



Outlook for Japanese Stock Market & Economy

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-August 2025-



Sumitomo Mitsui DS Asset Management



Outlook for Japanese Stock Market

Market Outlook

- **Japanese Stock Market Rebounded Sharply Following the Surprise Agreement on Trump Tariffs. We Expect the Japanese Market to Resume its Long-Term Upward Trend.**

Japan's economic downturn is expected to bottom out thanks to the unexpected agreement reached in the Japan-US trade talks in Q3 of 2025. Thereafter, fiscal expansion by the US and the EU will bolster Japanese economy and corporate earnings going forward.

- **Rising Interest Rates Weigh on Share Price Valuations**

Following the ruling party's loss of its majority in the House of Councilors, concerns over loosening fiscal discipline have arisen, which could weigh on share price valuations.

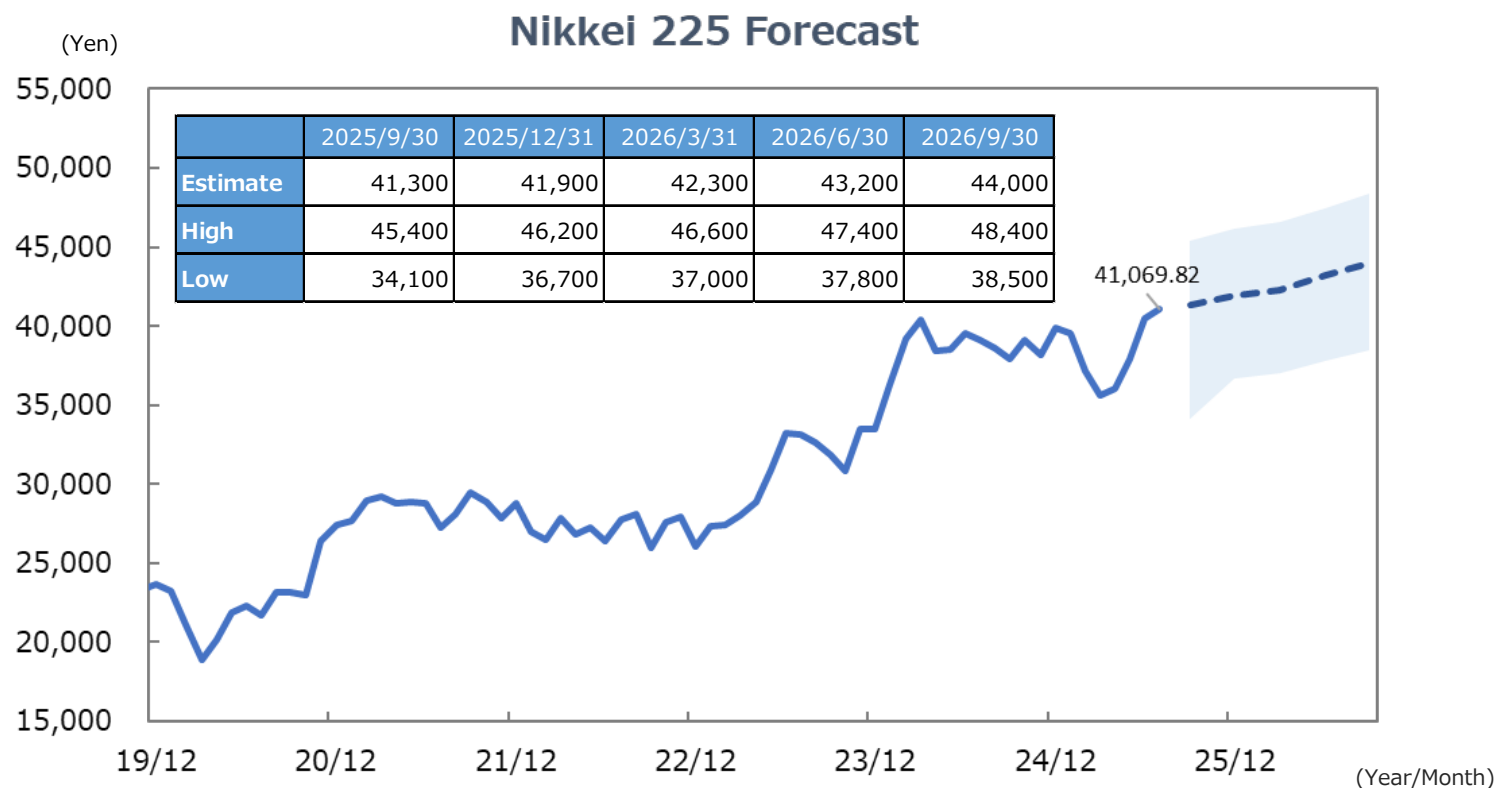
- **Nikkei 225 Target Prices Rise**

We have raised our target price for the Nikkei 225 from 40,200 to 41,900 for December 2025 and from 40,700 to 42,300 for March 2026, based on our EPS forecast and valuations.

- **Share-Buybacks and Corporate Governance Ignite Stock Market Dynamics**

The corporate sector has become a major buyer in the Tokyo stock exchange due to the rising volume of buybacks and improving corporate governance.

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

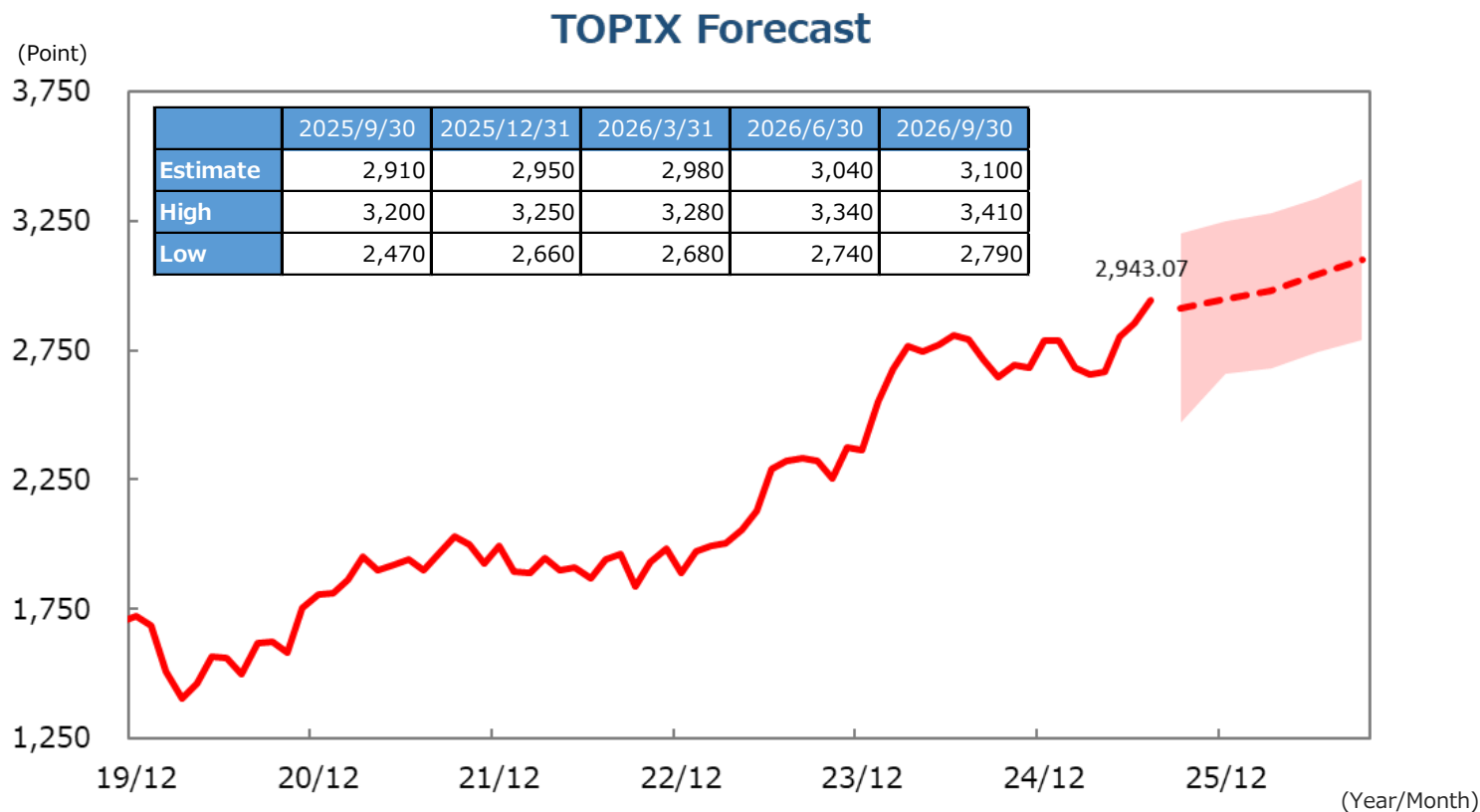


Data is from December 2019 to September 2026. Data after July 2025 is our forecast.

Note: The forecasts are as of July 31st, 2025.

(Source) Bloomberg, SMDAM

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

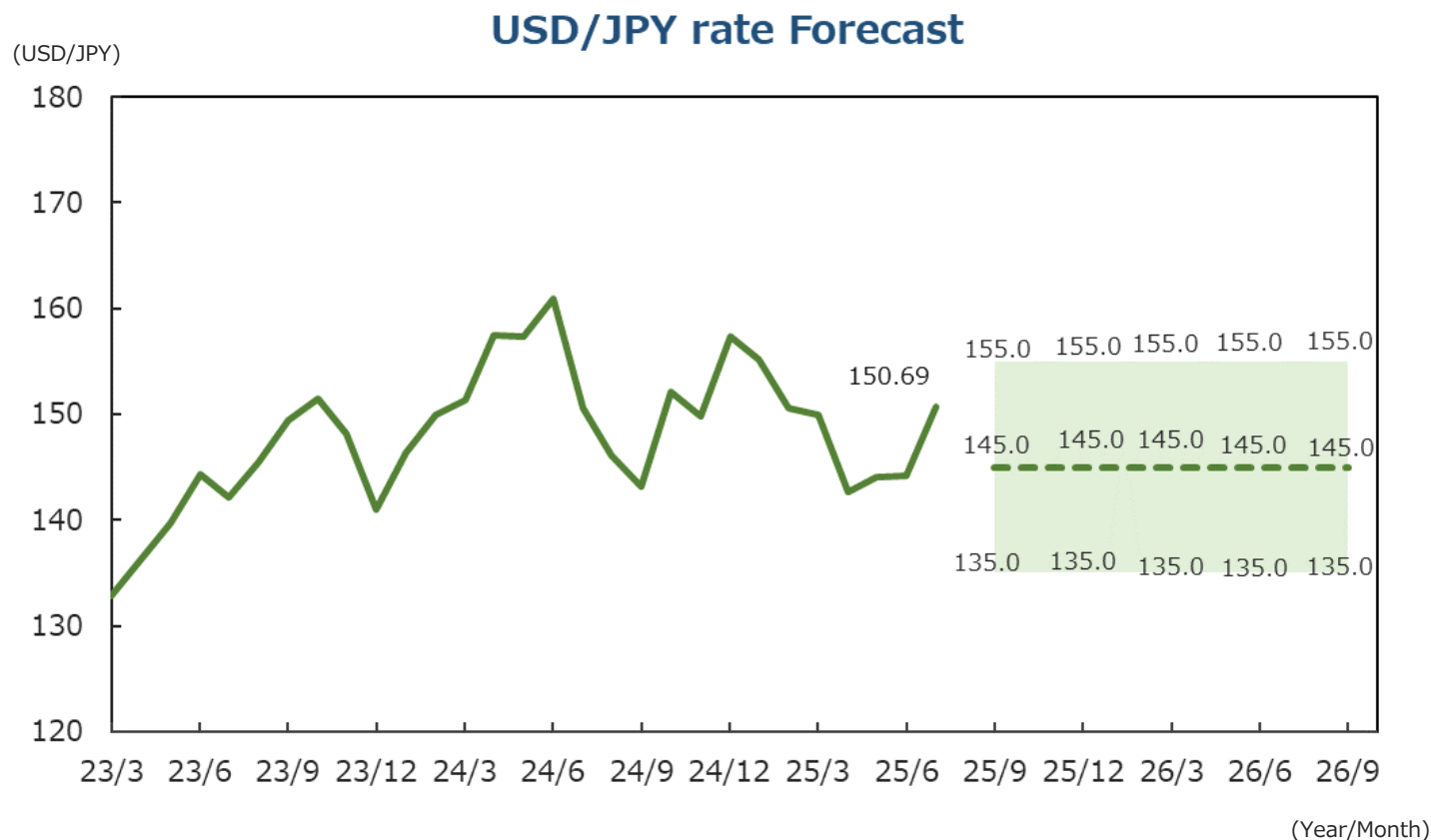


Data is from December 2019 to September 2026. Data after July 2025 is our forecast.

Note: The forecasts are as of July 31st, 2025.

(Source) Bloomberg, SMDAM

USD/JPY to be Supported by Recovery in Confidence of the US



Data is from March 2023 to September 2026. Data after July 2025 is our forecast.

Note: The forecasts are as of July 31st, 2025.

