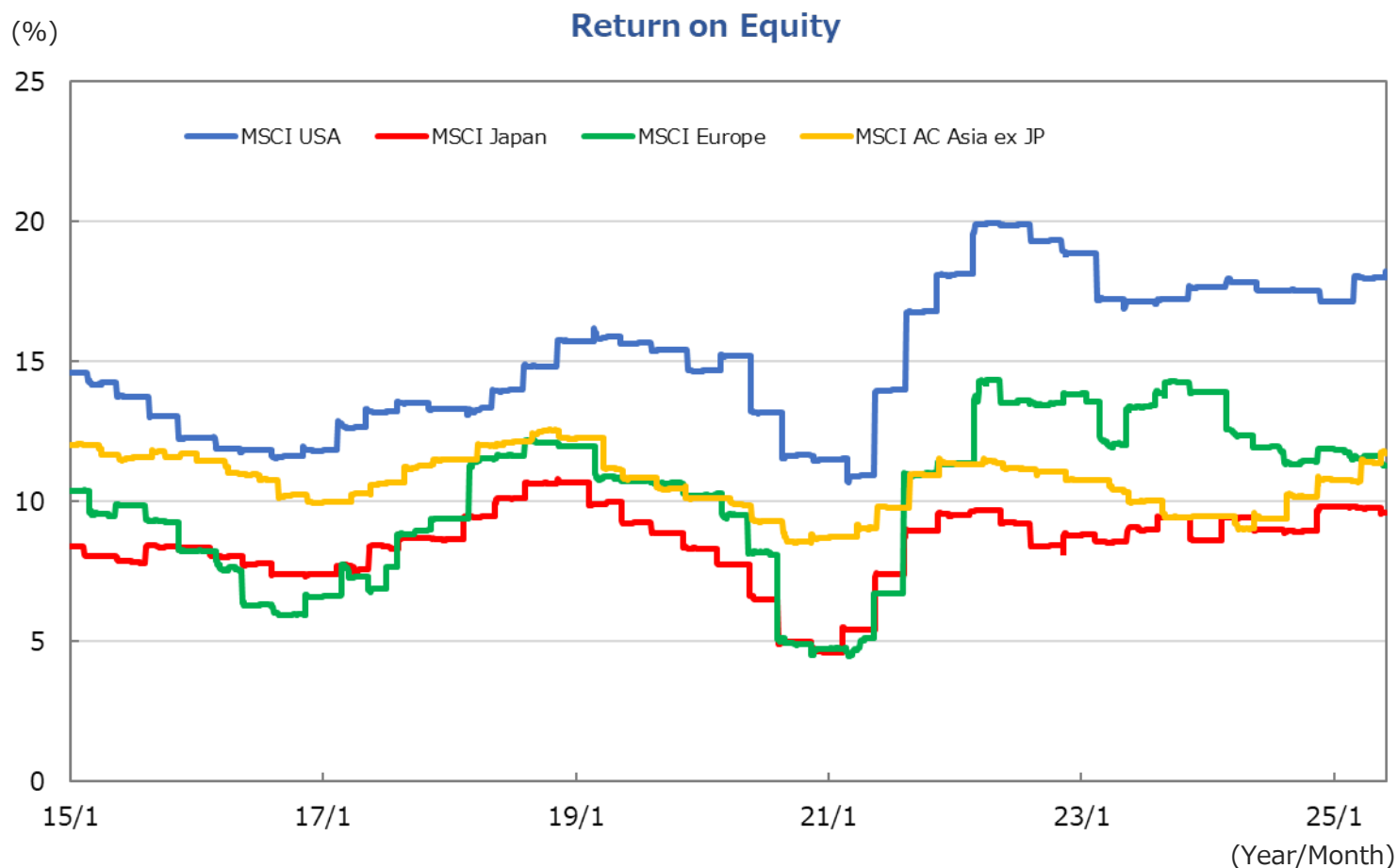
Data is from January 2015 to May 2025.
(Source) SMDAM, Bloomberg

P/B Ratio is Recovering Towards the Levels of Last February



Data is from January 2015 to May 2025.
(Source) SMDAM, Bloomberg

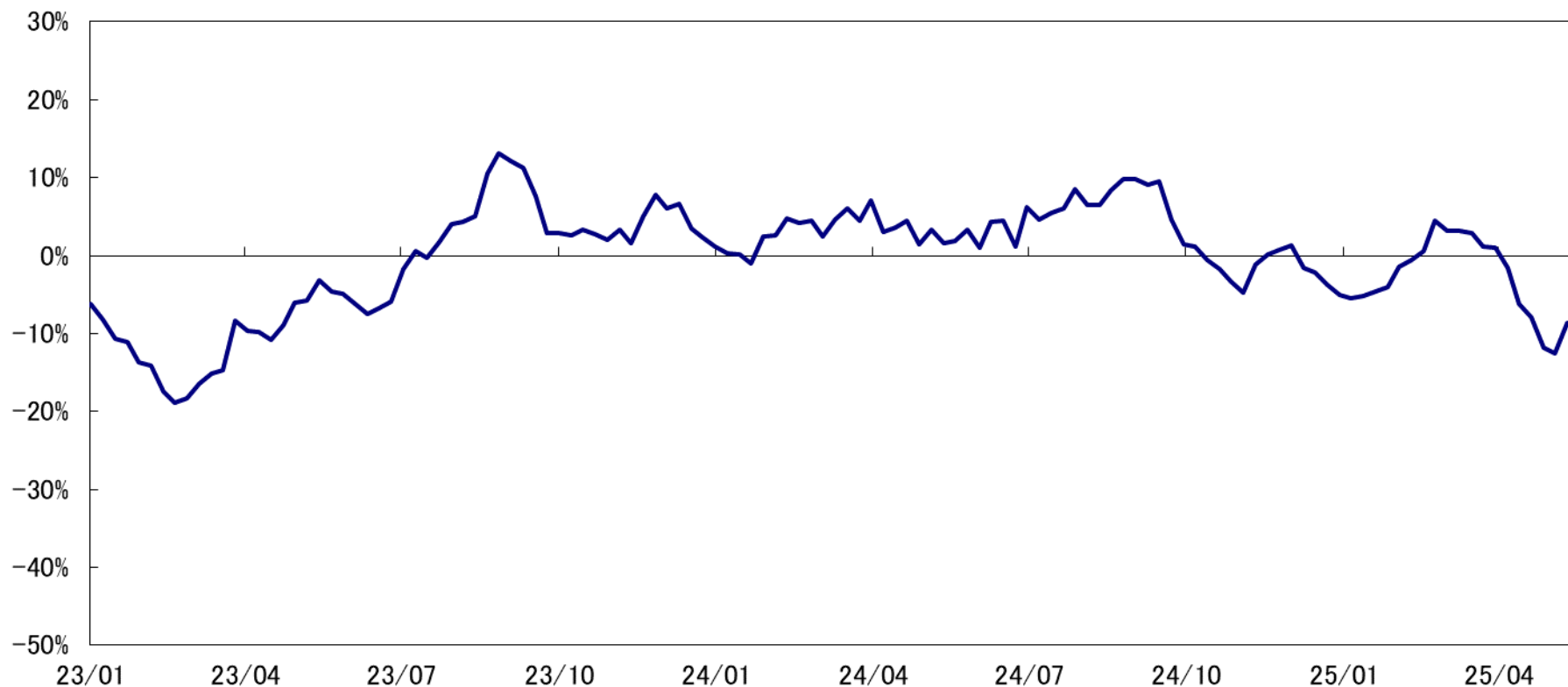
Earnings Growth Boosts Japan's ROE Closer to Double Digits



Data is from January 2015 to May 2025.
(Source) SMDAM, Bloomberg

Concern Over Trump Tariffs Hurt Analysts' Earnings Forecasts

TOPIX EPS Revision Index

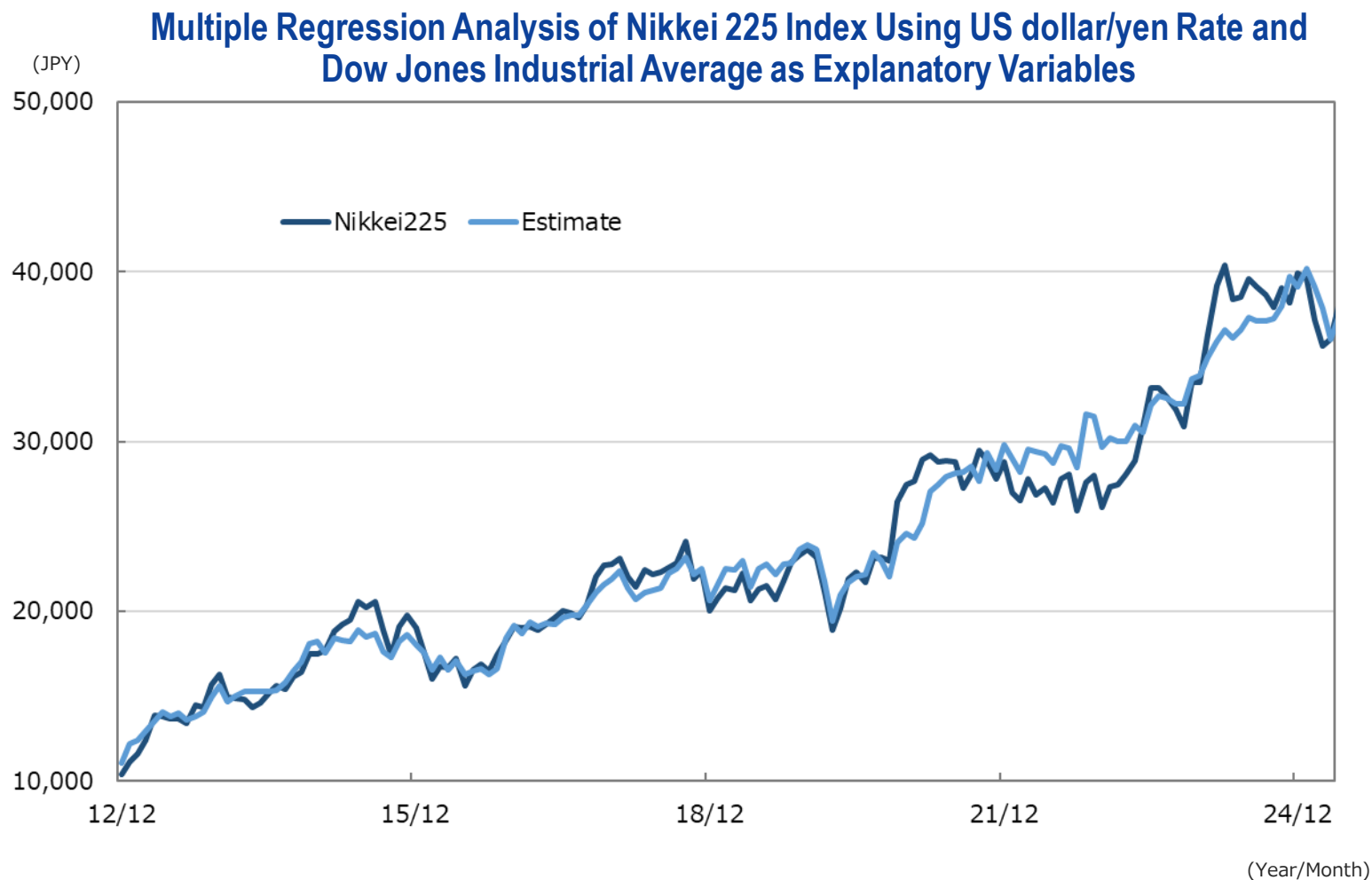


Data is from January 5th 2023 to May 22nd 2025
(Source) Datastream, IBES

(YY/MM)