(Source) Bloomberg, SMDAM

Upside / Downside Risk Scenarios

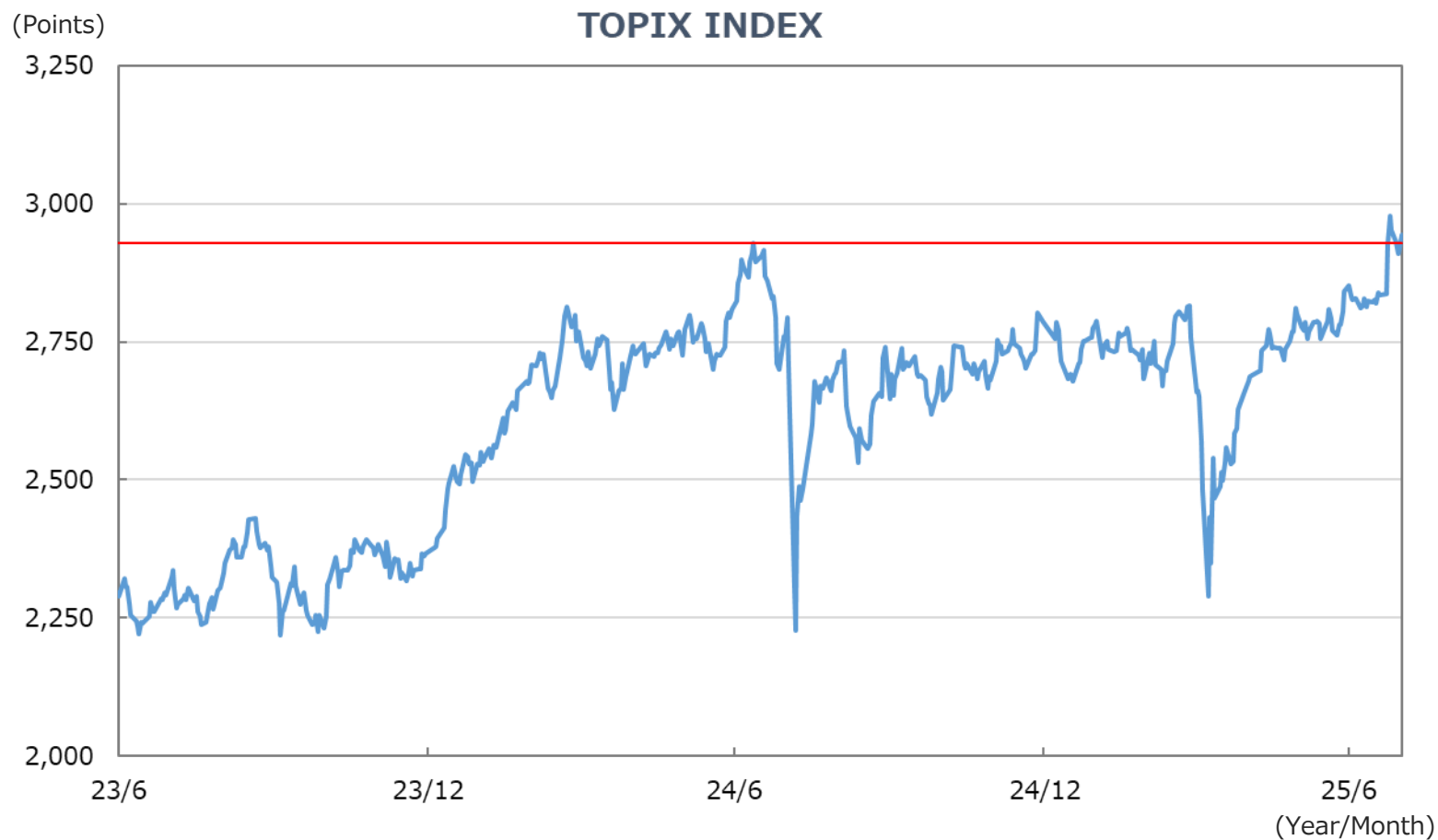
■ Upside Risks

- Growing optimism for the global economy thanks to the settlement of the trade talks
- Robust foreign inflows into the Japanese stock market fueled by further improvements in corporate governance
- Resurgence of Big Tech stocks boosted by the social implementation and monetization of artificial intelligence (AI)

■ Downside Risks

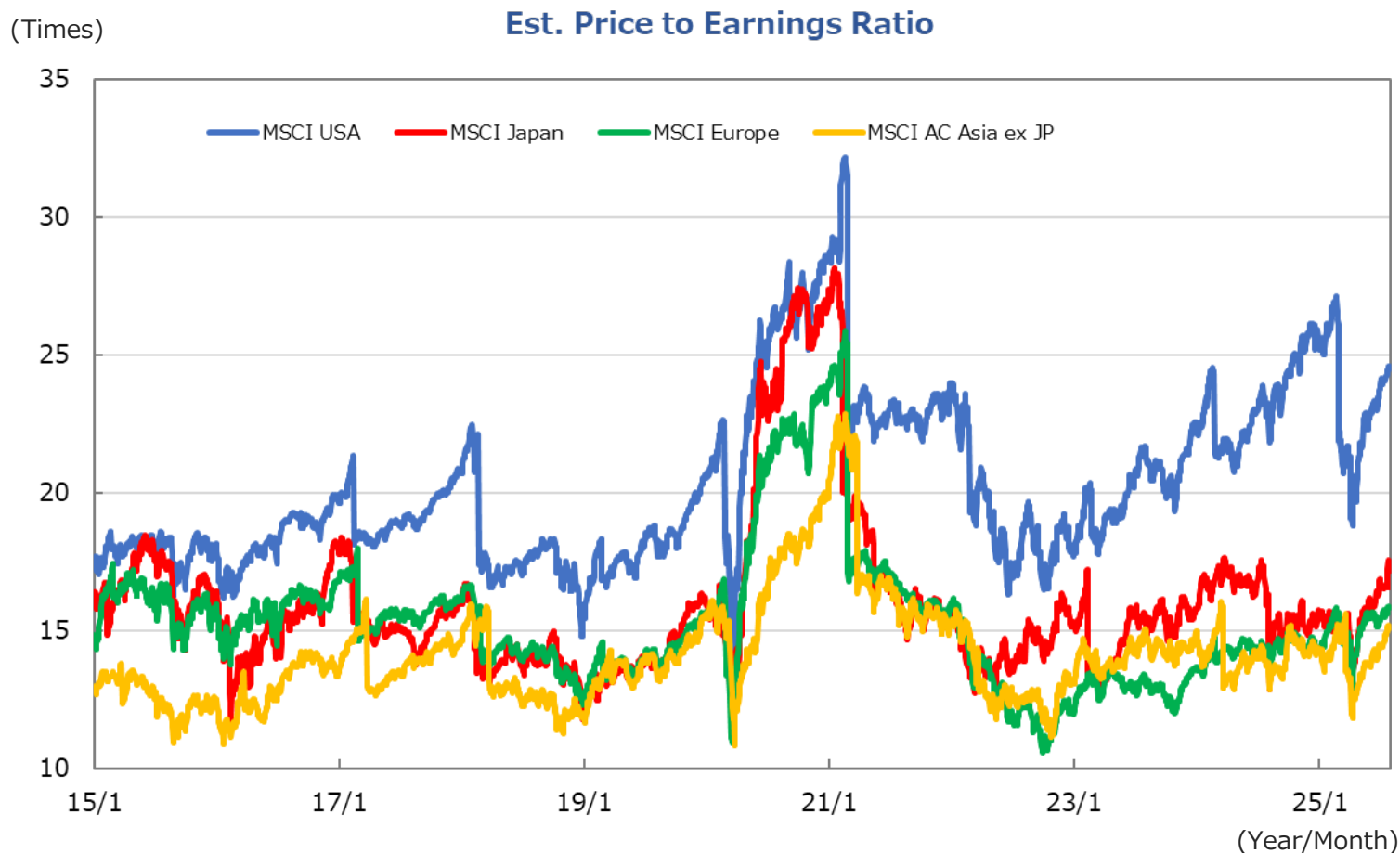
- Global recession owing to the escalation of the trade war between the US and China
- Spike of Japanese government bond (JGB) yields owing to the concern over fiscal deficit and increased defense spending
- Foreign investors' sell-off due to the turmoil in domestic politics
- Negative impact of excessive accumulation of inventories owing to Trump tariffs

TOPIX Breaking Record High After Year of Range-Bound Trading



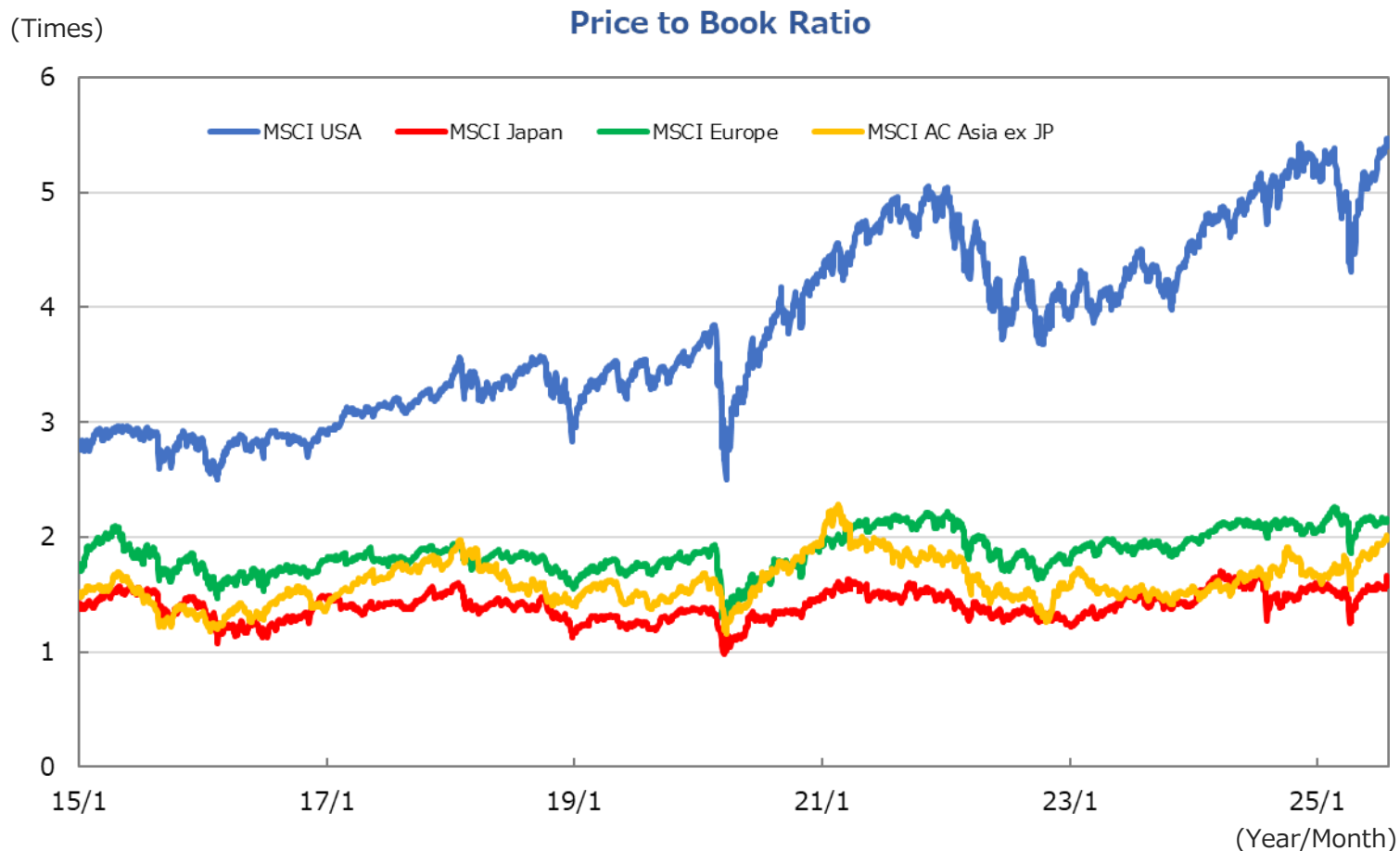
Data is from 30th June 2023 to 31st July 2025.
(Source) SMDAM, Bloomberg

P/E Ratio Back to Normal After a Sharp Correction in April



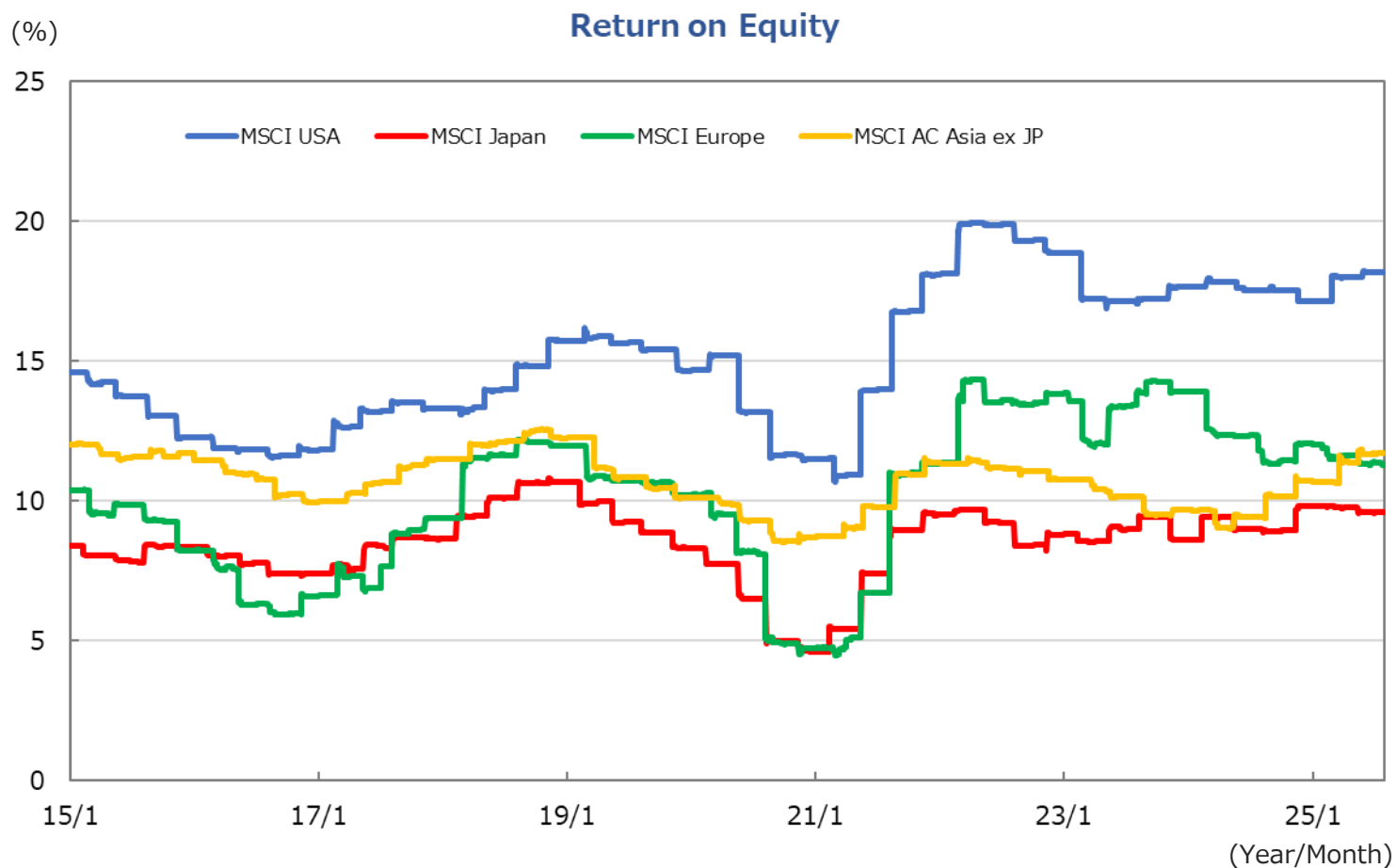
Data is from January 2015 to July 2025.
(Source) SMDAM, Bloomberg

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



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

Japan's ROE is Hovering Just Below 10%

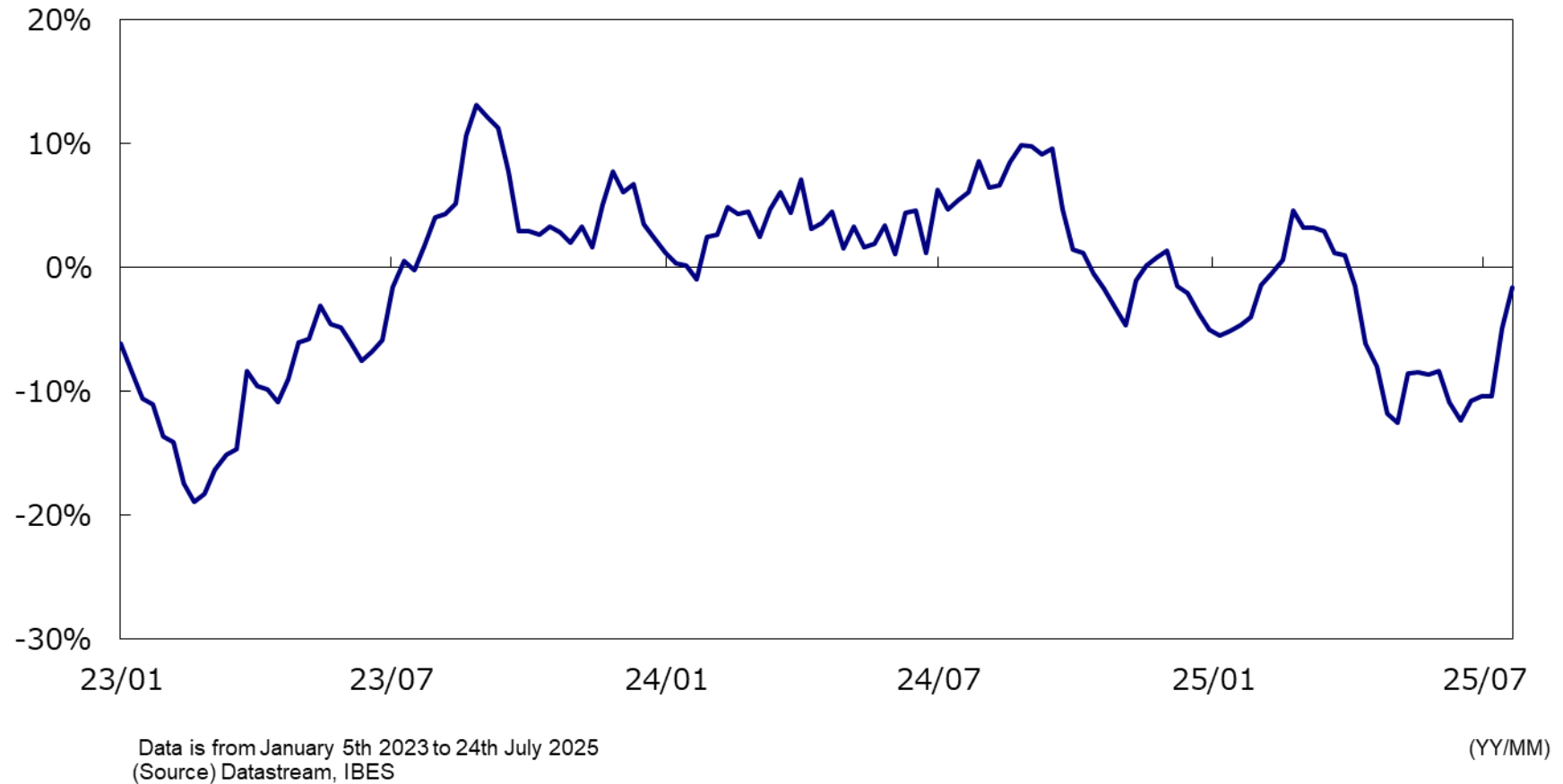


Data is from January 2015 to July 2025.
(Source) SMDAM, Bloomberg

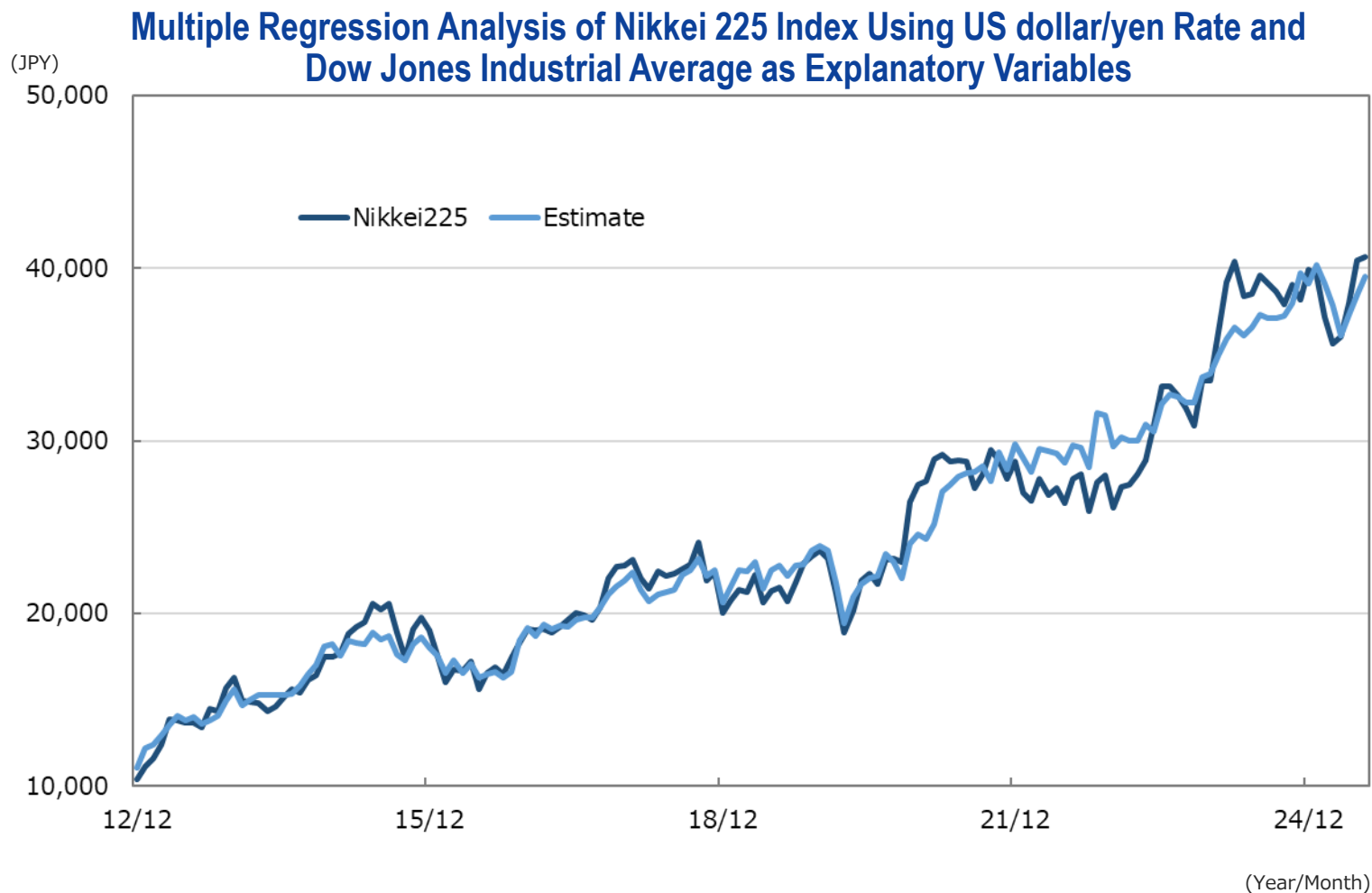


Analysts Becoming Less Pessimistic Amid Progress in Tariff Talks

TOPIX EPS Revision Index

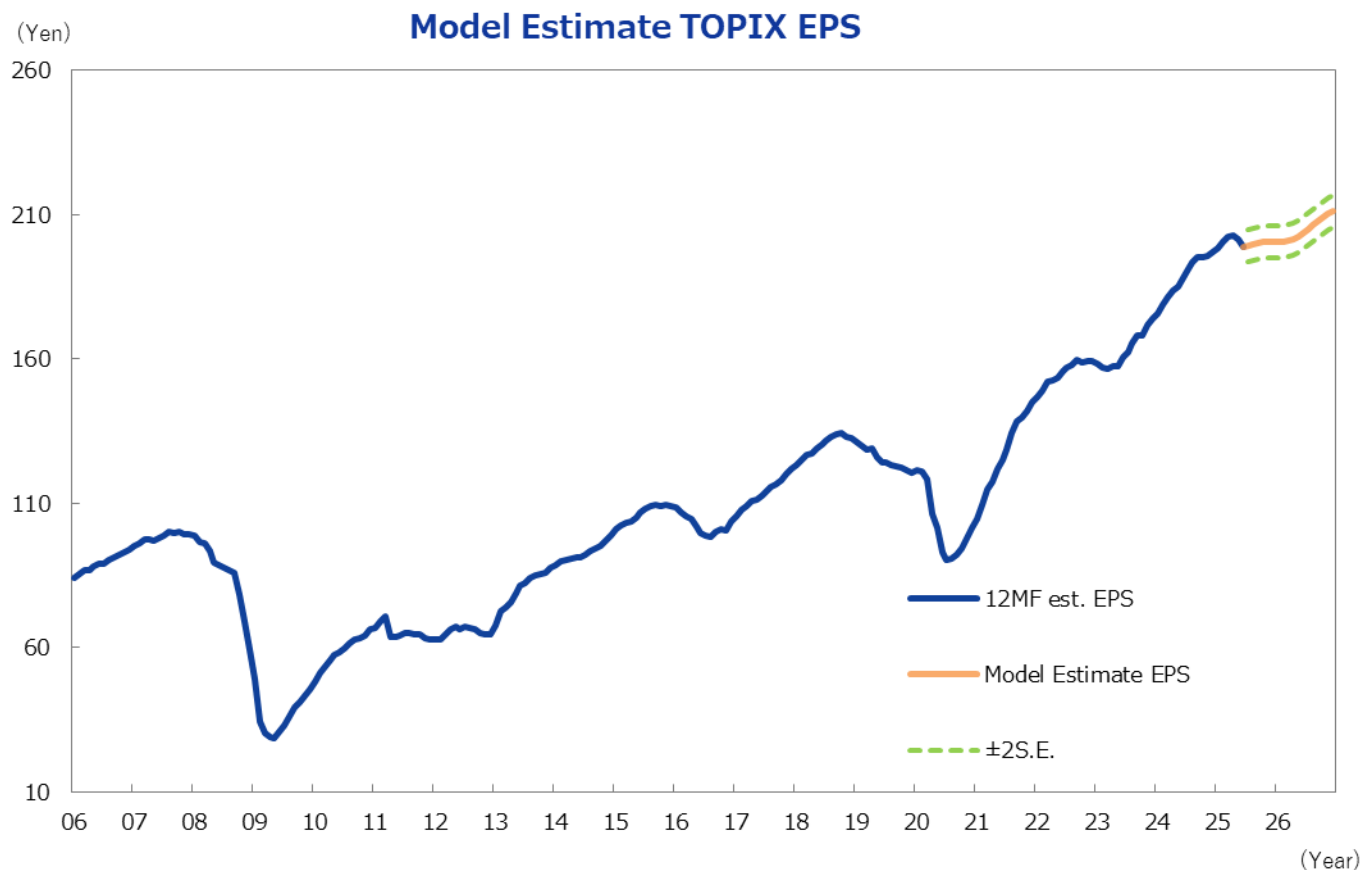


US Stocks and Dollar/Yen Rate Drive Japanese Stock Market



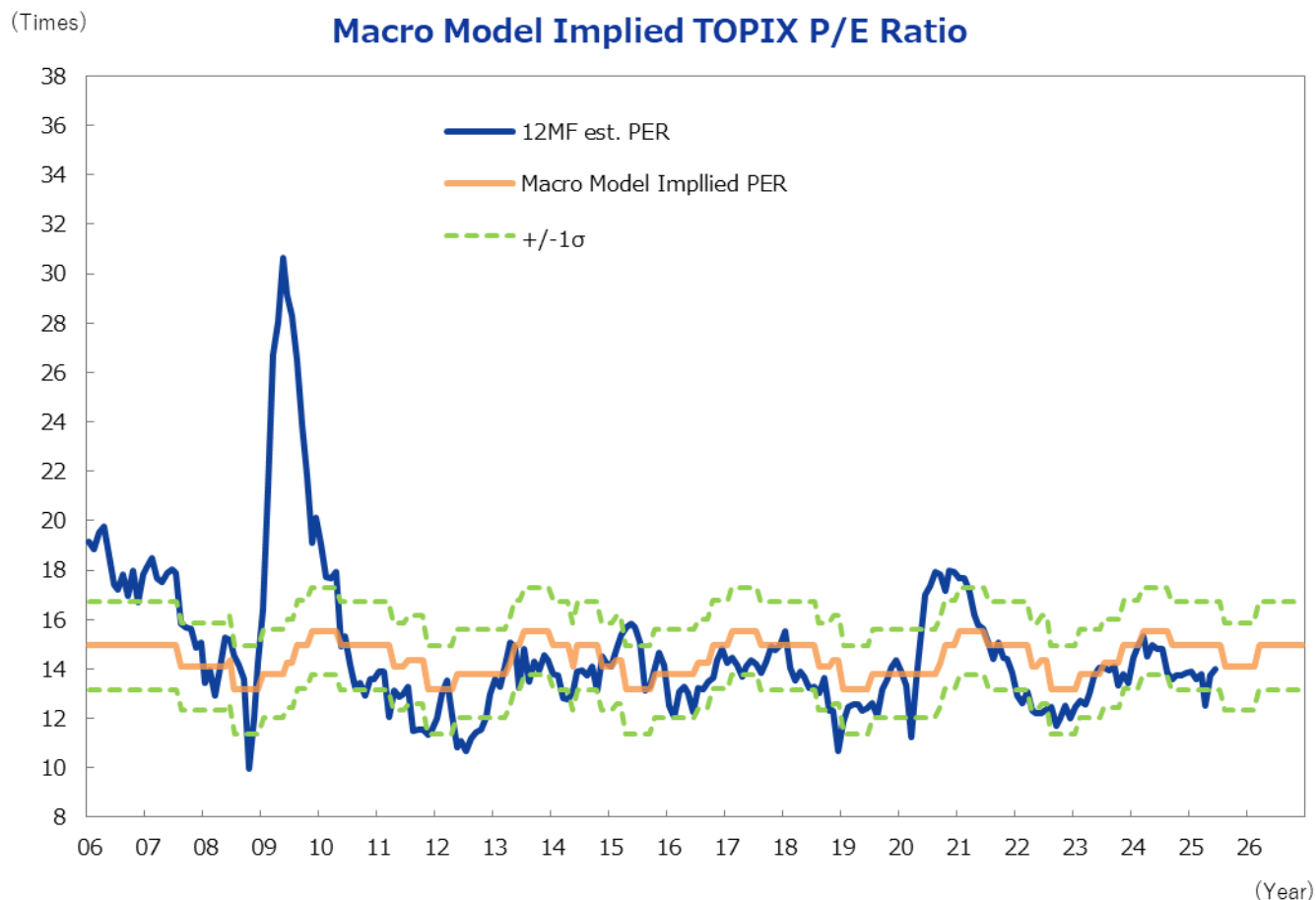
Data is from December 2012 to July 2025.
(Source) SMDAM, Bloomberg