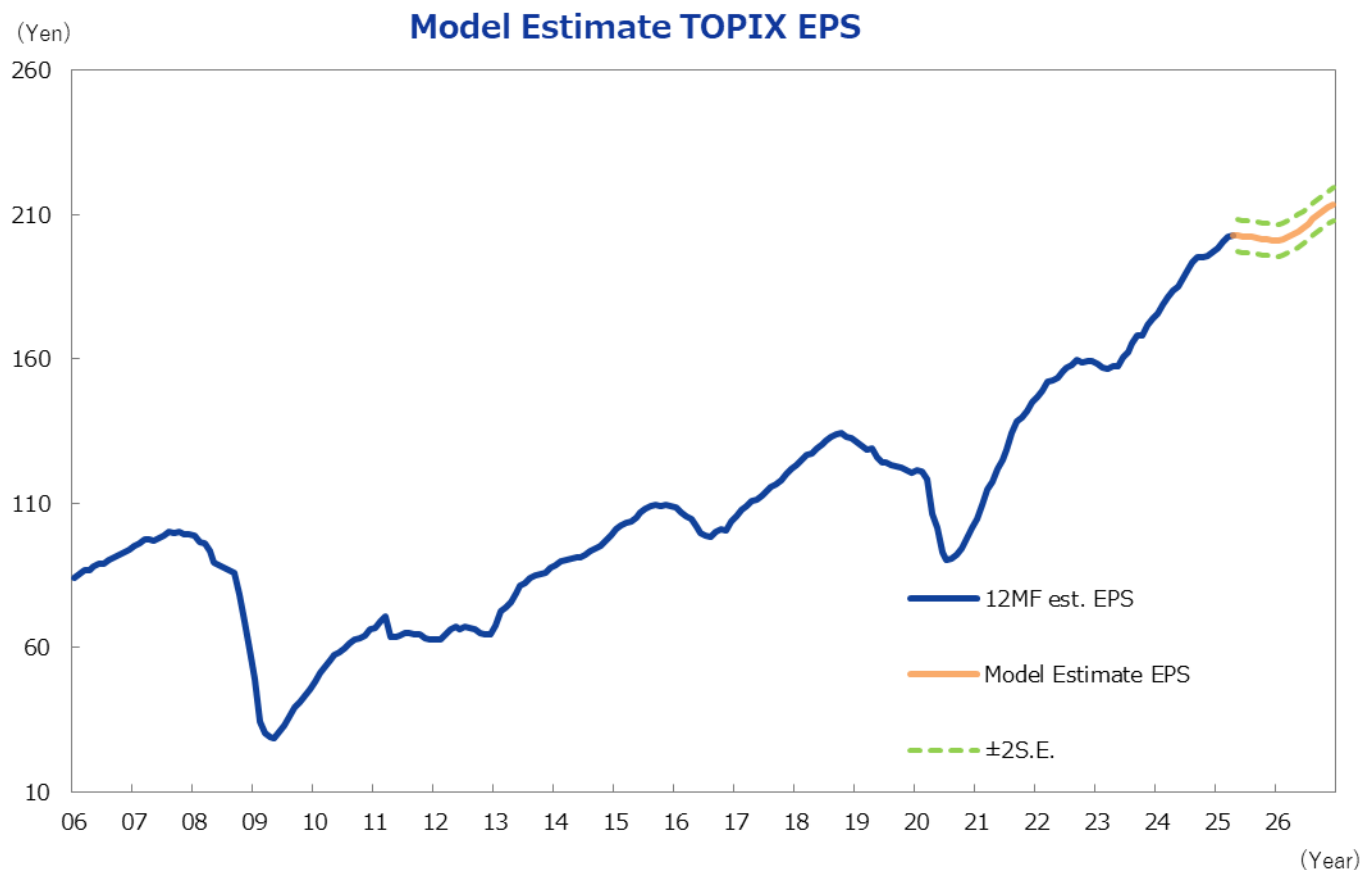


US Stock and Dollar/Yen Rate Moves Japanese Stock Market



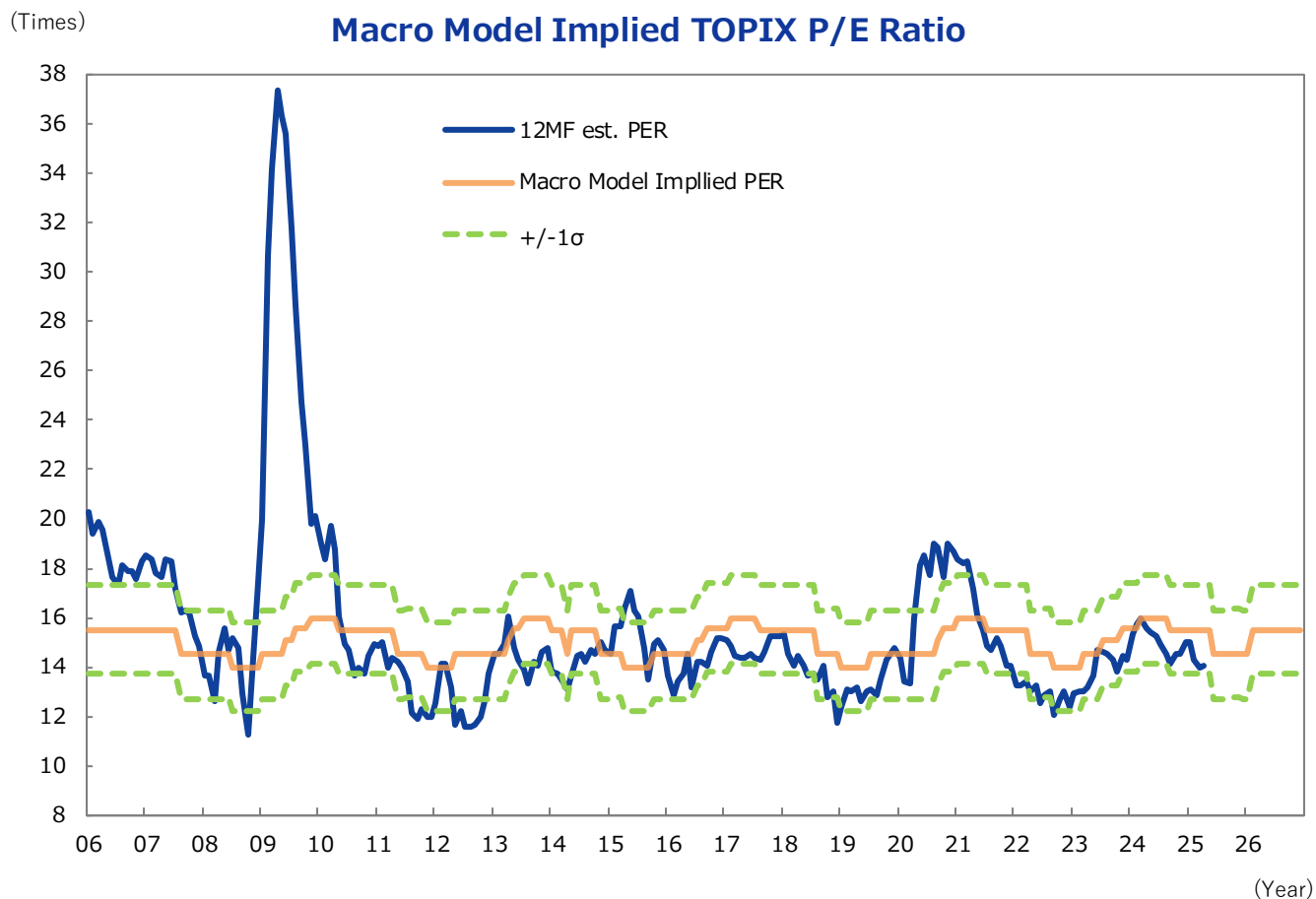
Data is from December 2012 to May 2025.
(Source) SMDAM, Bloomberg

Quant Model Suggests EPS Growth Will Slow Down Temporarily



Note: Consensus data is from January 2006 to April 2025. Model estimate Data is from May 2025 to December 2026.
Source: SMDAM

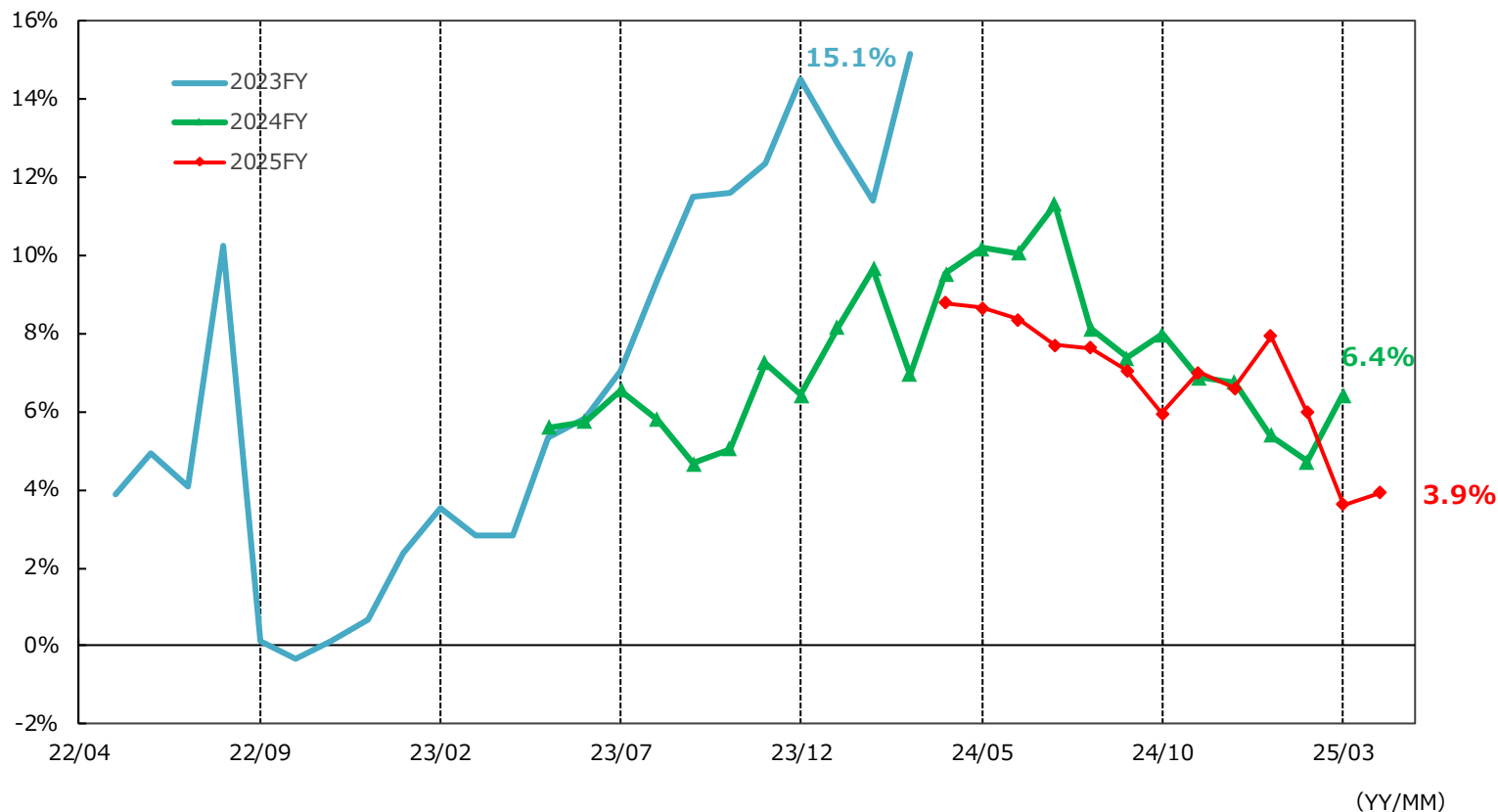
Market Turmoil Brought P/E Ratio to the Lower End of the Range



Note: Consensus data is from January 2006 to May 2025. Model estimate Data is from June 2025 to December 2026.
Source: SMDAM

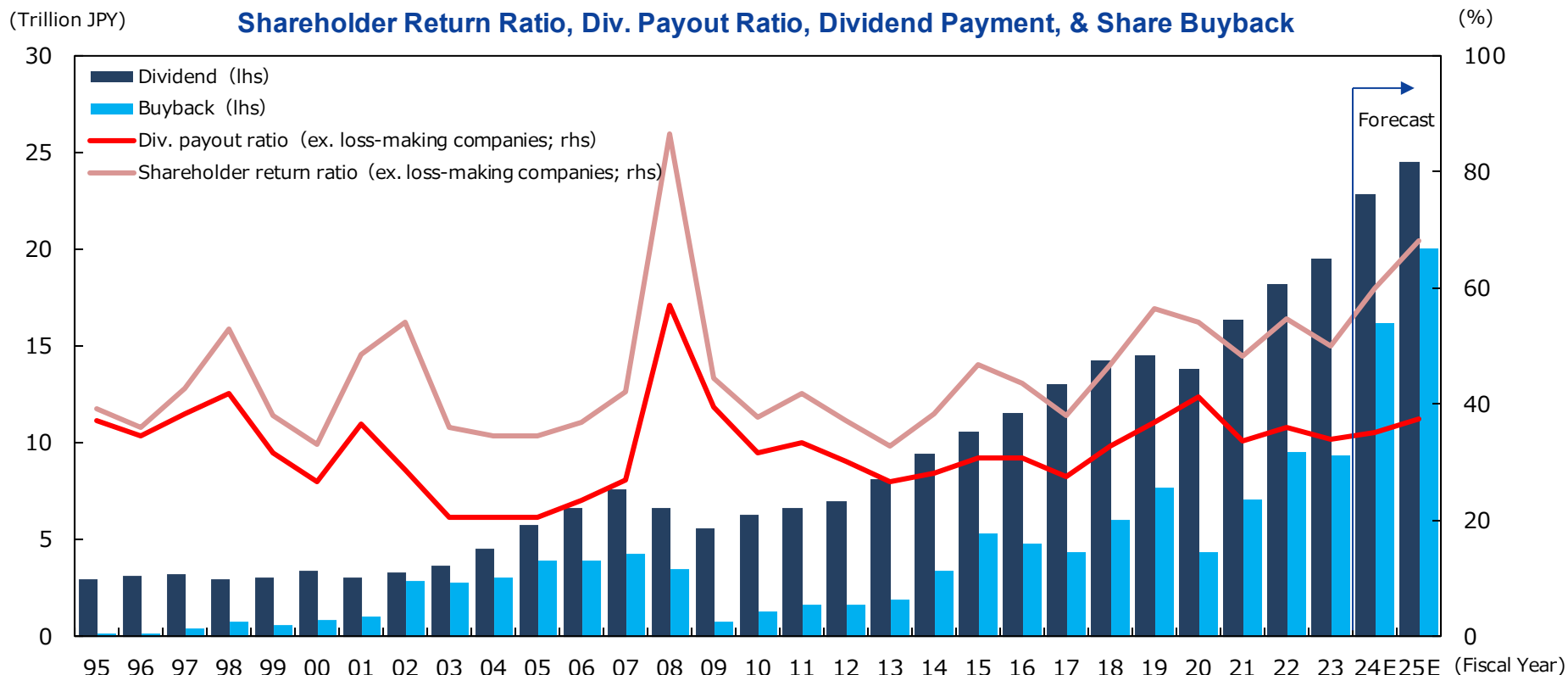
SMDAM Analysts Feel Uneasy with Global Economic Outlook

SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 14th April 2025, SMDAM Core Universe (Excl. Financials) consists of 398 Japanese companies covered by SMDAM in-house analysts.
Source: SMDAM

Record-Breaking Dividends and Share Buybacks Continue



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

Small Caps as a Safer Harbor for the Gloomy Global Economy

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	-7.88	-4.79	-9.29	-4.61	24.52	33.08	80.80
Total Value	-6.88	-2.59	-8.71	-5.15	36.79	49.60	116.88
Top Cap Value	-11.75	-5.24	-13.33	-8.66	40.77	51.72	136.53
Large Cap Value	-8.12	-3.89	-9.95	-6.76	36.96	48.02	121.01
Mid Cap Value	-3.88	-2.18	-6.02	-4.48	32.53	43.78	103.57
Small Cap Value	-1.74	2.62	-3.55	1.74	34.86	55.25	97.25
Micro Cap Value	-0.50	3.61	-2.62	3.95	33.09	53.84	89.21
Total Growth	-8.93	-6.87	-9.90	-4.15	13.53	18.75	50.04
Top Cap Growth	-13.13	-9.62	-13.59	-7.15	14.40	17.49	53.55
Large Cap Growth	-9.76	-7.52	-10.55	-4.80	14.16	19.41	51.73
Mid Cap Growth	-1.66	-2.37	-3.35	0.92	15.08	24.45	50.51
Small Cap Growth	-1.97	-1.50	-4.47	1.10	7.92	13.22	35.39
Micro Cap Growth	-0.88	-3.53	-4.31	-4.35	1.72	8.00	29.17
Top Cap Total	-12.55	-7.91	-13.48	-7.75	25.15	31.26	85.55
Large Cap Total	-8.97	-5.86	-10.26	-5.71	24.45	32.13	81.92
Mid Cap Total	-2.99	-2.38	-4.95	-2.26	23.88	34.05	77.92
Small Cap Total	-1.83	1.09	-3.88	1.53	24.02	37.68	72.03
Micro Cap Total	-0.61	1.29	-3.14	1.23	22.11	37.10	68.61

Note : As of 30th May 2025
(Source) Bloomberg

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Outlook for Japanese Economy



Current Status & Outlook of the Japanese Economy

■ Current Status

- **The economy is in a soft patch.** Currently, there are few signs of a severe decline in exports compared to the levels before the implementation of the 10% baseline tariff and the 25% tariffs on automotive imports. Regarding domestic demand, consumer spending is stagnant due to price increases, while CAPEX remains steady due to a strong demand for digitalization and labor shortages. Additionally, business and consumer sentiment is deteriorating due to growing concerns about US tariffs.
- **Nationwide core CPI continues to exceed the Bank of Japan's (BOJ) "price stability target" of 2% YOY.** Nationwide core CPI rose by +3.2% YOY in March, up from +3.0% in February. The elevated nationwide core CPI was driven by cost-push pressures from import prices and rising rice prices. Currently, the surge in food prices was particularly noticeable.

■ Outlook

- ① **We have lowered our estimate for FY 2025 from +0.6% to +0.4% and for FY 2026 from +0.8% to +0.7%.** The downward revision is mainly due to the incorporation of actual Q1 2025 data and the delayed outlook of the US economic recovery. In the first half of 2025, we anticipate a high likelihood that the Japanese economy's growth rate will fall into negative territory due to US tariffs. In the latter half of 2025, we also expect that Japan's economic growth will be slow owing to the delayed recovery of the US economy. After 2026, we maintain an optimistic outlook for the Japanese economy thanks to the wage increases, a steady CAPEX, and the resilience of overseas economies.
- ② **While we have raised core CPI forecast for FY 2025 from +2.2% to +2.3%, we have lowered our estimate for FY 2026 from +1.7% to +1.6%.** Looking ahead, we expect the nationwide core CPI to remain at a higher level until the end of the first half of 2025, primarily driven by food price increases. Thereafter, we expect core CPI to start slowing down due to the alleviation of cost-push pressures from import prices, the stabilization of rice prices, and subsidies for tuition fees for high school students. On the other hand, we expect that rises in service prices, driven by wage hikes, will support an upward trend in core CPI. We forecast core CPI to maintain a momentum of around +2.0% YOY, excluding the impact of the tuition support programs.
- ③ **We expect the government to adopt accommodative fiscal policies.** The ruling party has reached an agreement to announce economic measures ahead of the upcoming House of Councillors election this summer to cope with US tariffs and rising prices. However, the opposition party continues to insist on further fiscal stimulus, including tax cuts such as a reduction in consumption tax. There is a risk that the opposition party will gain momentum and fiscal policy will get more accommodative if the ruling party is defeated in the election. Specifically, the opposition, Democratic Party for the People, advocates for significant tax cuts, including a flat 5% reduction in consumption tax, raising the minimum taxable income, and abolishing the provisional gasoline tax earlier.
- ④ **We expect the BOJ to raise its policy rate from 0.50% to 0.75% in April 2026, postponed from January 2026, and from 0.75% to 1.00% in October 2026.** We anticipate the terminal rate of monetary policy will be 1.25% by October 2027, although this is beyond our current estimation scope. Regarding the next rate hike, we assume the BOJ will increase its policy rate in April 2026 after reviewing wage increase data from the union's spring wage negotiations in 2026. Regarding important factors in 2025, we will closely monitor the impact of the US tariffs and politics following the House of Councillors election. Changes in the US tariffs could influence the BOJ's outlook on economic growth and inflation, potentially affecting the next rate decision. Additionally, we remain cautious about the emerging influence of Ms. Takaichi and Mr. Tamaki, who are opposed to further rate hikes.

Note: The forecasts are as of May 20th, 2025.

Forecast for the Japanese Economy

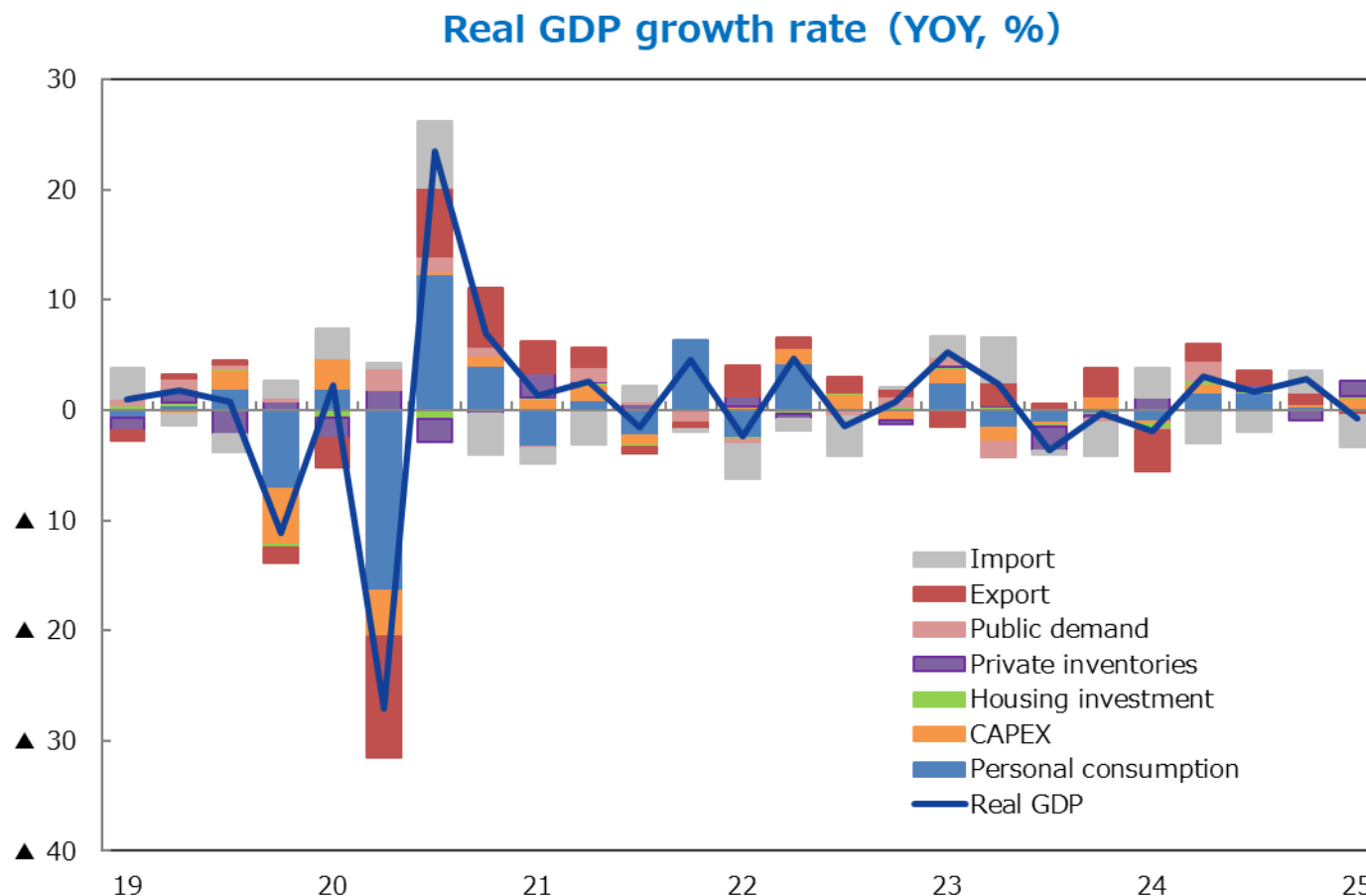
Forecast of annual Real GDP growth and its breakdown						
Fiscal Year	FY21	FY22	FY23	FY24	FY25 Est	FY26 Est
Real GDP	3.0%	1.3%	0.6%	0.8%	0.4%	0.7%
Private final consumption expenditure	1.8%	2.6%	-0.4%	0.8%	0.7%	0.8%
Private housing investment	0.3%	-2.6%	0.8%	-1.0%	-0.6%	-1.4%
Private-sector capital investment	3.2%	3.6%	-0.1%	2.6%	1.0%	0.9%
Private inventory investment	0.5%	0.0%	-0.3%	0.0%	0.1%	0.0%
Public fixed capital formation	-6.4%	-5.5%	-0.3%	1.4%	-0.3%	0.7%
Net export contribution	0.8%	-0.6%	1.4%	-0.4%	-0.5%	-0.1%
Exports of goods and services	12.5%	5.0%	3.1%	1.7%	0.2%	1.4%
Imports of goods and services	7.3%	7.4%	-2.7%	3.4%	2.6%	1.9%
Nominal GDP	2.9%	2.3%	4.9%	3.7%	2.9%	2.5%
GDP deflator	-0.1%	0.9%	4.2%	2.9%	2.5%	1.8%
Industrial Production Index	5.6%	-0.3%	-1.9%	-1.4%	-0.9%	1.0%
Consumer Price Index (Core)	0.1%	3.0%	2.8%	2.7%	2.3%	1.6%
Consumer Price Index (BOJ Core)	0.1%	3.0%	2.8%	2.7%	2.5%	1.9%
Domestic corporate goods price index	7.1%	9.6%	2.4%	3.2%	2.2%	1.4%
Employee compensation	2.1%	2.5%	1.9%	4.6%	3.5%	3.3%
Unemployment rate	2.8%	2.6%	2.6%	2.5%	2.6%	2.5%
Monetary Policy interest rate (Short term)	-0.10%	-0.10%	0-0.1%	0.50%	0.50%	1.00%

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.

Note: The forecasts are as of May 20th, 2025.