Macro Quant Model Suggests EPS Growth to Slow Down Temporarily



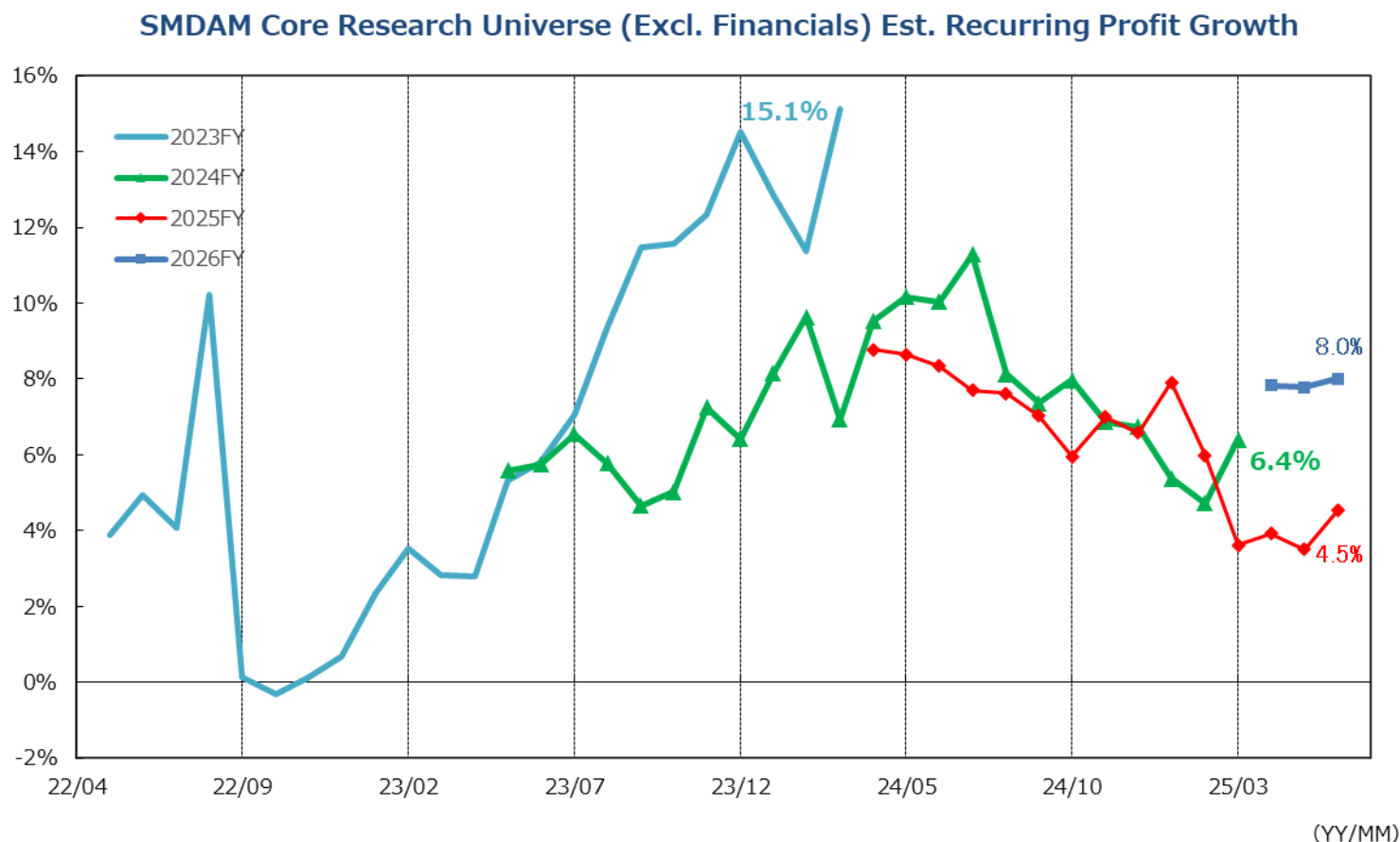
Note: Consensus data is from January 2006 to June 2025. Model estimate Data is from July 2025 to December 2026.
Source: SMDAM

Recent Market Correction Made P/E Ratio Highly Attractive



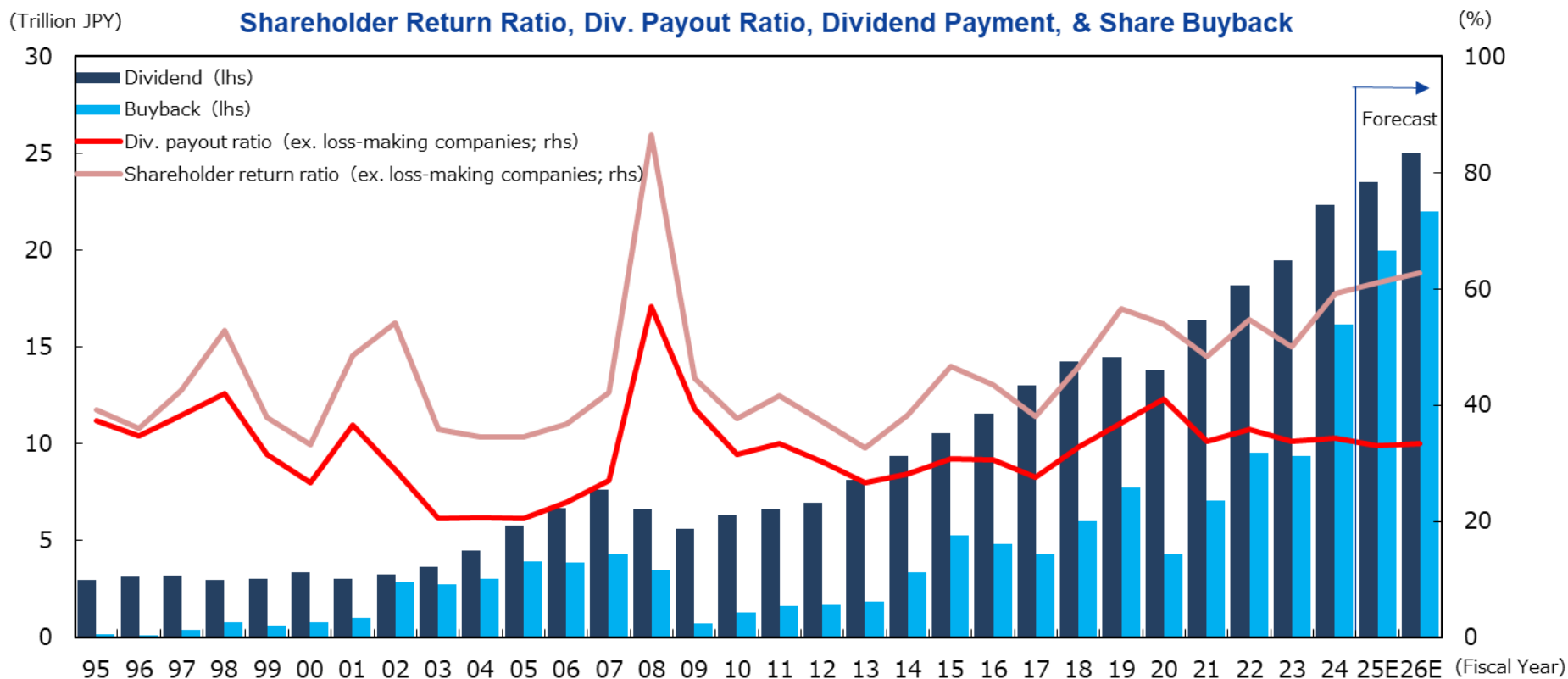
Note: Consensus data is from January 2006 to June 2025. Model estimate Data is from July 2025 to December 2026.
Source: SMDAM

In-House Analysts See Positive Outlook After Temporary Pause



Note: Data is as of 31st July 2025, SMDAM Core Universe (Excl. Financials) consists of 391 Japanese companies covered by SMDAM in-house analysts.
Source: SMDAM

Record-Breaking Dividends and Share Buybacks Continue



Note: Data is from FY1995 to FY2026. FY2025, FY2026 are forecasts by Daiwa Securities.
Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

Small Caps Becoming a Safe Harbor Amid Global Market Turmoil

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	10.25	4.96	4.69	5.78	27.46	50.82	88.32
Total Value	10.02	5.30	4.97	5.81	34.72	68.91	130.65
Top Cap Value	12.03	3.90	3.60	4.84	38.51	81.47	161.72
Large Cap Value	9.83	4.24	3.99	4.35	33.91	69.36	136.48
Mid Cap Value	7.41	4.64	4.44	3.84	29.57	56.26	110.01
Small Cap Value	10.79	9.68	9.04	12.20	37.61	65.85	104.65
Micro Cap Value	12.38	12.63	11.55	14.06	39.68	67.68	99.23
Total Growth	10.49	4.60	4.40	5.72	20.73	35.11	53.71
Top Cap Growth	10.33	2.20	1.88	2.77	22.83	37.88	61.39
Large Cap Growth	10.44	4.20	4.09	5.27	21.39	36.72	56.42
Mid Cap Growth	10.70	8.91	9.31	11.08	19.69	35.63	49.37
Small Cap Growth	10.91	7.90	7.03	9.68	14.99	22.28	31.86
Micro Cap Growth	8.47	5.87	4.95	3.32	7.29	12.64	21.94
Top Cap Total	11.04	2.92	2.61	3.63	29.19	55.32	99.47
Large Cap Total	10.15	4.22	4.04	4.83	27.15	51.25	90.50
Mid Cap Total	8.75	6.37	6.40	6.79	24.62	45.77	78.87
Small Cap Total	10.83	9.05	8.32	11.31	28.70	47.62	74.05
Micro Cap Total	11.17	10.50	9.48	10.60	28.45	47.42	71.02

Note : As of 31st July 2025
(Source) Bloomberg





Outlook for Japanese Economy

Current Status & Outlook of the Japanese Economy

■ Current Status

- **The economy is in a soft patch.** Though sluggish exports and production are weighing on economic activity, mainly caused by the implementation of Trump tariffs, the Japanese economy shows no immediate signs of a major correction, thanks to steady CAPEX, supported by a strong demand for digitalization, persistent labor shortages and stable consumer spending despite price increases.
- **Nationwide core CPI continues to exceed the Bank of Japan's (BOJ) "price stability target" of 2% year-on-year (YOY).** Nationwide core CPI rose by +3.7% YOY in May, up from +3.5% in April. Nationwide core CPI remains elevated due to cost-push pressures stemming from import prices and rising rice prices. A surge in food prices was particularly noticeable.

■ Outlook

- ① **We have slightly lowered our real GDP growth estimate from +0.4% to +0.3% for FY 2025, and from +0.7% to +0.6% for FY 2026.** The revisions to our estimates primarily reflect updated assumptions regarding Trump tariffs. Following the Japan-U.S. trade agreement on July 22nd, whose terms were more favorable than anticipated, we now expect the negative impact of the tariffs to ease somewhat, providing a modest boost to our GDP forecast. We anticipate that the Japanese economy will avoid a severe downturn. Our outlook remains optimistic, supported by steady CAPEX, driven by persistent labor shortages, and recovery in consumer spending thanks to a gradual decline in inflation. From FY 2026 onward, we also expect the resilience of overseas economies to contribute to a recovery in the Japanese economy.
- ② **While we have raised core CPI forecasts for FY 2025 from +2.5% to +2.6%, we have maintained our forecast for FY 2026 at +1.6%.** Looking ahead, we estimate core CPI to start slowing down due to the easing cost-push pressures from import prices and the stabilization of rice prices. 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 government support for education.
- ③ **We expect the government to adopt accommodative fiscal policies.** PM Ishiba has reiterated his intention to remain in office even after a critical defeat, losing the majority, in the House of Councilors election. As PM Ishiba and his ruling party have lost political power, the influence of opposition parties will grow and increasing the likelihood of a deterioration in fiscal discipline, such as a cut in sales tax and an expansion of fiscal spending.
- ④ **We have changed our monetary policy forecast. Now we expect the BOJ to raise its policy rate from 0.50% to 0.75% in January 2026, and from 0.75% to 1.00% in July 2026.** Previously, we had estimated a rate hike to 0.75% in April 2026 and to 1% in October 2026. The reason for the revision is because the BOJ's "Outlook Report" and Governor Ueda's comments at the press conference following the policy meeting contained somewhat hawkish elements. Specifically, the neutralization of the risk balance in the inflation outlook, a reduced level of concern regarding uncertainties over Trump tariffs, and Governor Ueda's remark that the accuracy of the economic and price outlook has "slightly improved". While we have brought forward our forecast for the schedule of a rate hike, we continue to consider the probability of a hike within this year as low, given that Governor Ueda has not significantly changed his cautious stance towards carefully assessing the impact of tariffs on the economy and prices.

Note: The forecasts are as of July 17th, 2025.

Forecast for the Japanese Economy

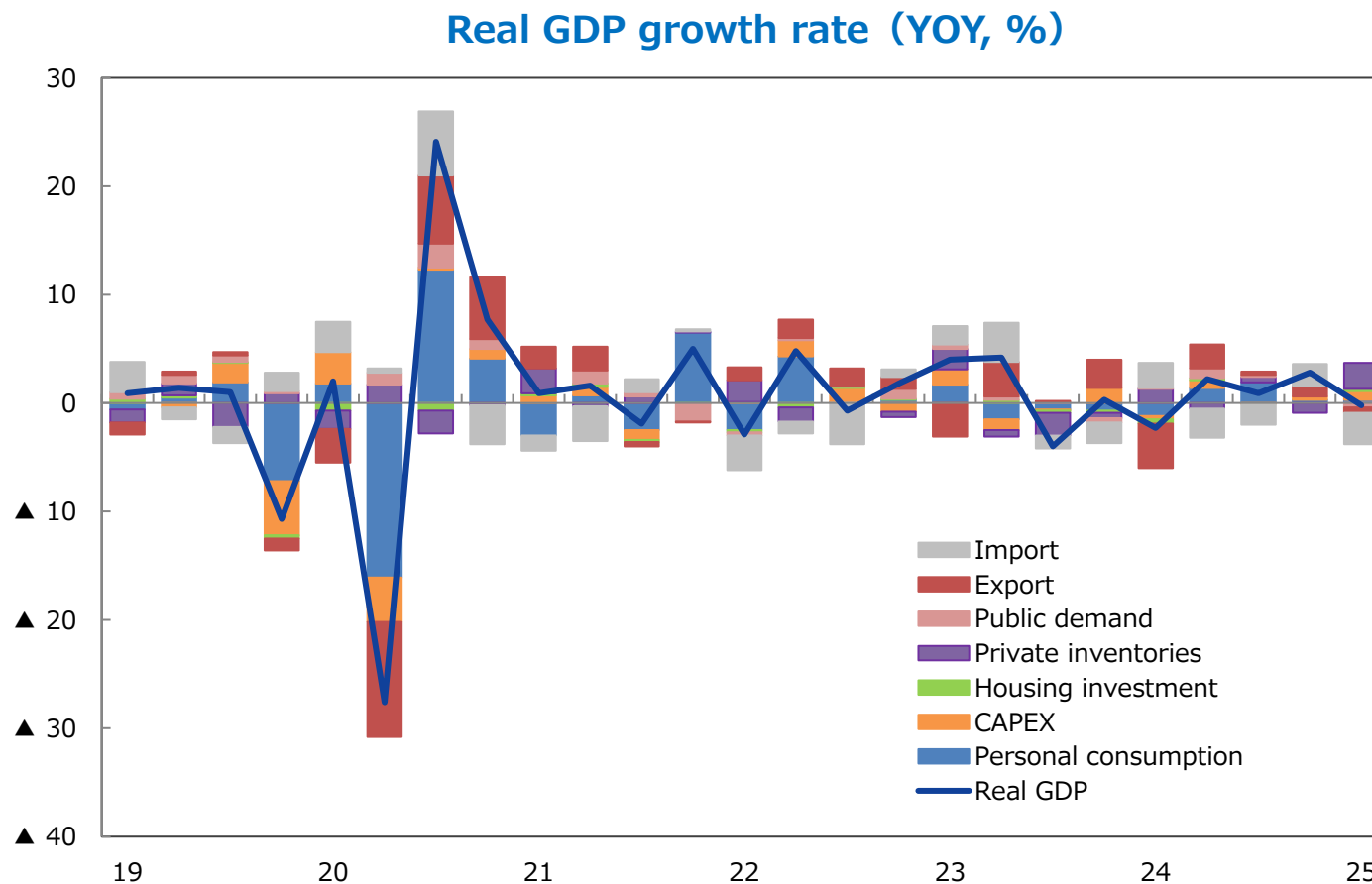
Forecast of annual Real GDP growth and its breakdown						
Fiscal Year	FY21	FY22	FY23	FY24	FY25 Est	FY26 Est
Real GDP	3.0%	1.3%	0.6%	0.8%	0.3%	0.6%
Private final consumption expenditure	1.8%	2.6%	-0.4%	0.8%	0.8%	0.8%
Private housing investment	0.3%	-2.6%	0.8%	-1.0%	-0.7%	-1.4%
Private-sector capital investment	3.2%	3.6%	-0.1%	2.4%	0.8%	0.8%
Private inventory investment	0.5%	0.0%	-0.3%	0.1%	0.2%	0.0%
Public fixed capital formation	-6.4%	-5.5%	-0.3%	1.3%	-0.4%	0.6%
Net export contribution	0.8%	-0.6%	1.4%	-0.4%	-0.6%	-0.1%
Exports of goods and services	12.5%	5.0%	3.1%	1.7%	0.0%	1.1%
Imports of goods and services	7.3%	7.4%	-2.7%	3.5%	2.8%	1.8%
Nominal GDP	2.9%	2.3%	4.9%	3.7%	3.0%	2.4%
GDP deflator	-0.1%	0.9%	4.2%	2.9%	2.6%	1.8%
Industrial Production Index	5.6%	-0.3%	-1.9%	-1.4%	-0.9%	0.8%
Consumer Price Index (Core)	0.1%	3.0%	2.8%	2.7%	2.6%	1.6%
Consumer Price Index (BOJ Core)	0.1%	3.0%	2.8%	2.7%	2.8%	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%	3.4%	3.2%
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 July 25th, 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

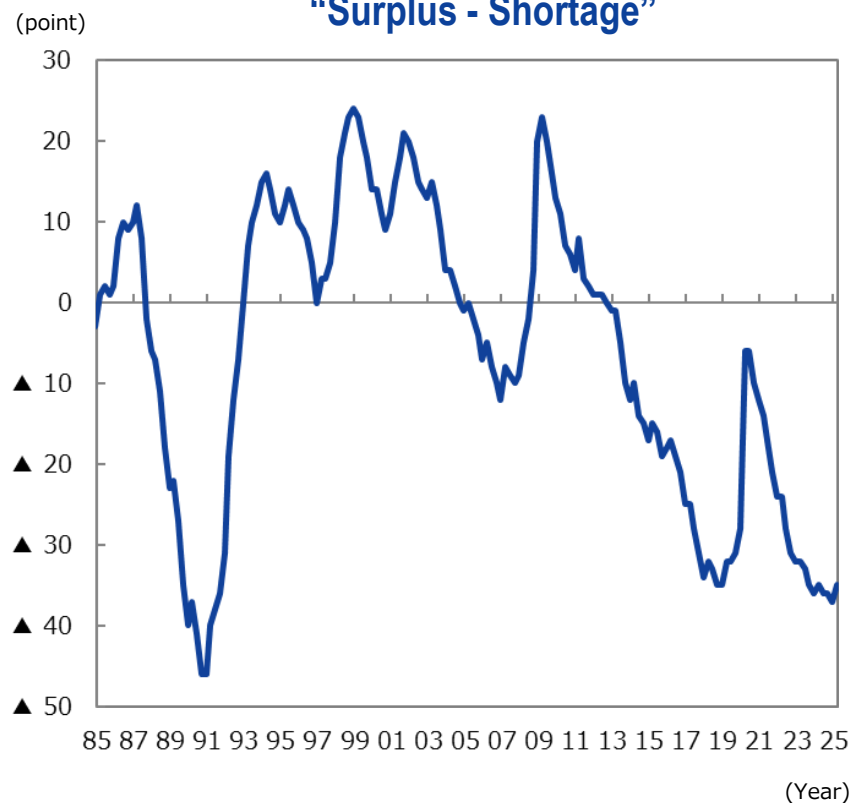
Inflation and Global Economic Fears Weigh on the Japanese Economy



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

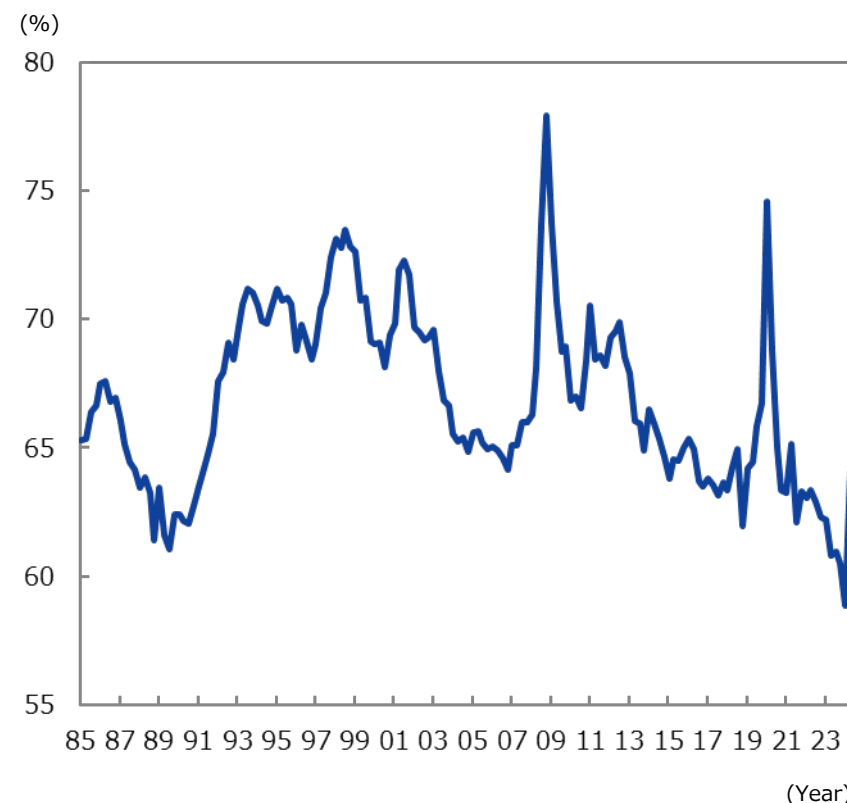
Conundrum of the Japanese Labor Market

Employment Sufficiency Index “Surplus - Shortage”



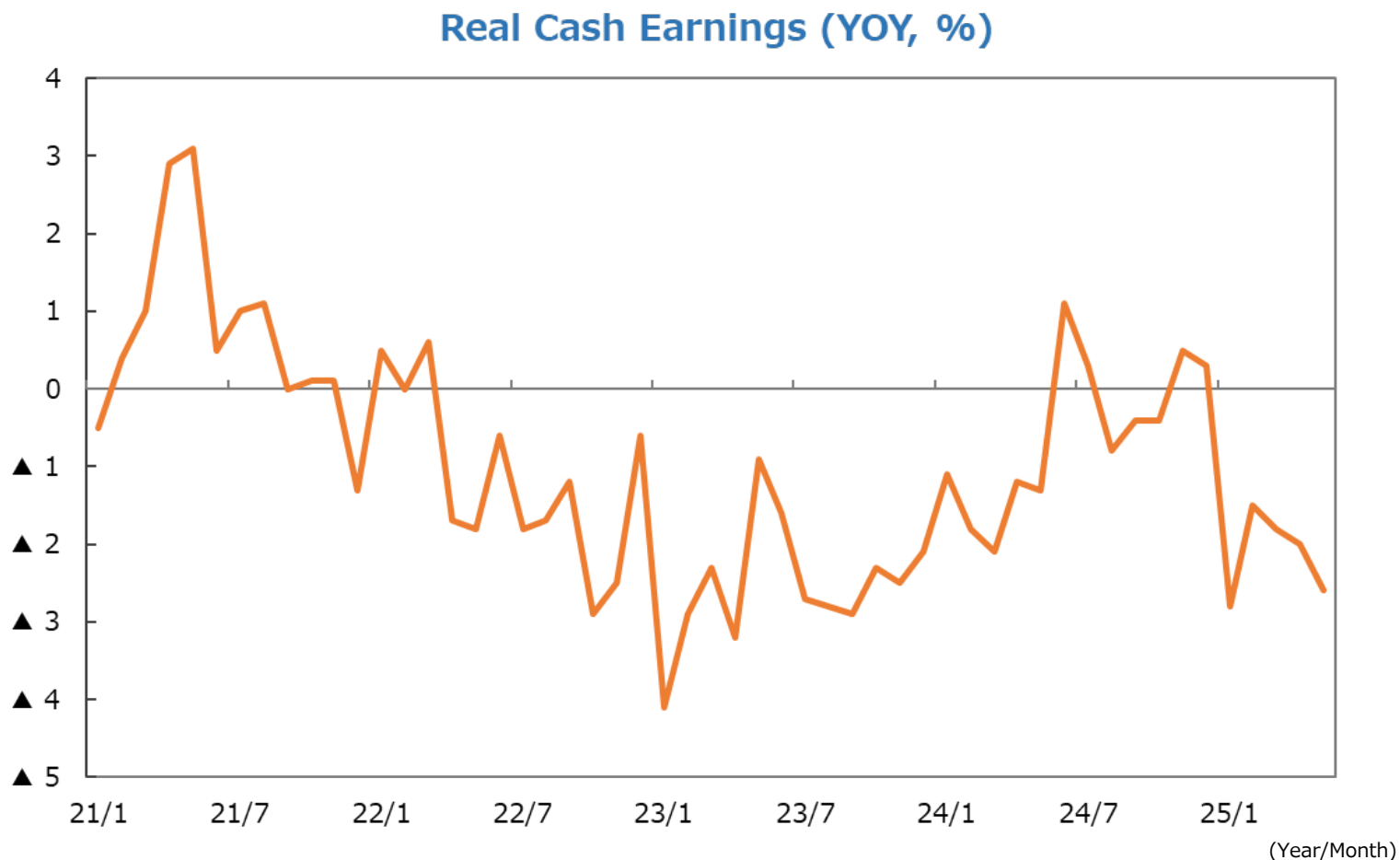
Note: Data is from April 1985 to June 2025.
Source: The bank of Japan, SMDAM

Labor Share of Added Value



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

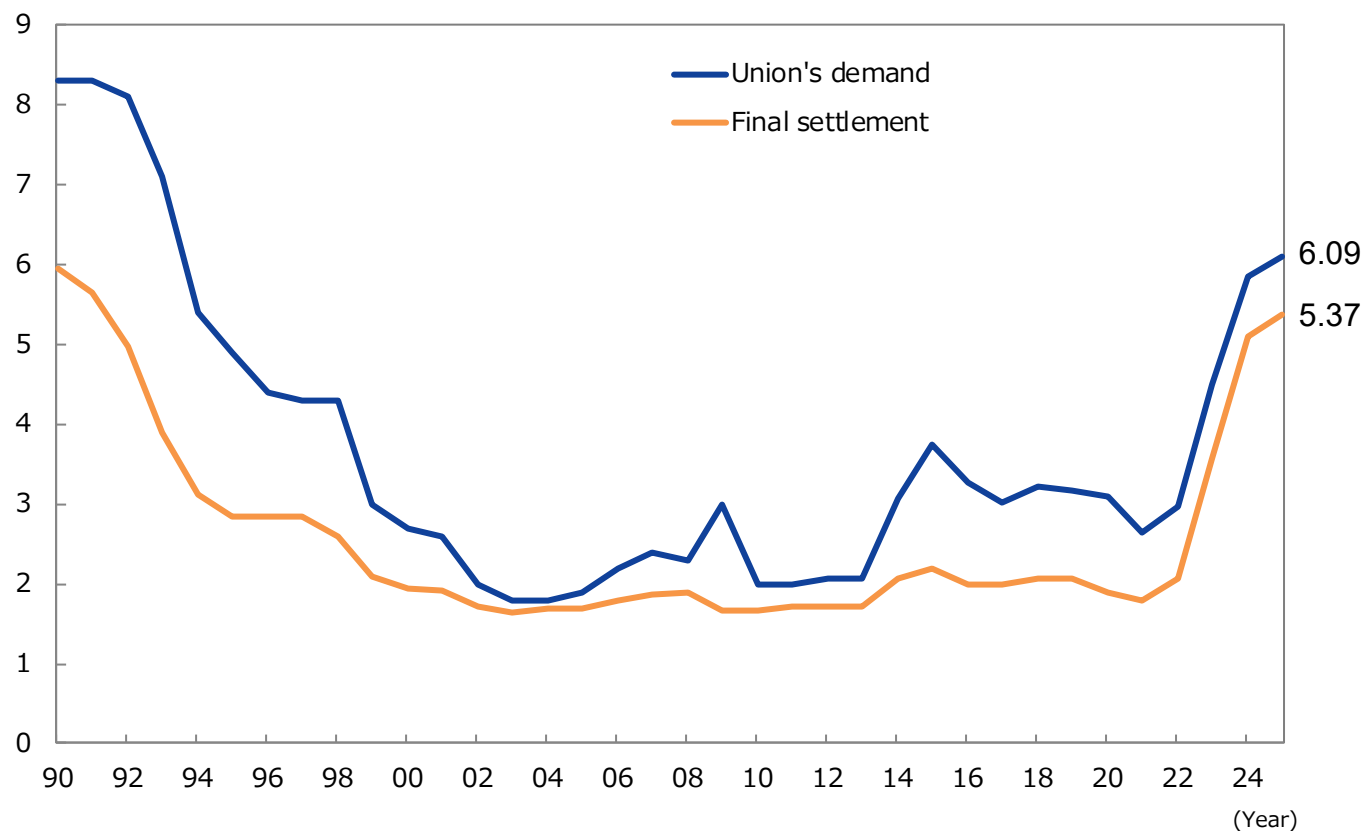
Inflation Eroding Consumers' Purchasing Power