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

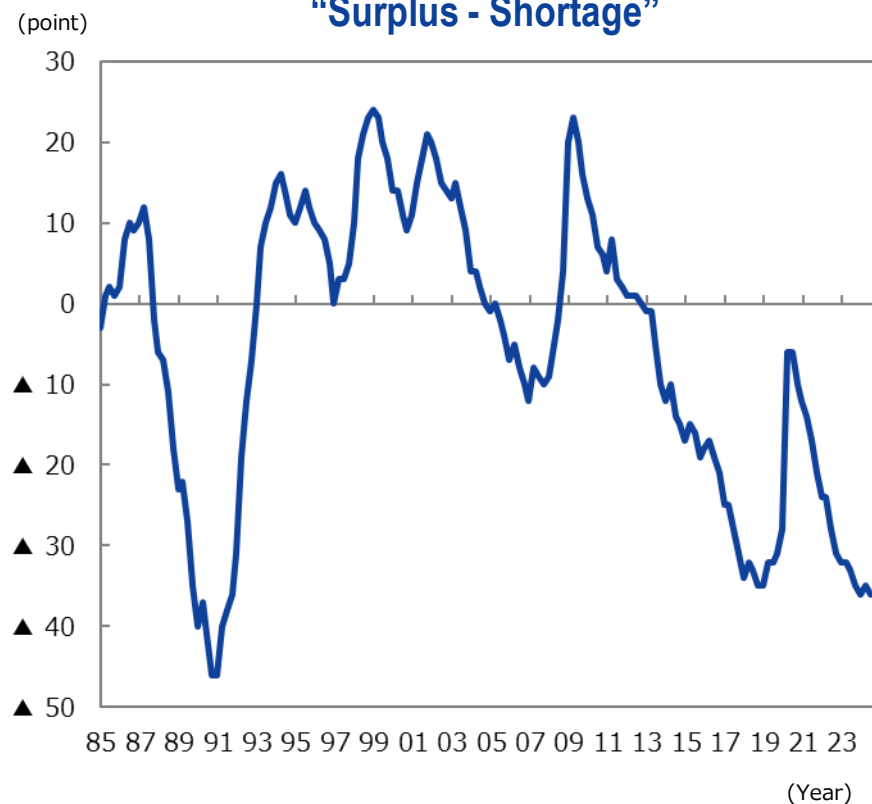
Inflation and Global Economic Fears Weigh on the Japanese Economy



Note: Data is from Q1 2019 to Q1 2025.
Source: Cabinet office, SMDAM

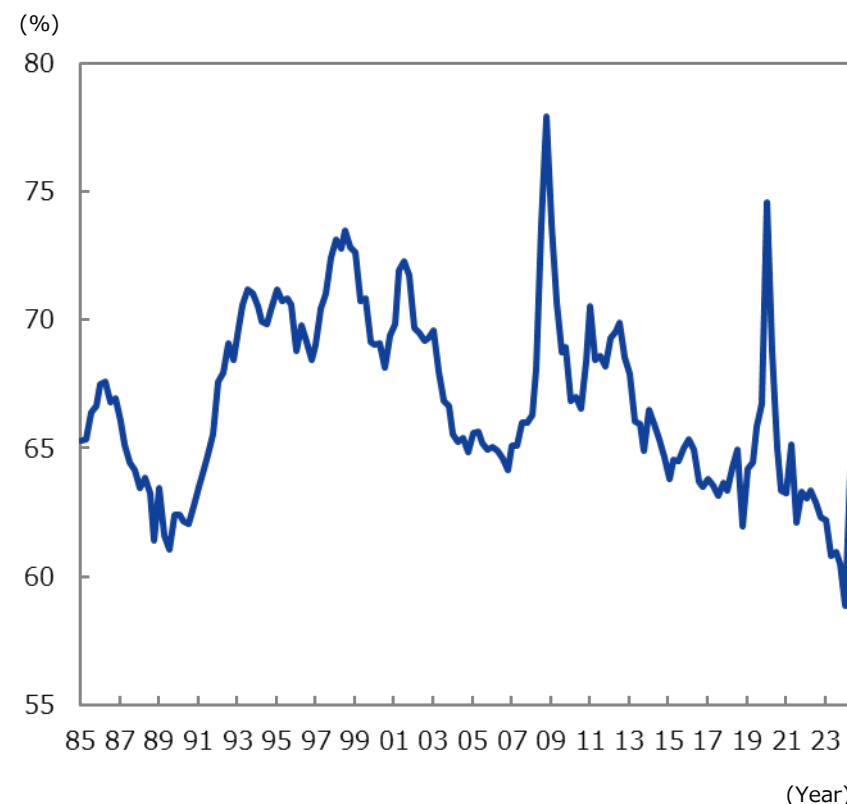
Conundrum of the Japanese Labor Market

Employment Sufficiency Index “Surplus - Shortage”



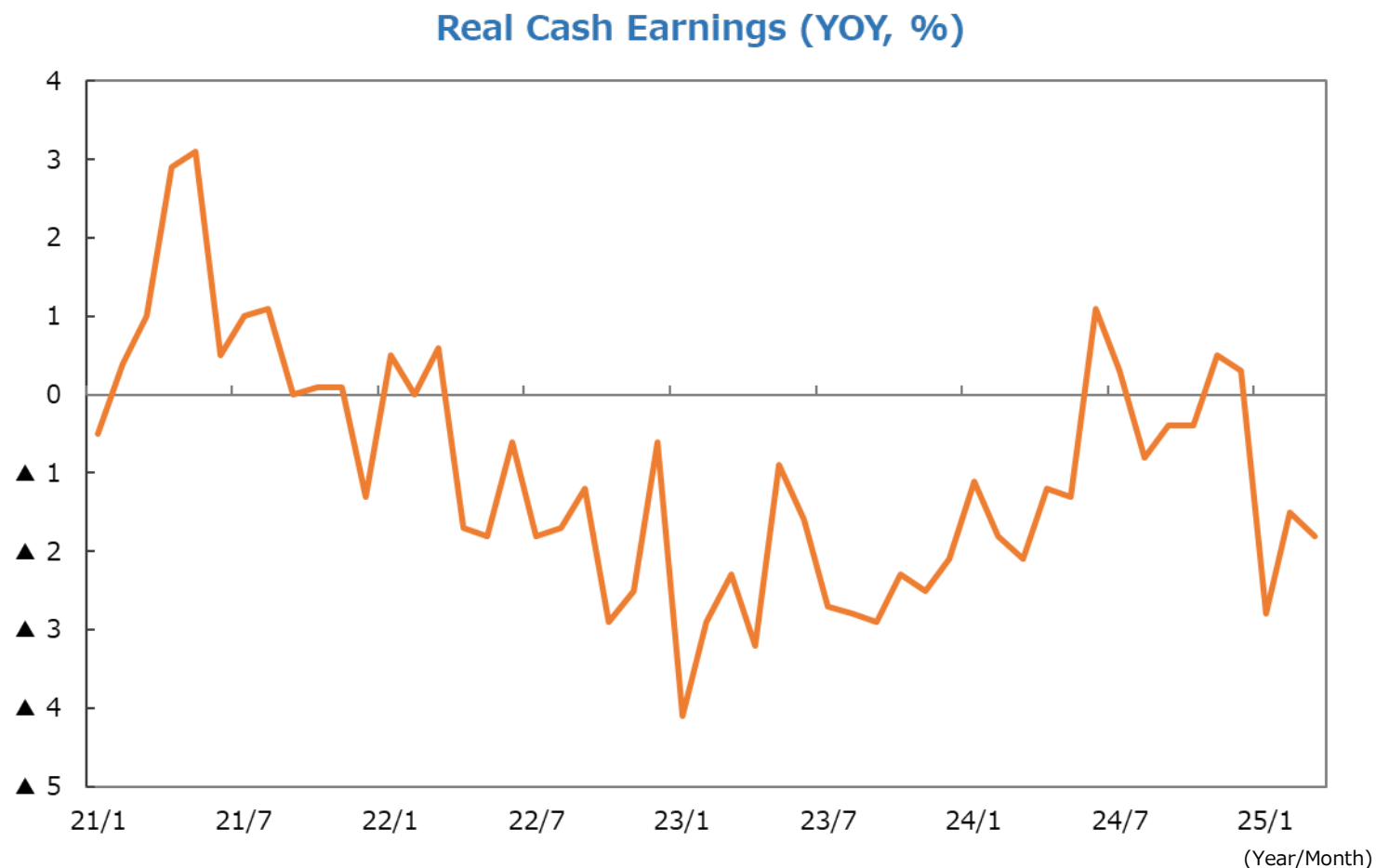
Note: Data is from April 1985 to March 2025.
Source: The bank of Japan, SMDAM

Labor Share of Added Value



Note: Data is from April 1985 to January 2025.
Source: Ministry of finance, SMDAM

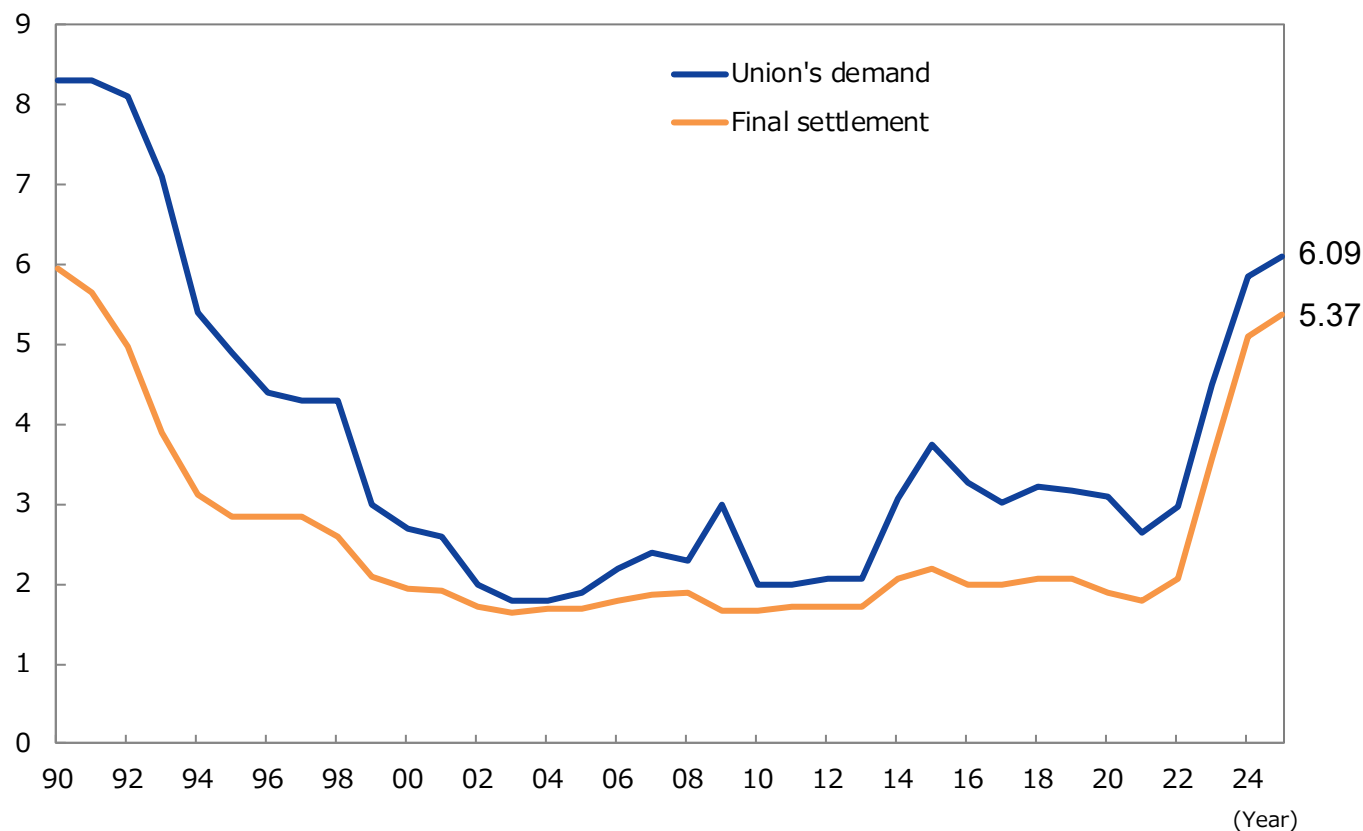
Inflation Eroding Consumer Purchasing Power



Note: Data is from January 2021 to March 2025.
Source: Japanese Trade Union Confederation, SMDAM

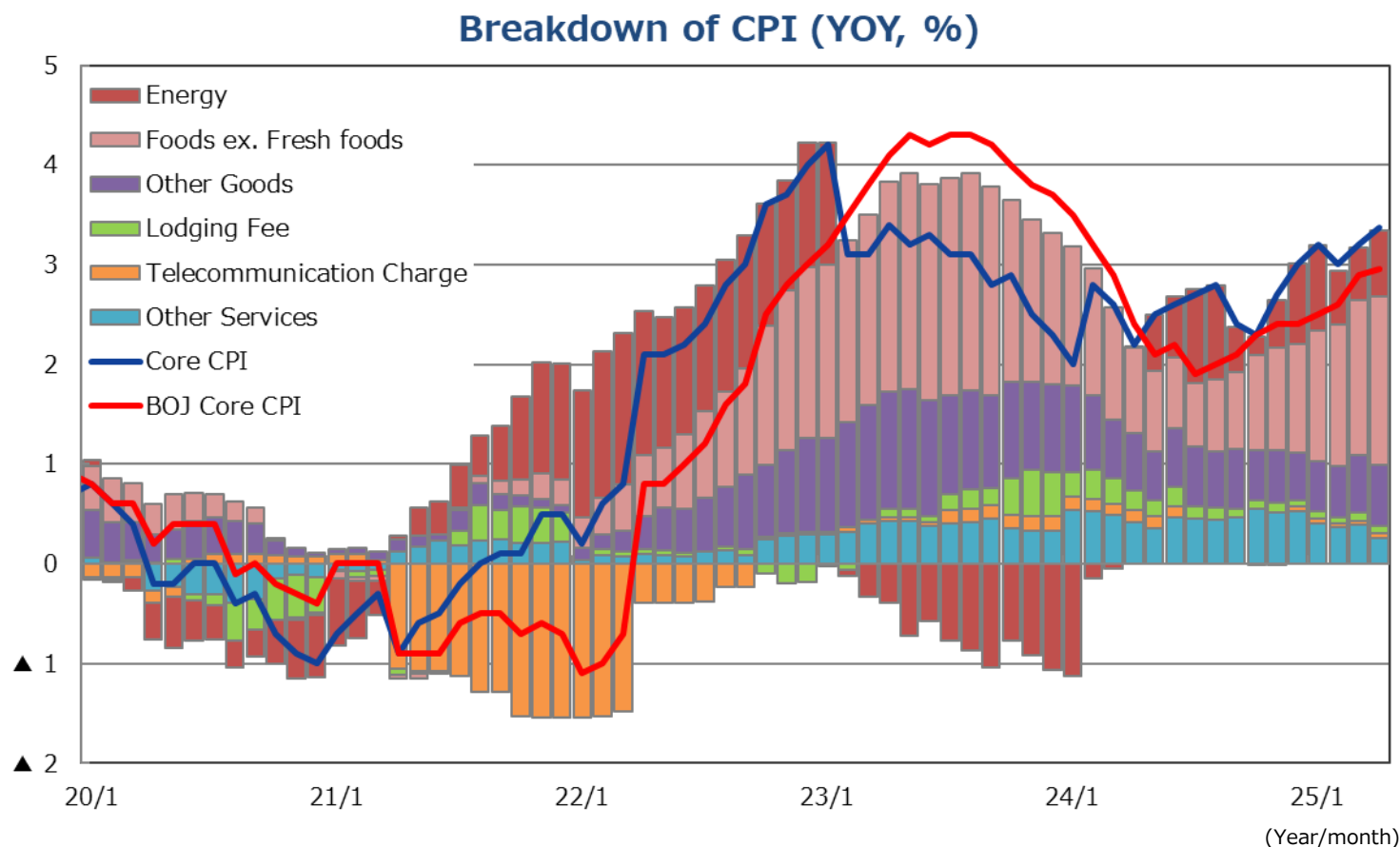
Highest Wage Increase in 33 Years

Wage increase (YOY, %)



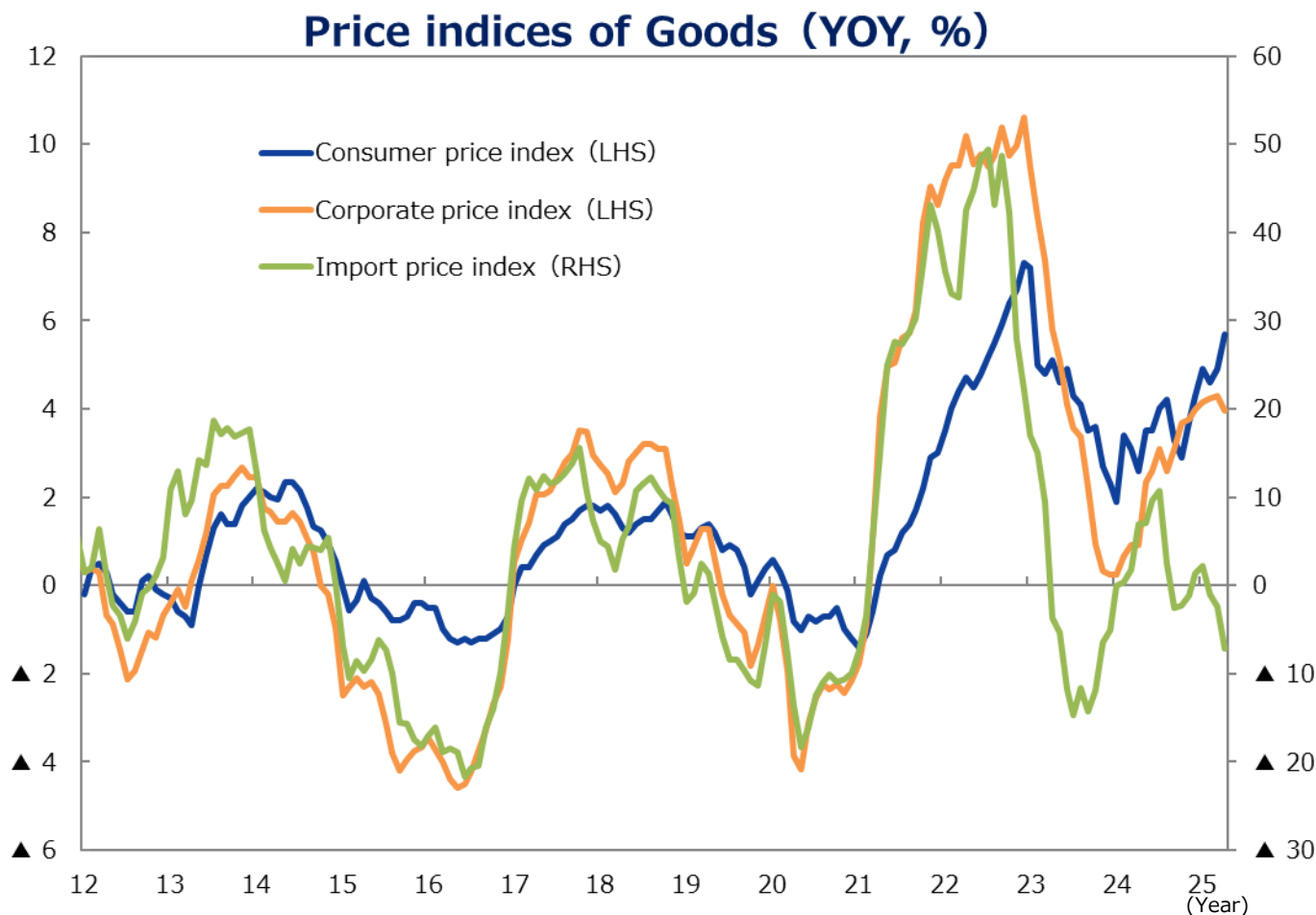
Note: Data is from FY 1990 to FY 2025.
Source: Japanese Trade Union Confederation, SMDAM

Rising Food Prices Push CPI Above BOJ's Target



Note: Data is from January 2020 to April 2025.
Source: MIAC, SMDAM

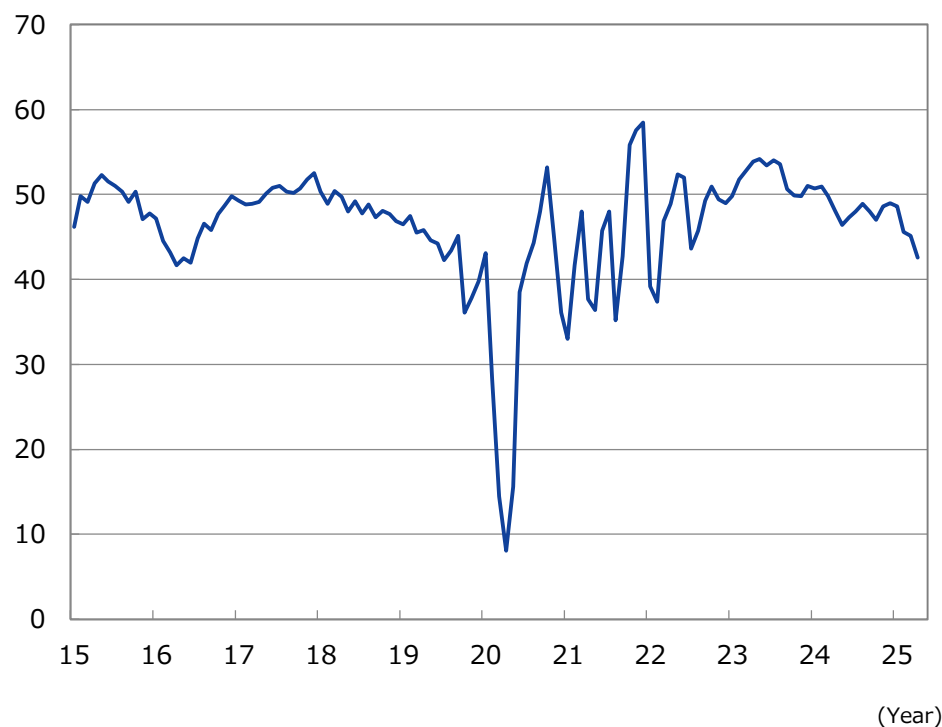
Import Prices Are No Longer the Major Source of Inflation



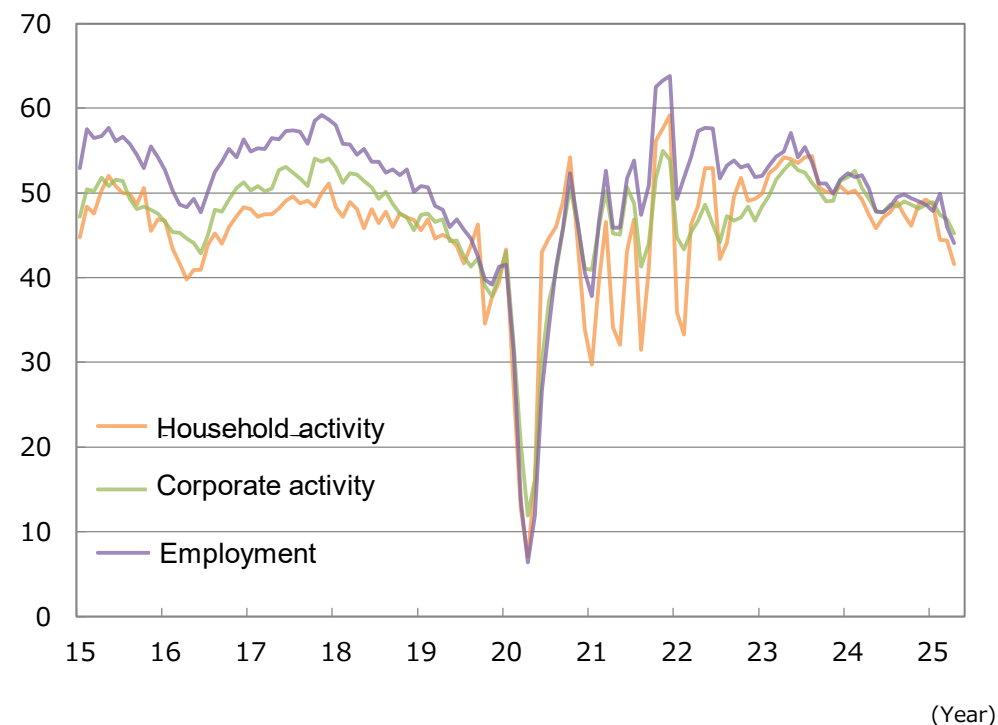
Note: Data is from January 2012 to April 2025.
Source: MIAC, Bloomberg, SMDAM

Improvements in Consumer and Business Sentiments Have Stalled

DI for Current Economic Conditions (%pt)