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

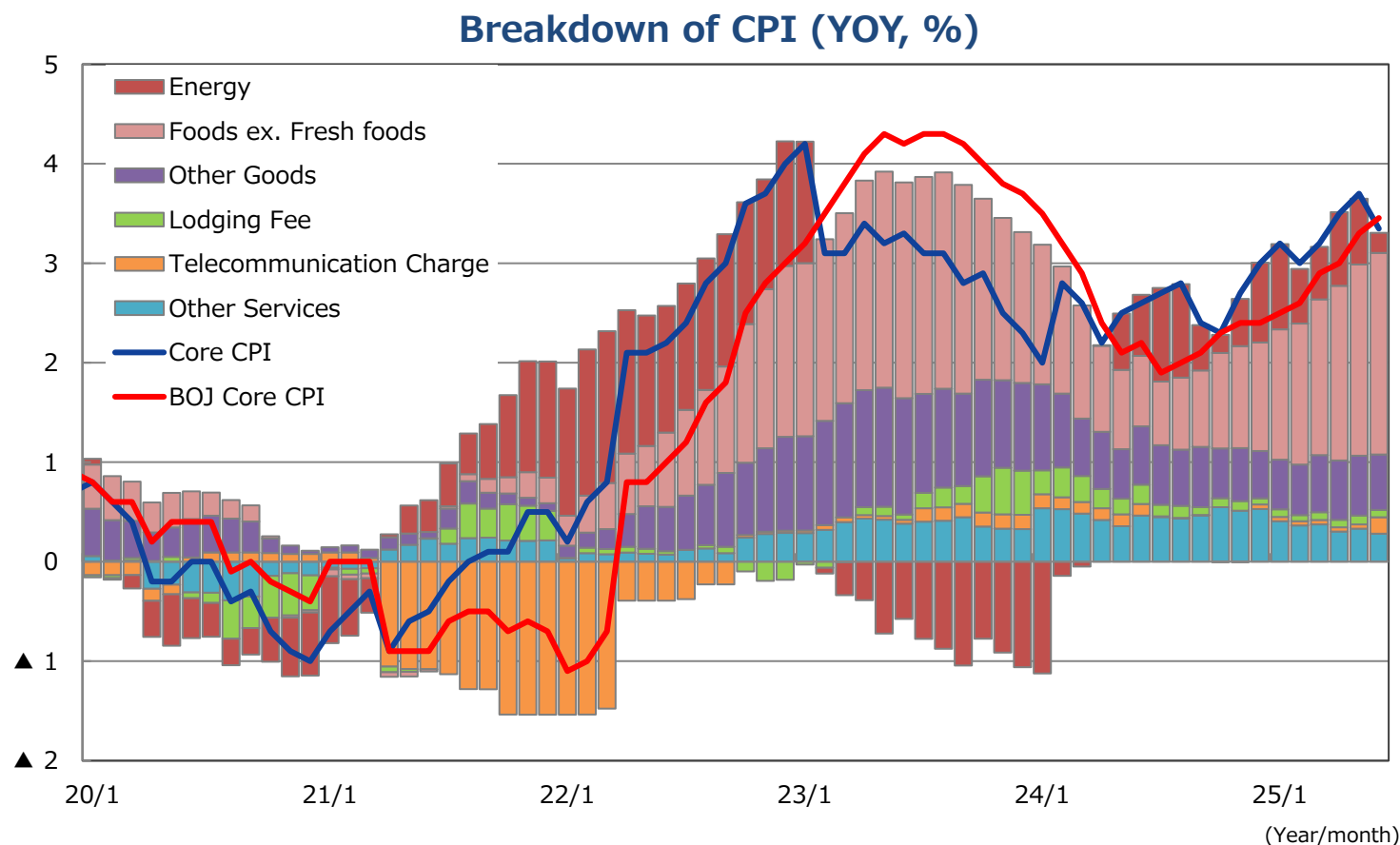
Highest Wage Increase in 33 Years

Wage increase (YOY, %)



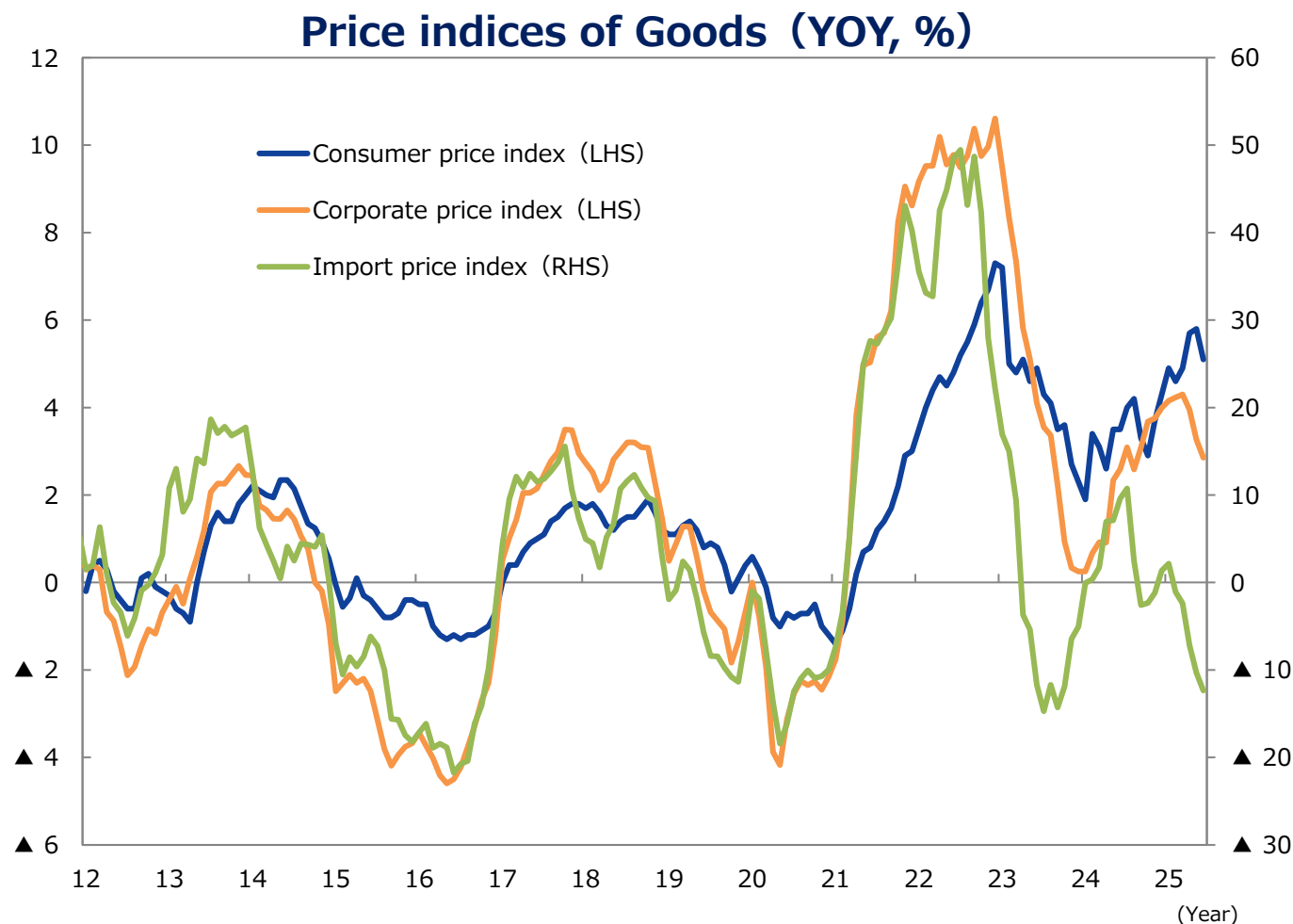
Note: Data is from FY 1990 to FY 2025.
Source: Japanese Trade Union Confederation, SMDAM

Rising Food Prices Push CPI Higher



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

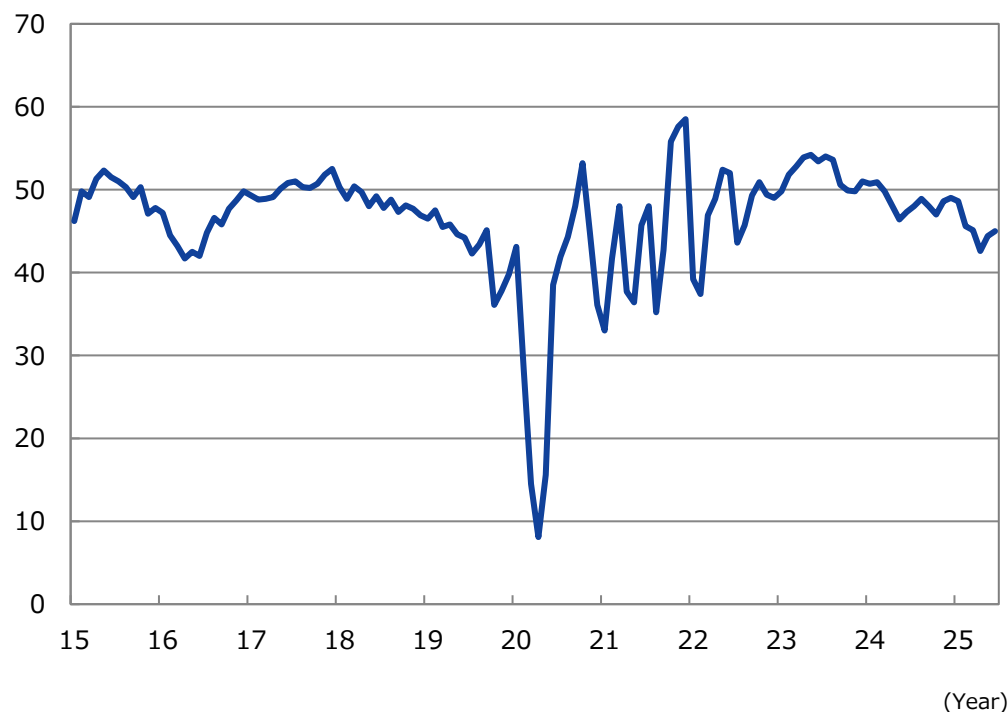
Rising CPI and Falling Import Prices Boost Profit Margin of Importers



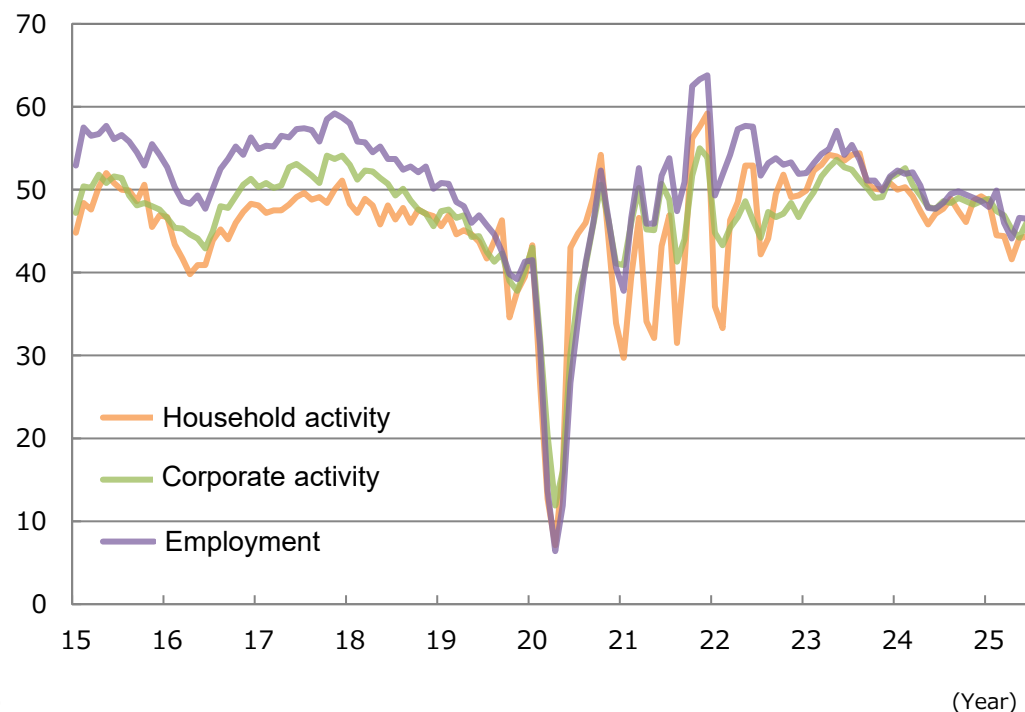
Note: Data is from January 2012 to June 2025.
Source: MIAC, Bloomberg, SMDAM

Growing Unease with Slowing Economy and Higher Inflation

DI for Current Economic Conditions



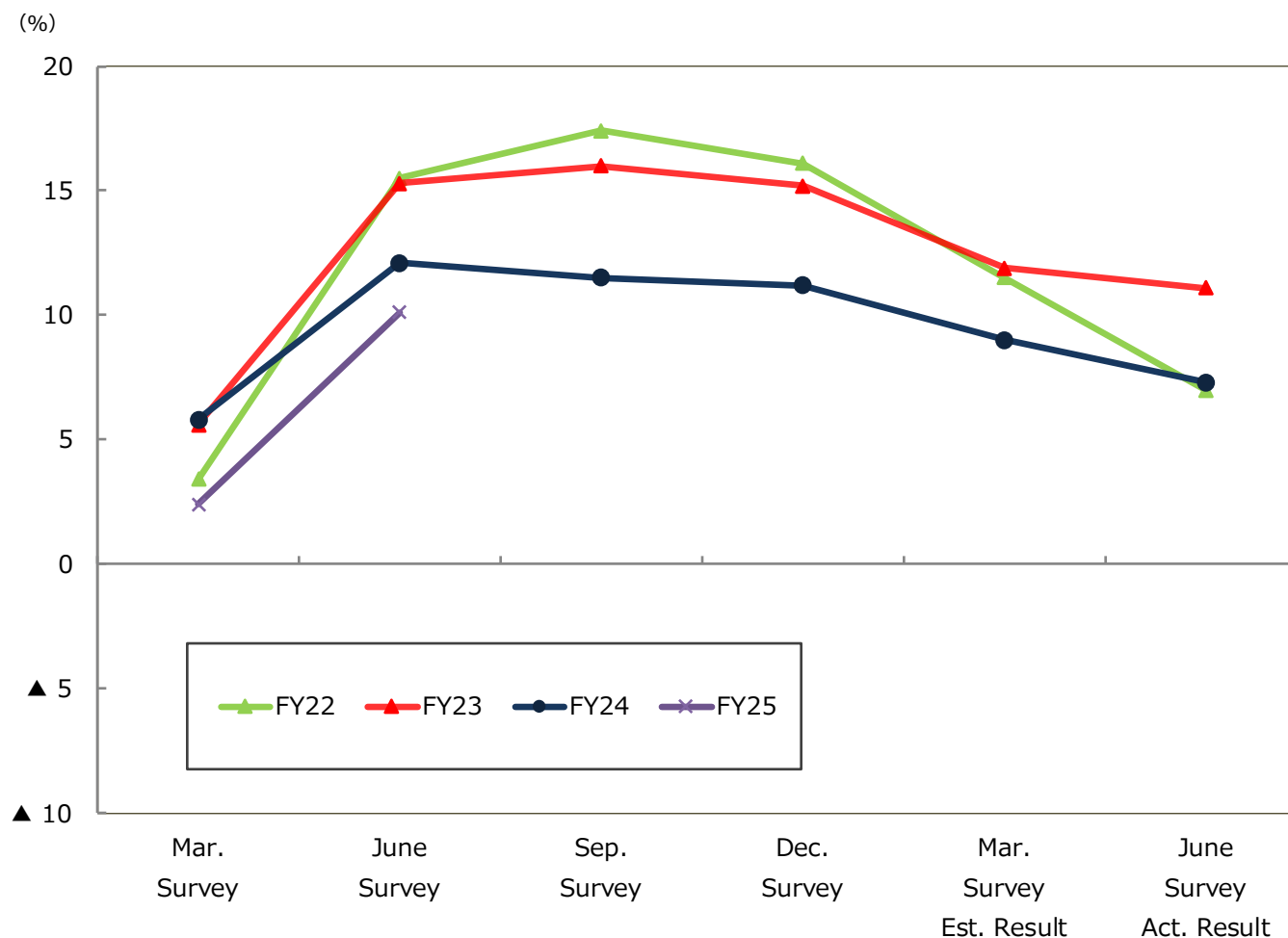
Breakdown of DI for Current Economic Conditions



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

Receding Uncertainty Lifts CAPEX Appetite Going Forward

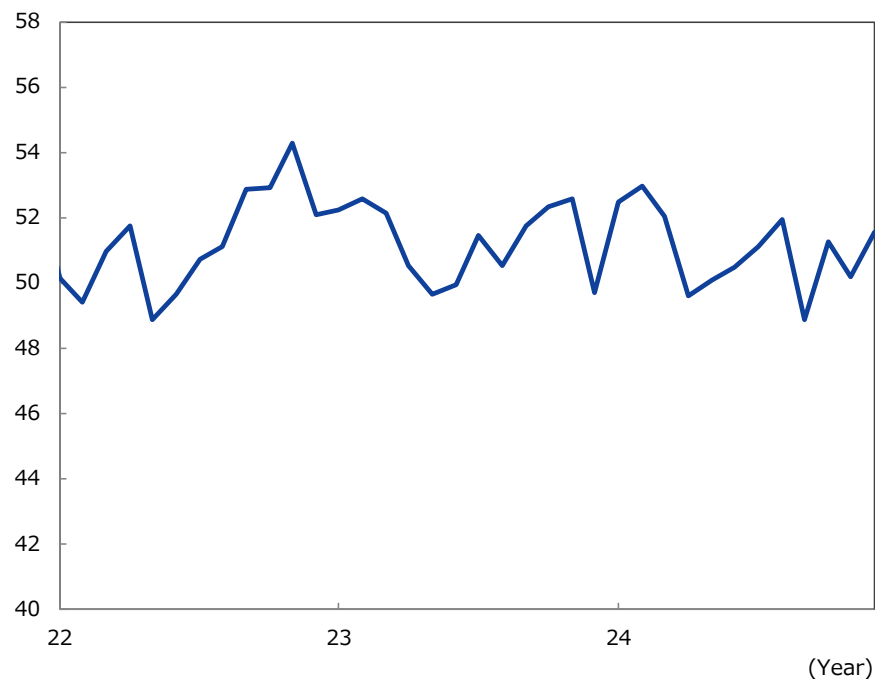
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



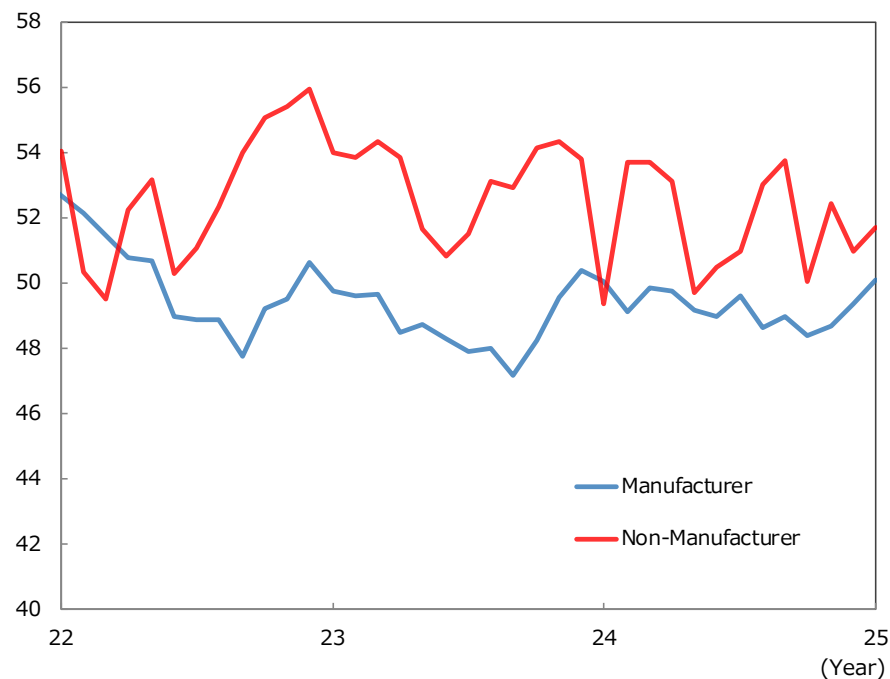
Note: Data is from Q1 FY2022 to Q2 FY2025.
Source: The Bank of Japan, SMDAM

Business Sentiment Bottoming Out but Still Lackluster

Composite PMI(%pt)

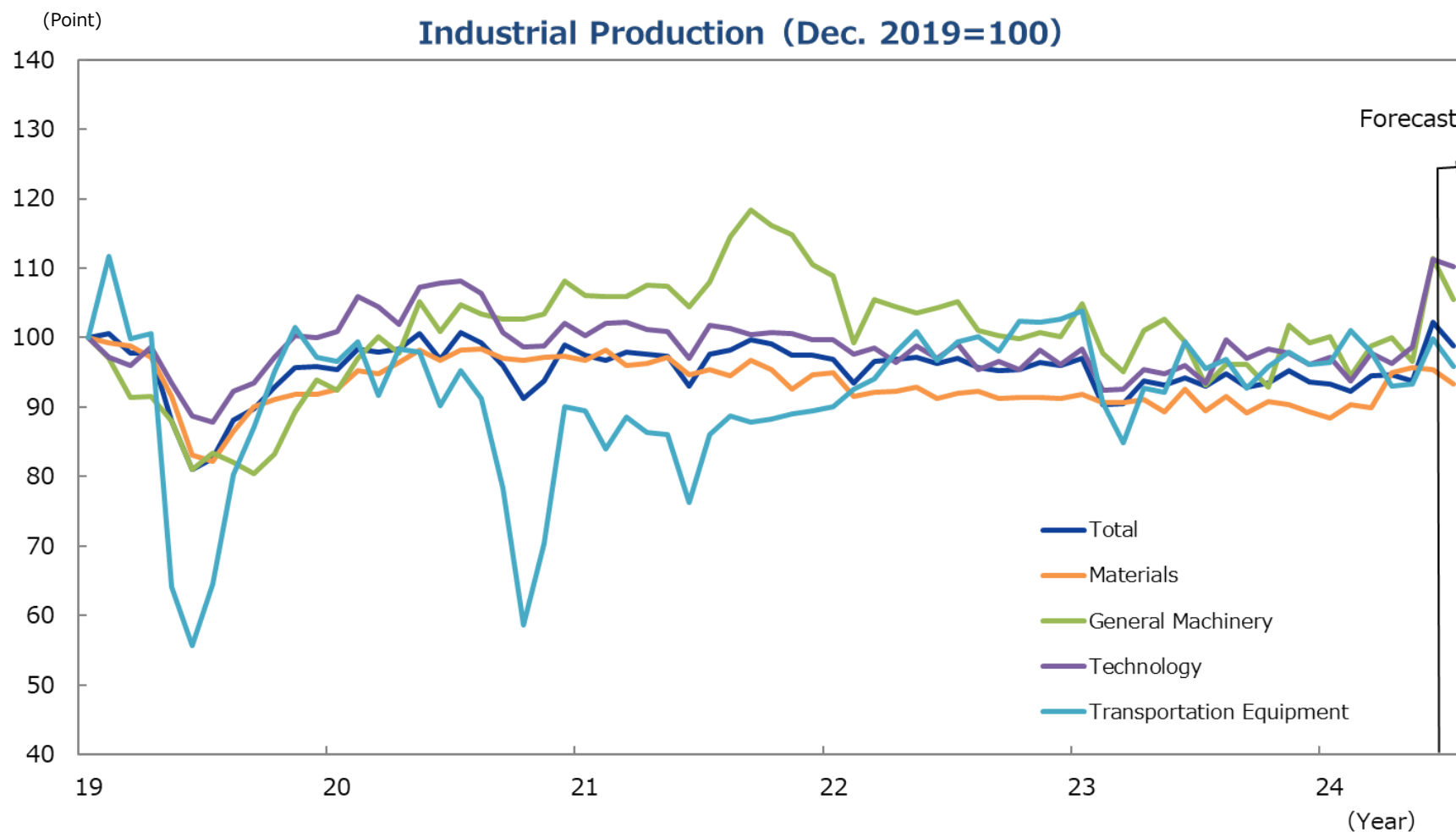


PMI, Manufacturer & Non-Manufacturer(%pt)



Note: Data is from July 2022 to June 2025.
Source: Bloomberg, SMDAM

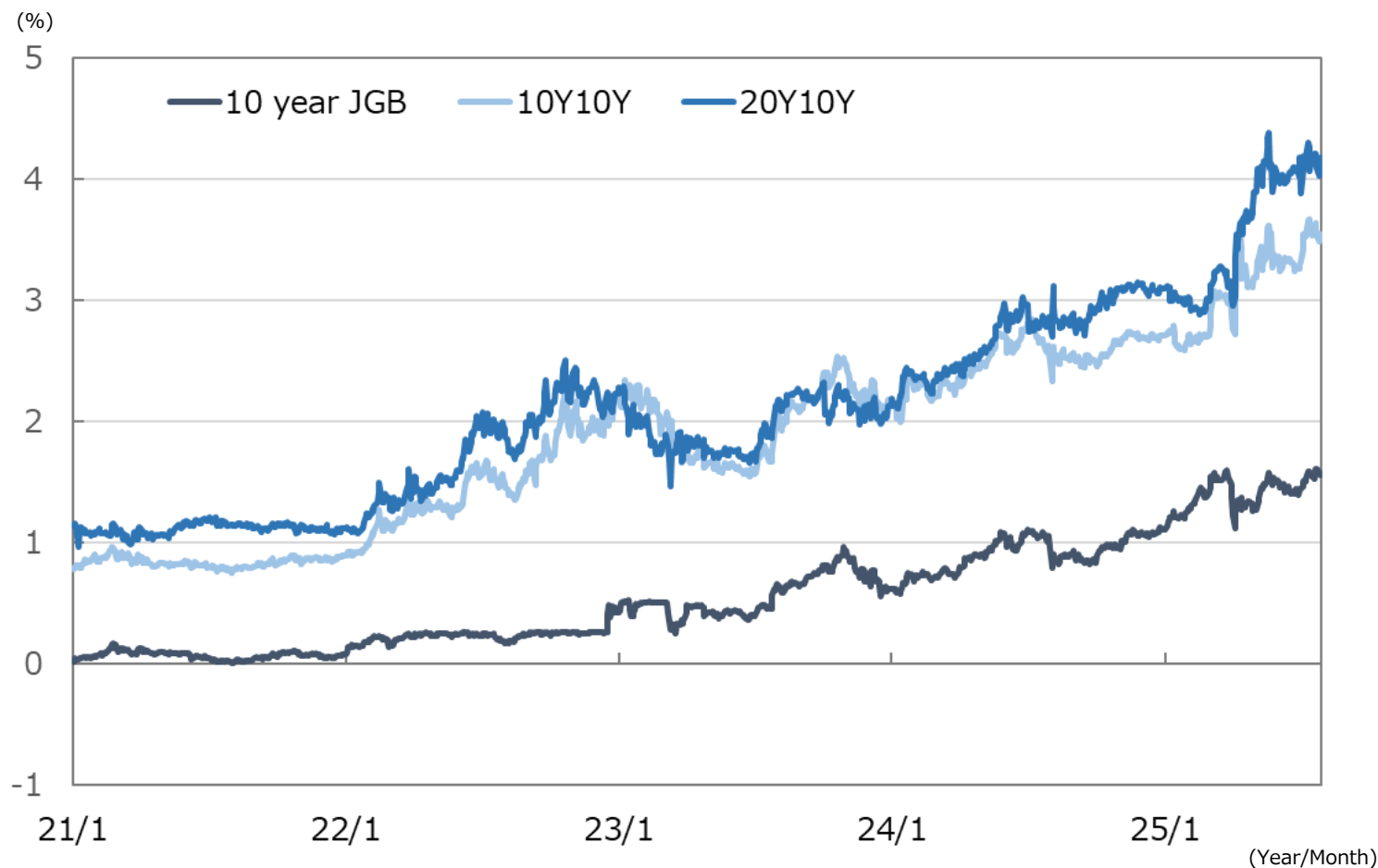
Industrial Production Expected to Slow Down in the Near Future



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

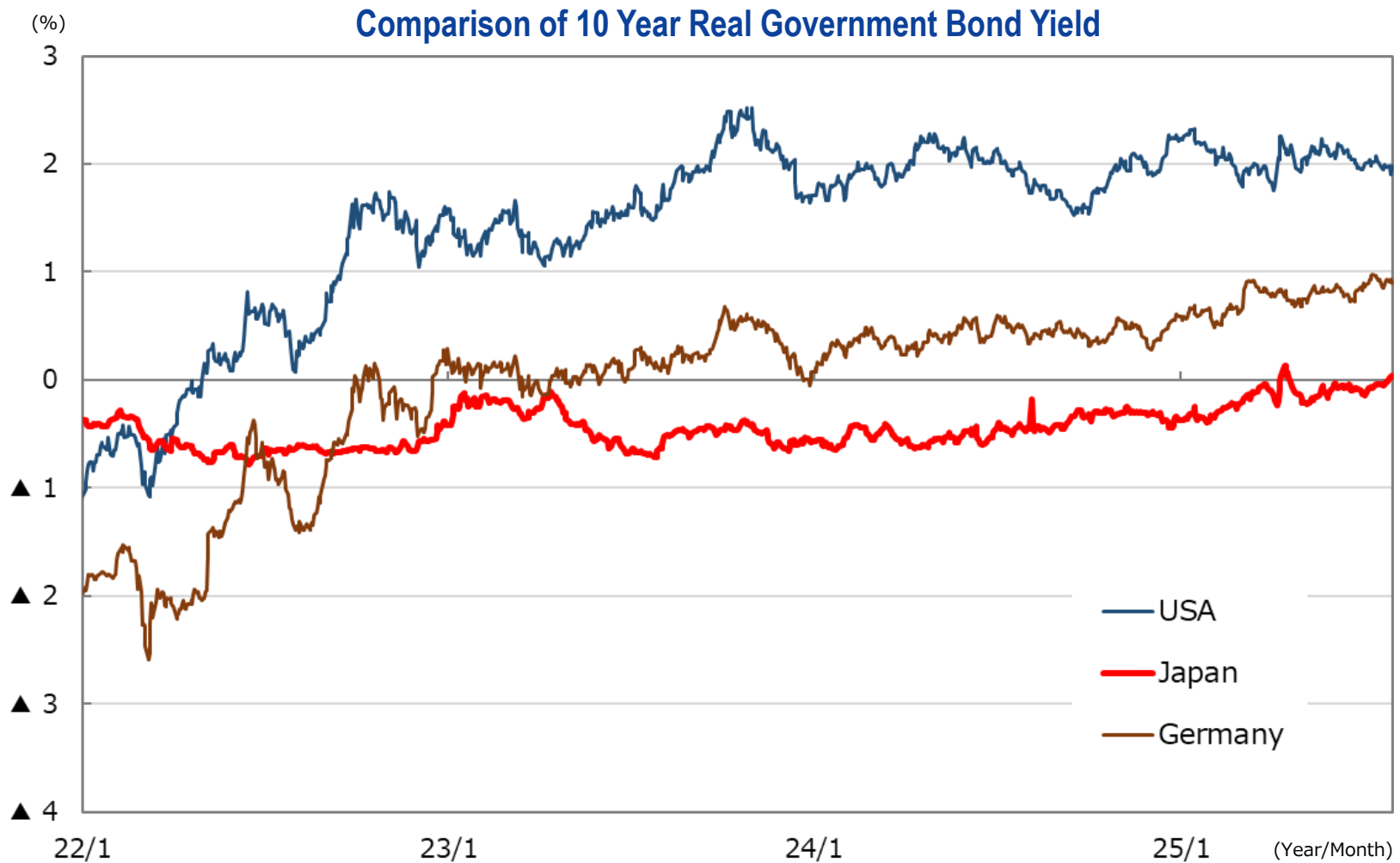
Ultra-Long FRA Rates Surge to Exceptionally High Levels