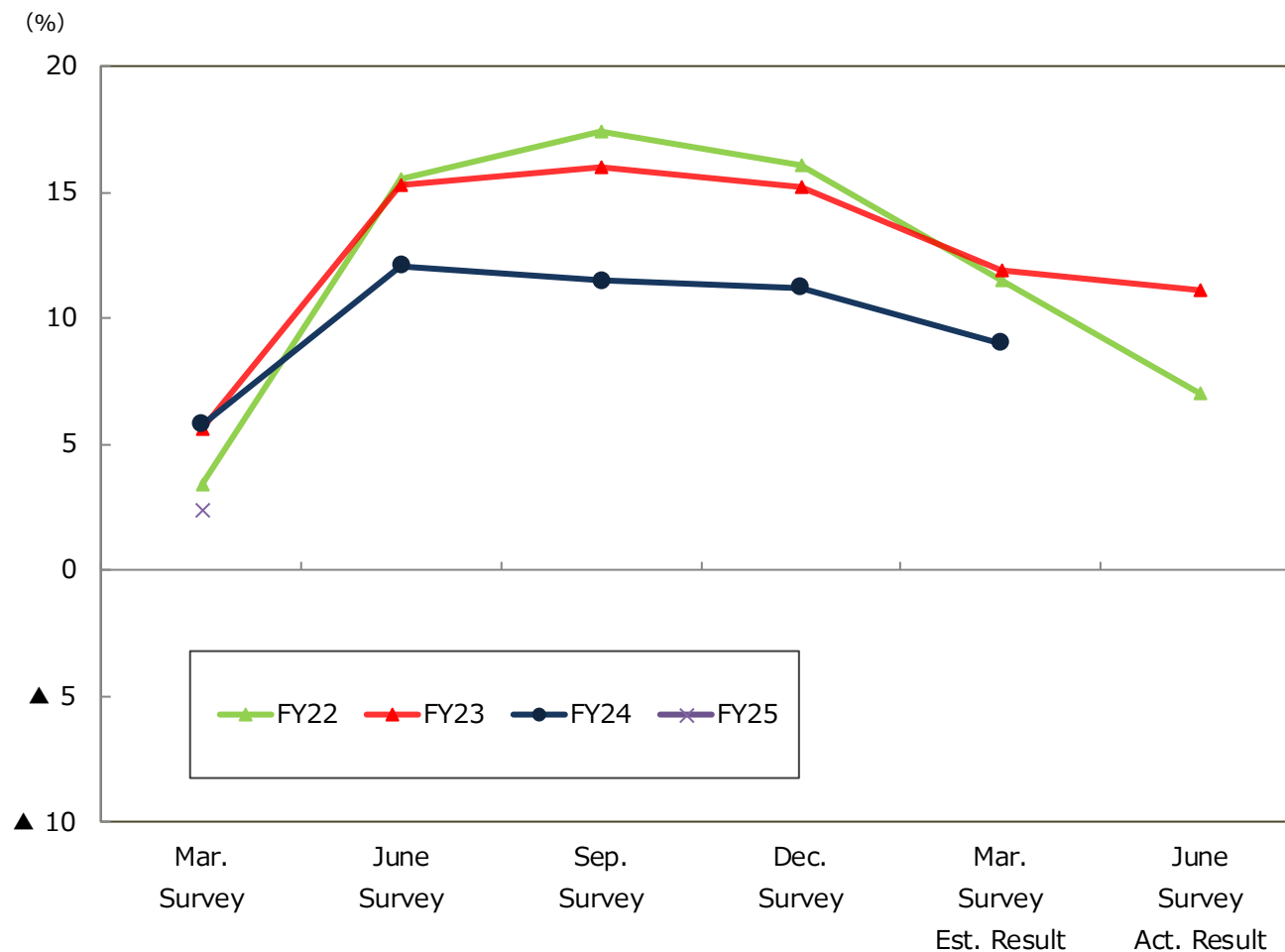
Breakdown of DI for Current Economic Conditions (%pt)



Note: Data is from January 2015 to April 2025.
Source: Economy Watchers Survey, Cabinet Office

Uncertainty Over the Global Economy Weighs on CAPEX Appetite

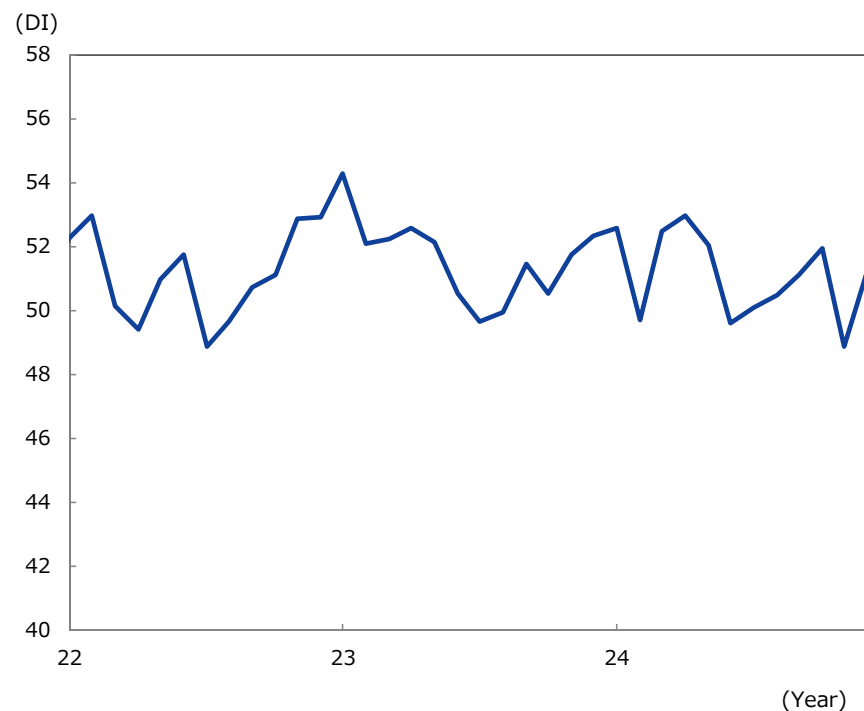
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



Note: Data is from Q1 FY2021 to Q1 FY2025.
Source: The Bank of Japan, SMDAM

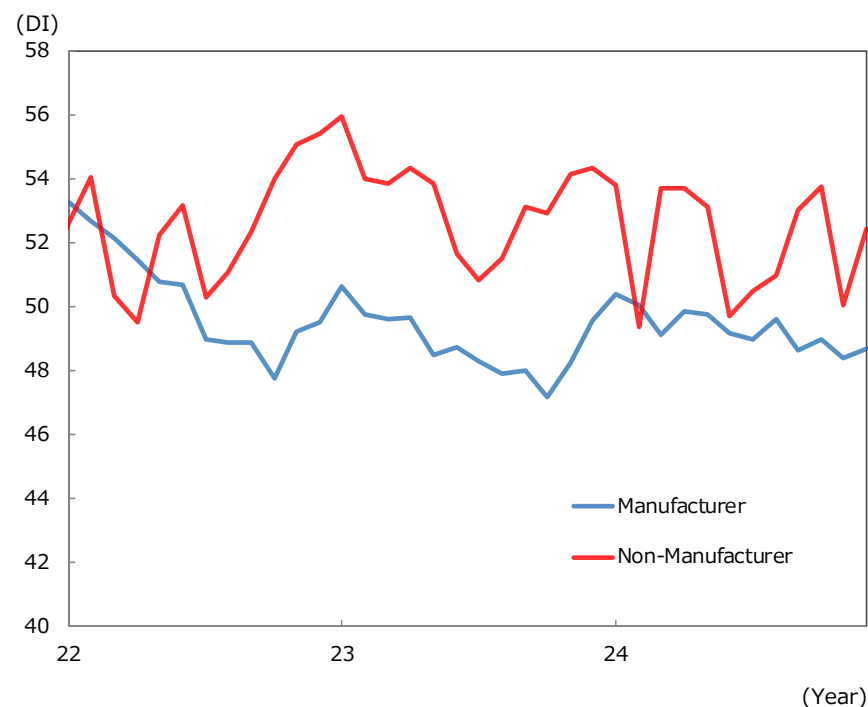
Sharp Correction in Service PMI Brings Composite PMI Lower

Composite PMI



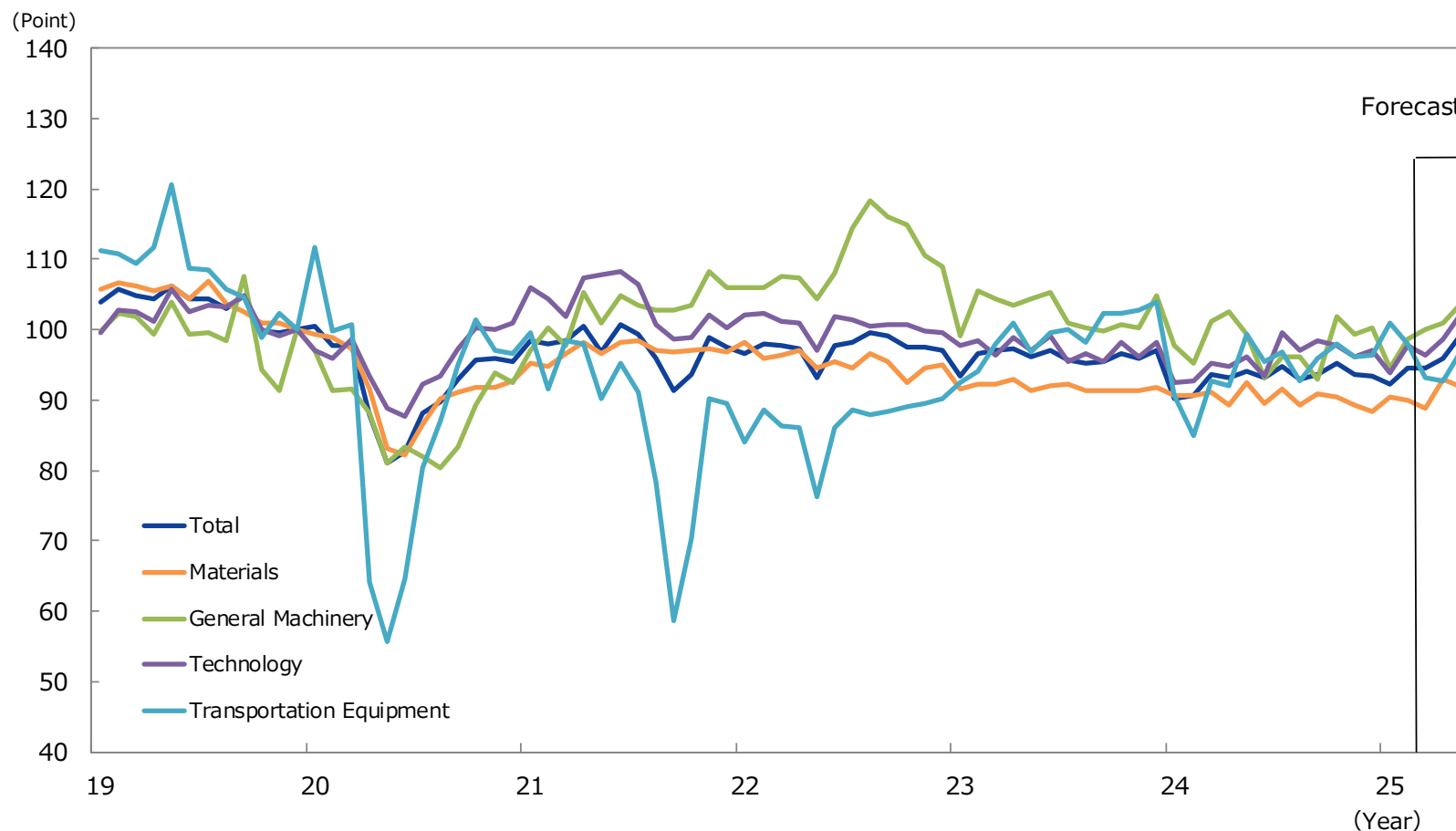
Note: Data is from May 2022 to April 2025.
Source: Bloomberg, SMDAM

PMI, Manufacturer & Non-Manufacturer



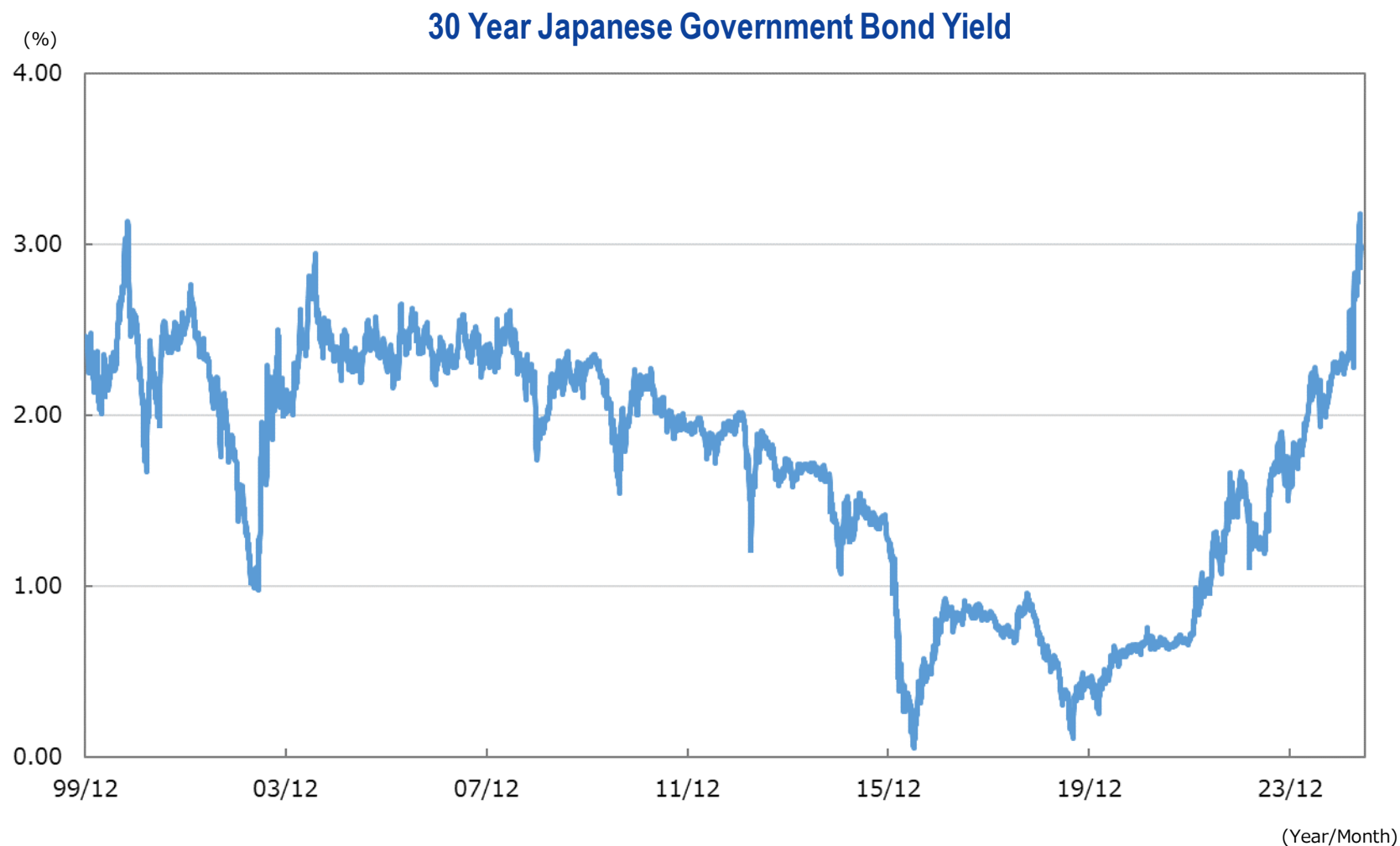
Recovery in Auto Production Lifts Industrial Production

Industrial Production (Dec. 2019=100)



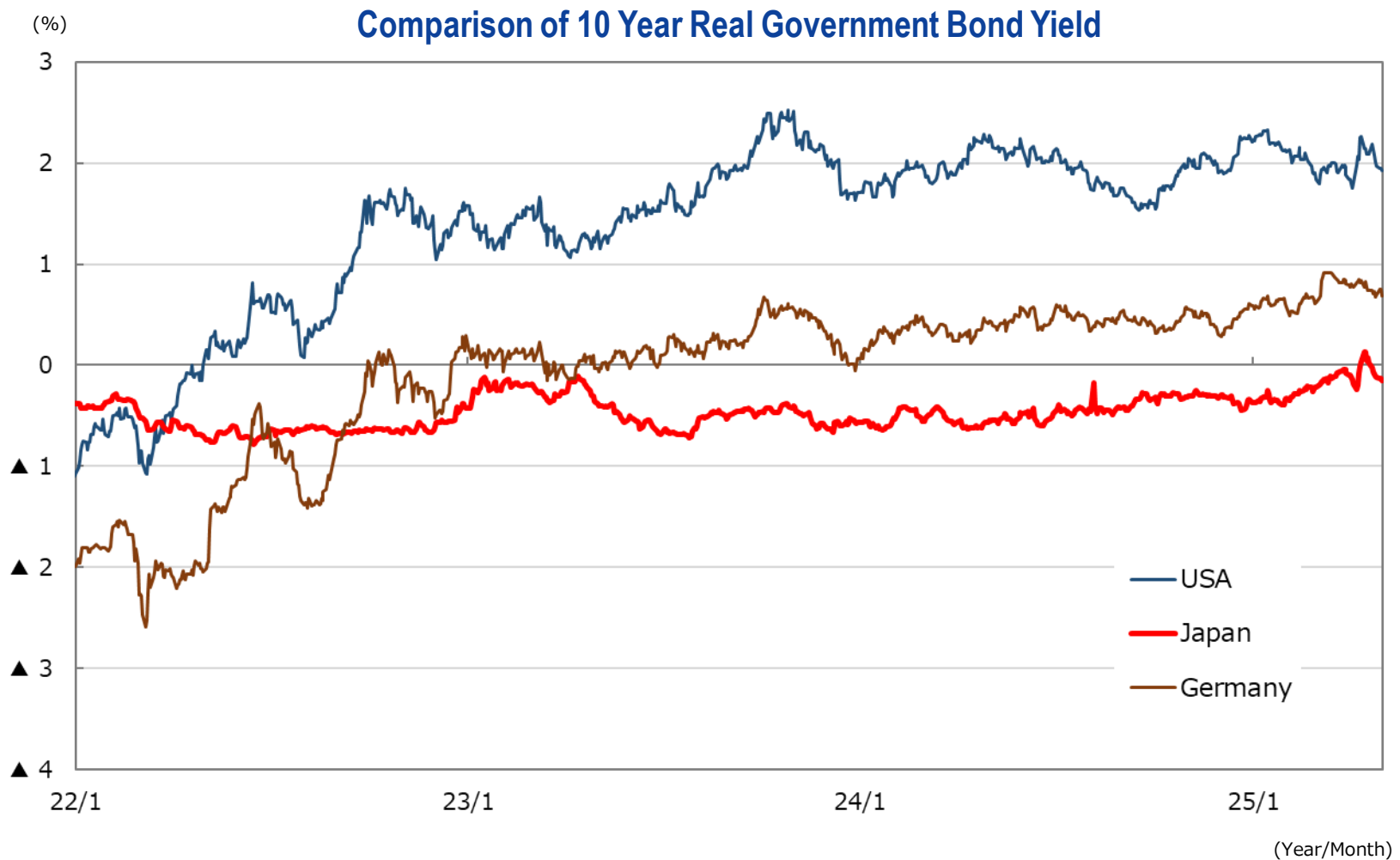
Note: Data is from January 2019 to May 2025. Data after April 2025 is forecasts.
Source: METI, SMDAM

30 Year JGB Yield Hits the Highest in History



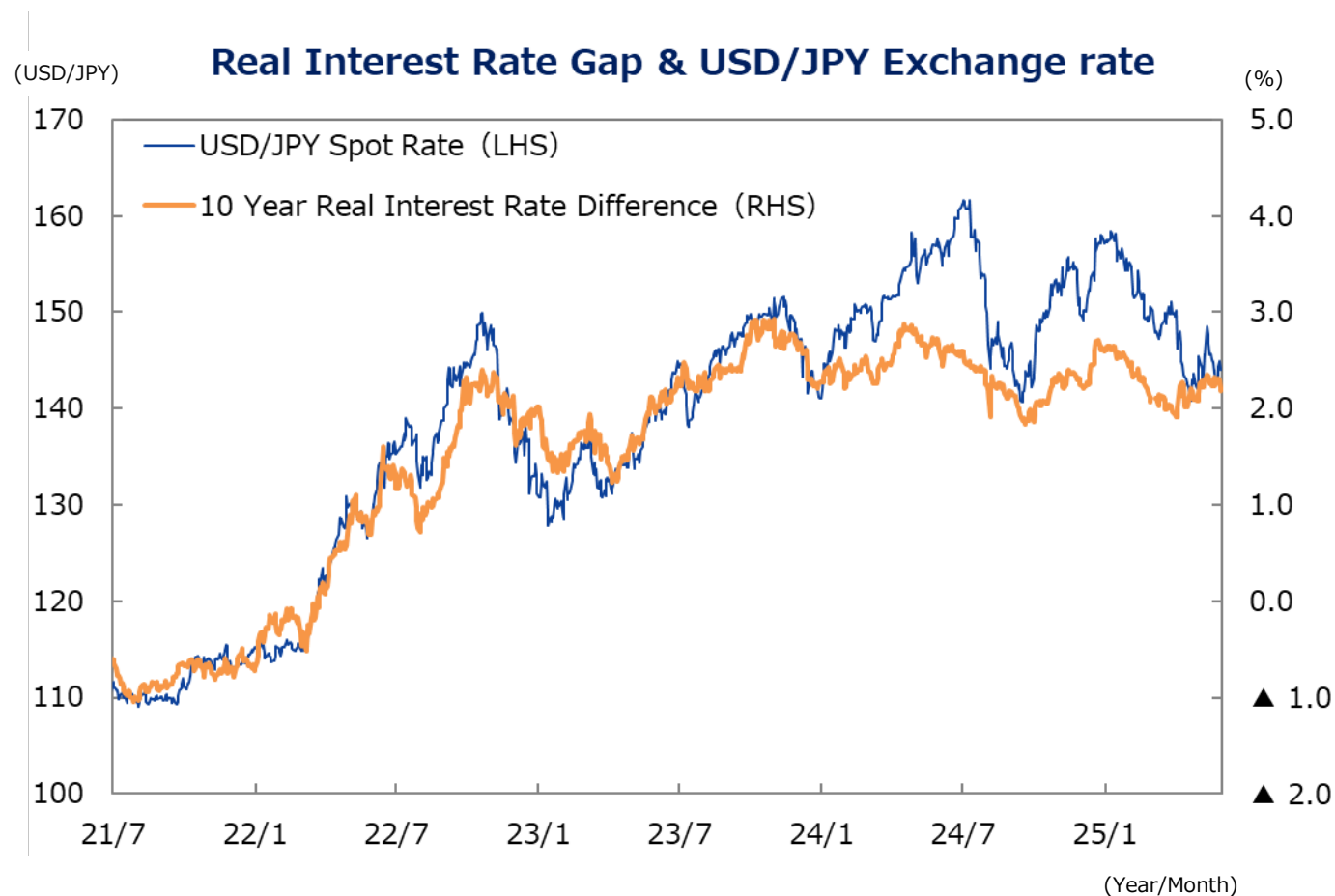
Note: Data is from 31st December 1999 to 30th May 2025.
Source: Bloomberg

Real 10 Year JGB Yield Temporarily Turns Positive



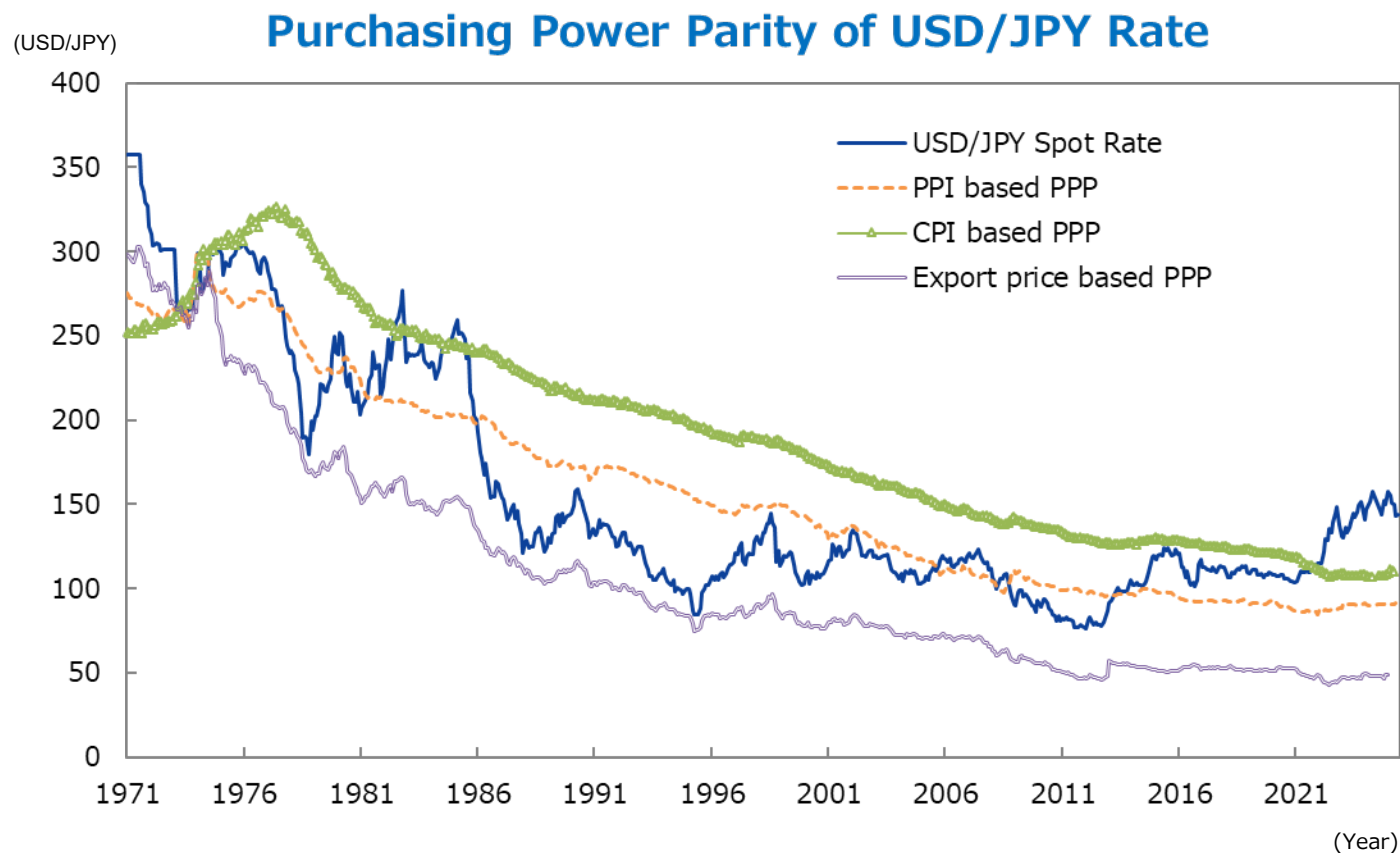
Note: Data is from 1st January 2011 to 30th May 2025.
Source: Bloomberg

Convergence Between Interest Rate Gap and Dollar/Yen Rate



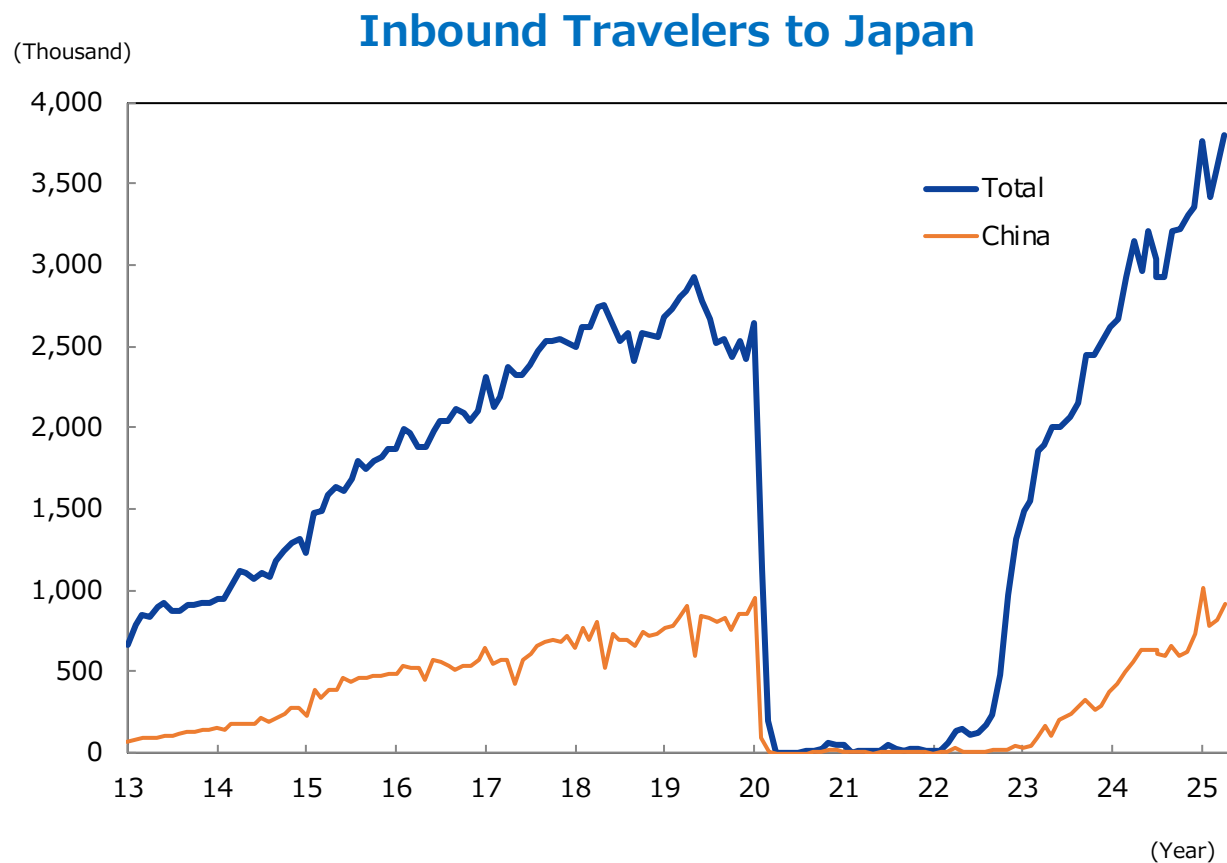
Note: Data is from 1st July 2021 to 30th May 2025.
Source: Bloomberg

PPP Still Suggests Overvaluation of Dollar/Yen Rate



Note: Data is from January 1971 to April 2025.
Source: DOL, Bank of Japan, SMDAM

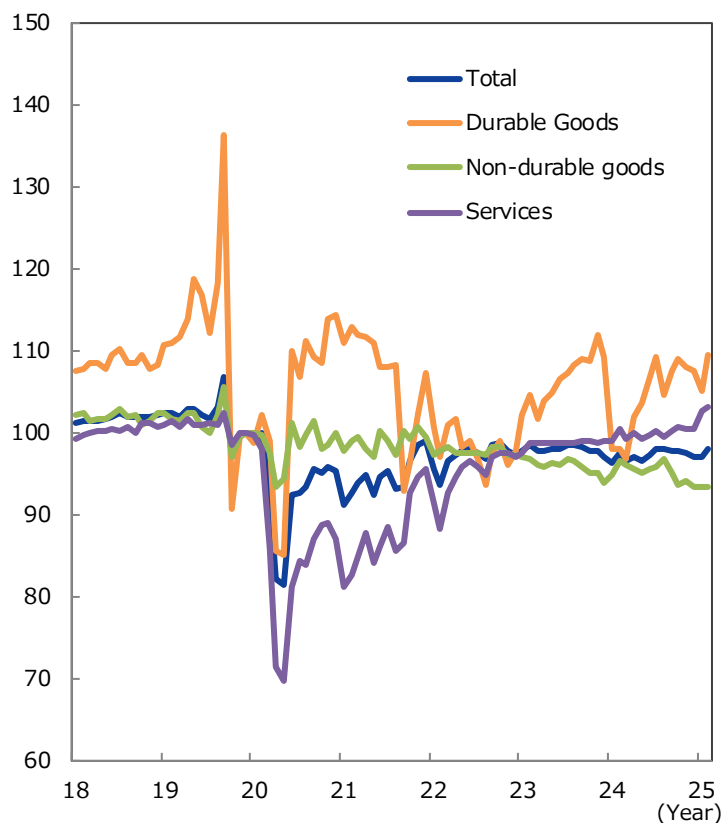
Inbound Travel Keeps its Strong Momentum



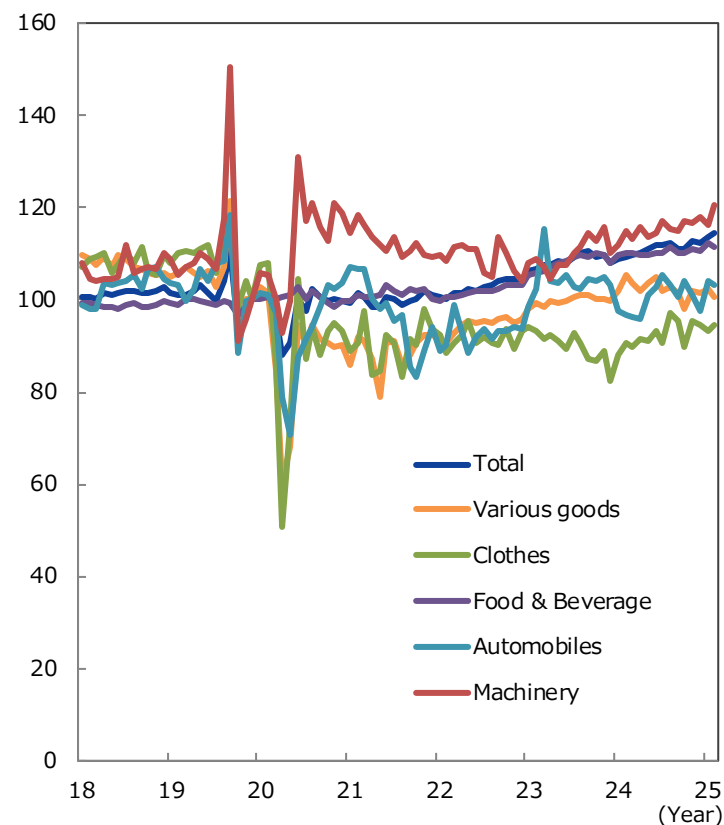
Note: Data is from January 2013 to April 2025. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Demand for Durable Goods Leads Consumer Activities

Consumer Activity Index (Dec. 2019 = 100)



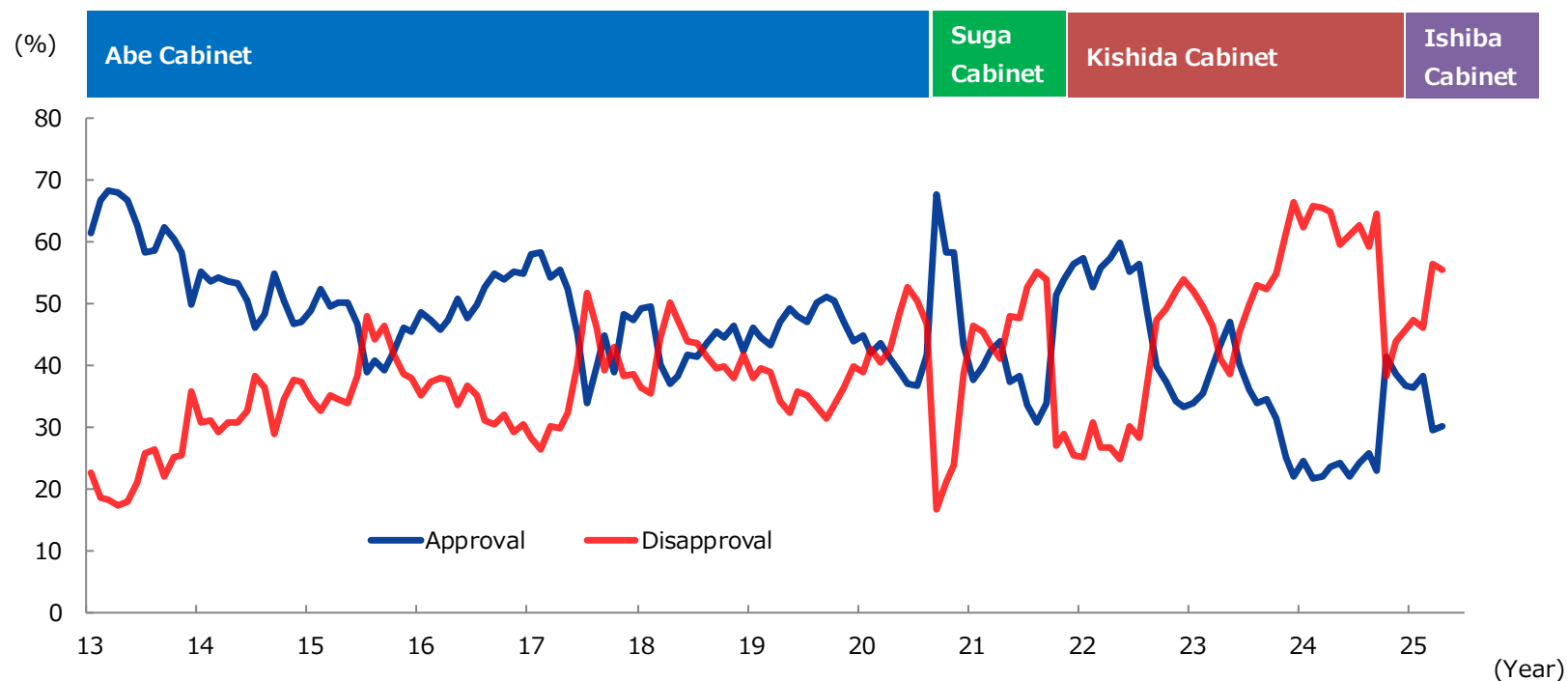
Retail Sales (Dec. 2019 = 100)



Note: Data is from January 2018 to February 2025.
Source; Bank of Japan, METI, and SMDAM

PM Ishiba and Ruling LDP are Struggling with Falling Approval Rate

Cabinet approval rate



Note: Data is from January 2013 to May 2025.

Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Schedule of Major Events

Year	Month	Date	Event
2025	June	9	Revision of 2025 Q1 GDP
		15-17	G7 Summit (A broad agreement on Japan-U.S. tariff talks)
		16-17	Monetary Policy Meeting (Interim assessment of the government bond purchase reduction plan)
		22	Election of the Tokyo Metropolitan Assembly Member
			End of the ordinary Diet session
	July		Cabinet's decisions on "Big-boned policy"
			Presentation of economic measures
		30	Expiration of the term of the Bank of Japan's Nakamura Policy Board member
		9	Deadline for the suspension of additional reciprocal U.S. tariffs
		28	Final results of spring negotiations of Trade Union Confederation
	August		Expiration of the term of office for a member of the House of Councillors
		15	Release of 2025 Q2 GDP
	Septemebr	8	Revision of 2025 Q2 GDP
		18-19	Monetary Policy Meeting
	October	29-30	Monetary Policy Meeting
	November	17	Release of 2025 Q3 GDP
			Cabinet approval of economic measures
	December	8	Revision of 2025 Q3 GDP
		18-19	Monetary Policy Meeting
			Cabinet approval of the initial budget for FY 2026 and the outline for tax reform

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

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