10 year Japanese Bond Yield, 10Y10Y, and 20Y10Y



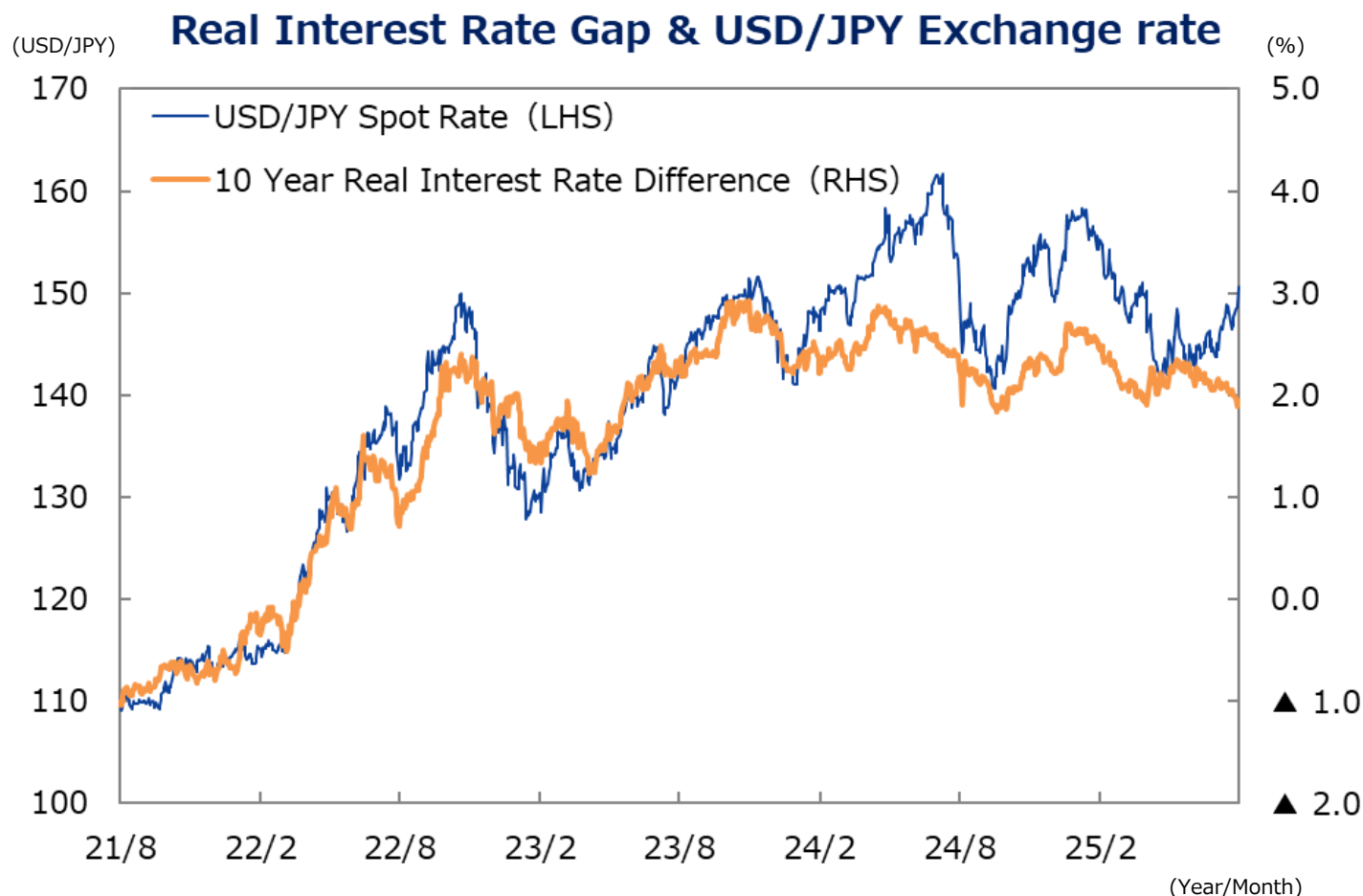
Note: Data is from 4th January 2021 to 31st July 2025.
Source: Bloomberg

Real 10 Year JGB Yield Becomes Positive Again



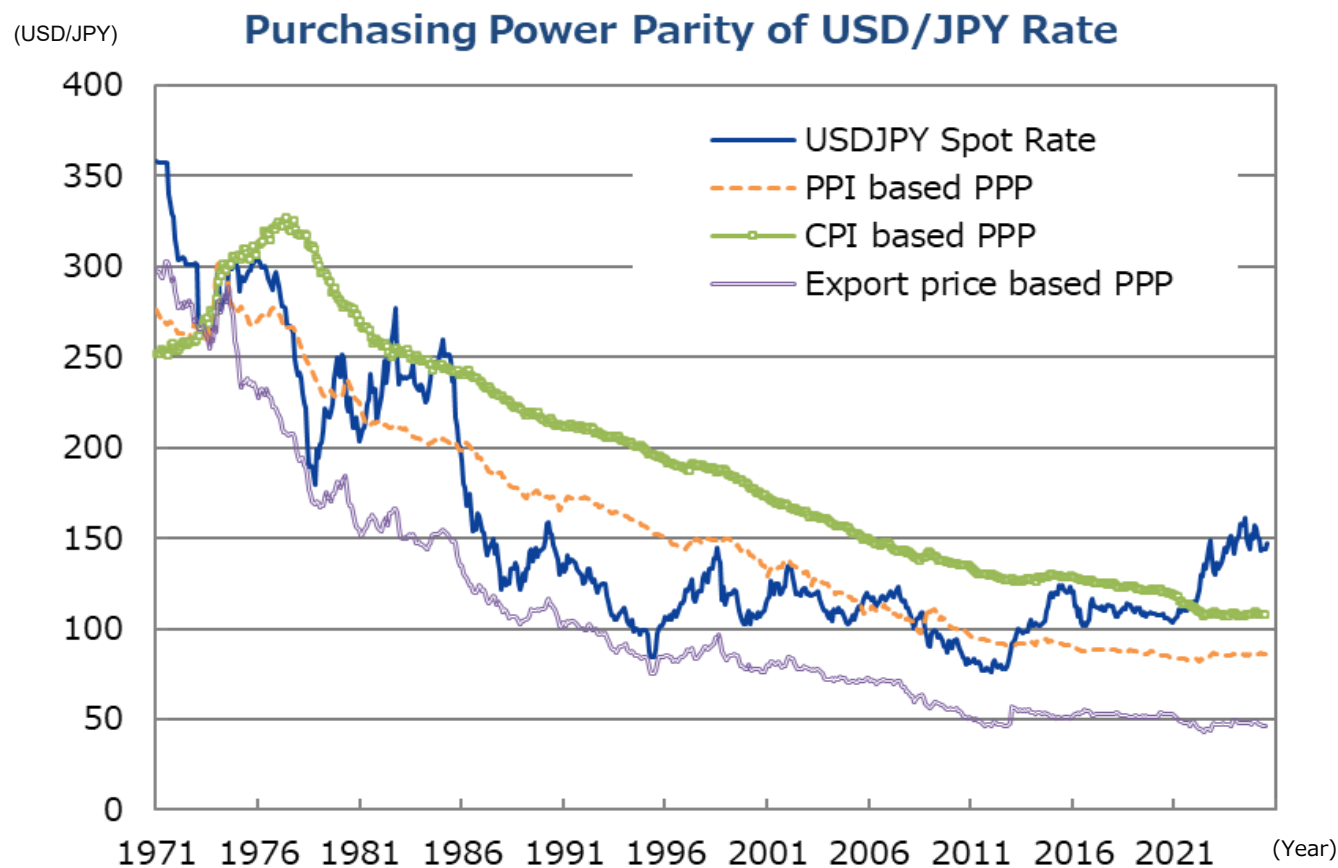
Note: Data is from 1st January 2022 to 31st July 2025.
Source: Bloomberg

Gap Between Interest Rate Difference and Dollar/Yen Widening Again



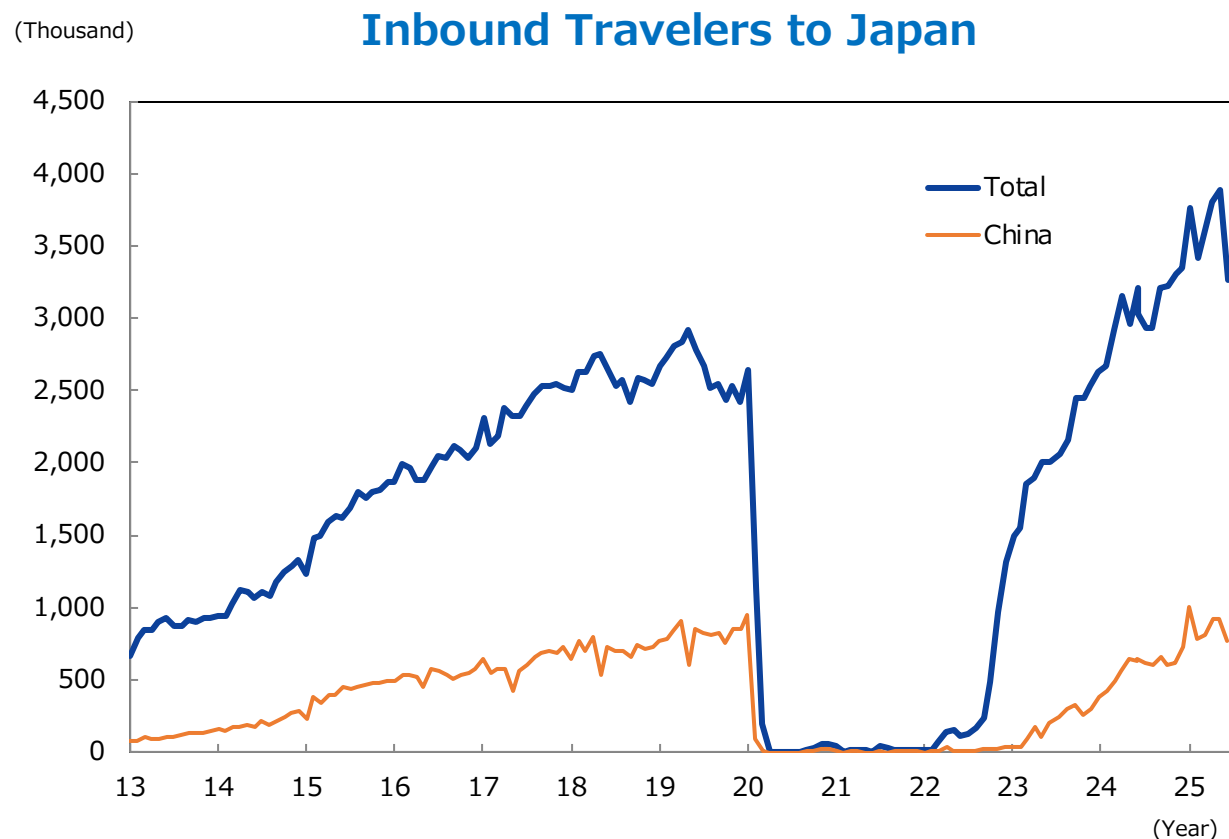
Note: Data is from 1st August 2021 to 31st July 2025.
Source: Bloomberg

PPP Still Suggests Overvaluation of Dollar/Yen Rate



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

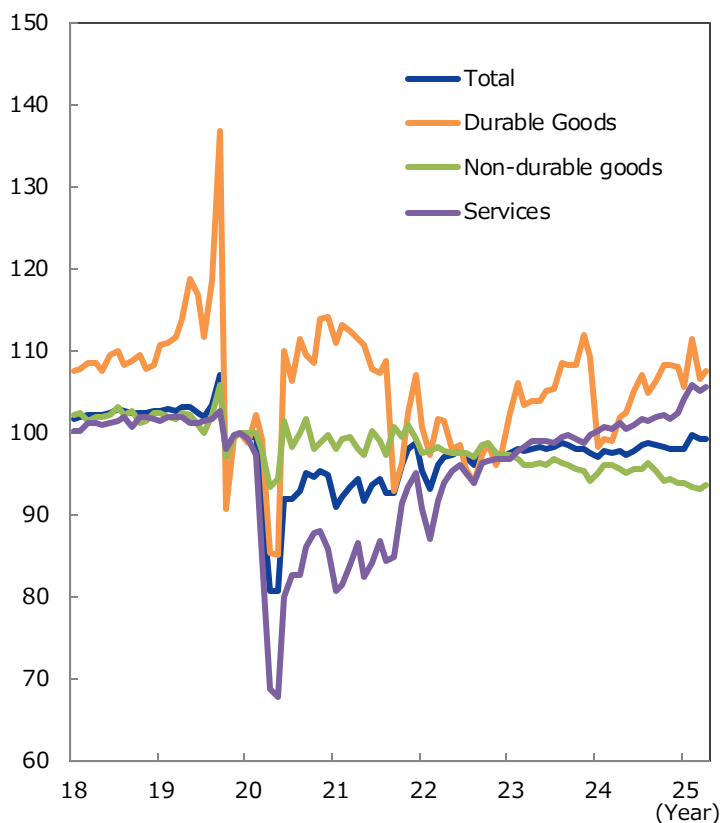
Inbound Travel in June Hit Record High for the Particular Month



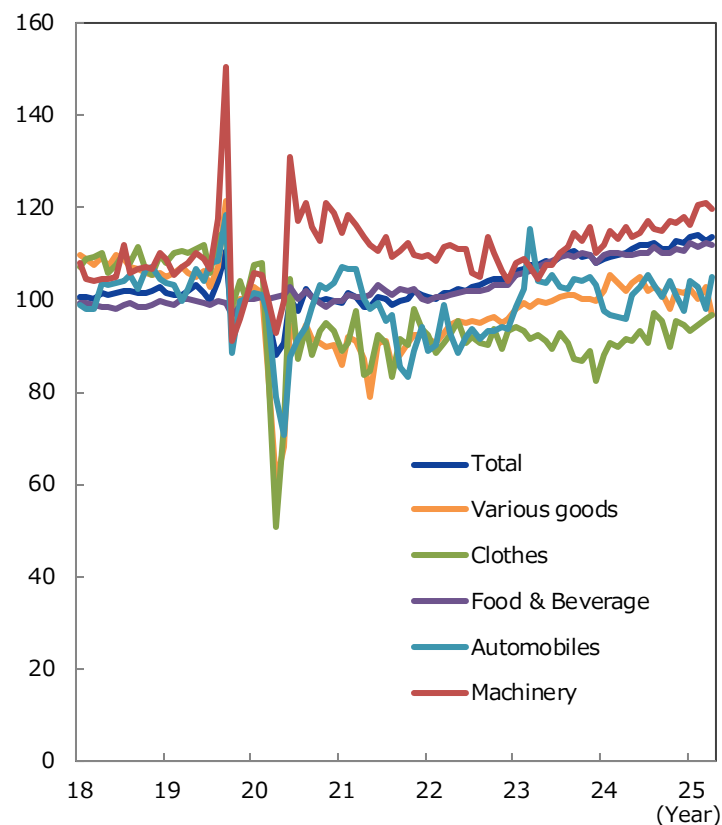
Note: Data is from January 2013 to June 2025. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Consumer Activities are Mixed due to Weak Real Income

Consumer Activity Index (Dec. 2019 = 100)



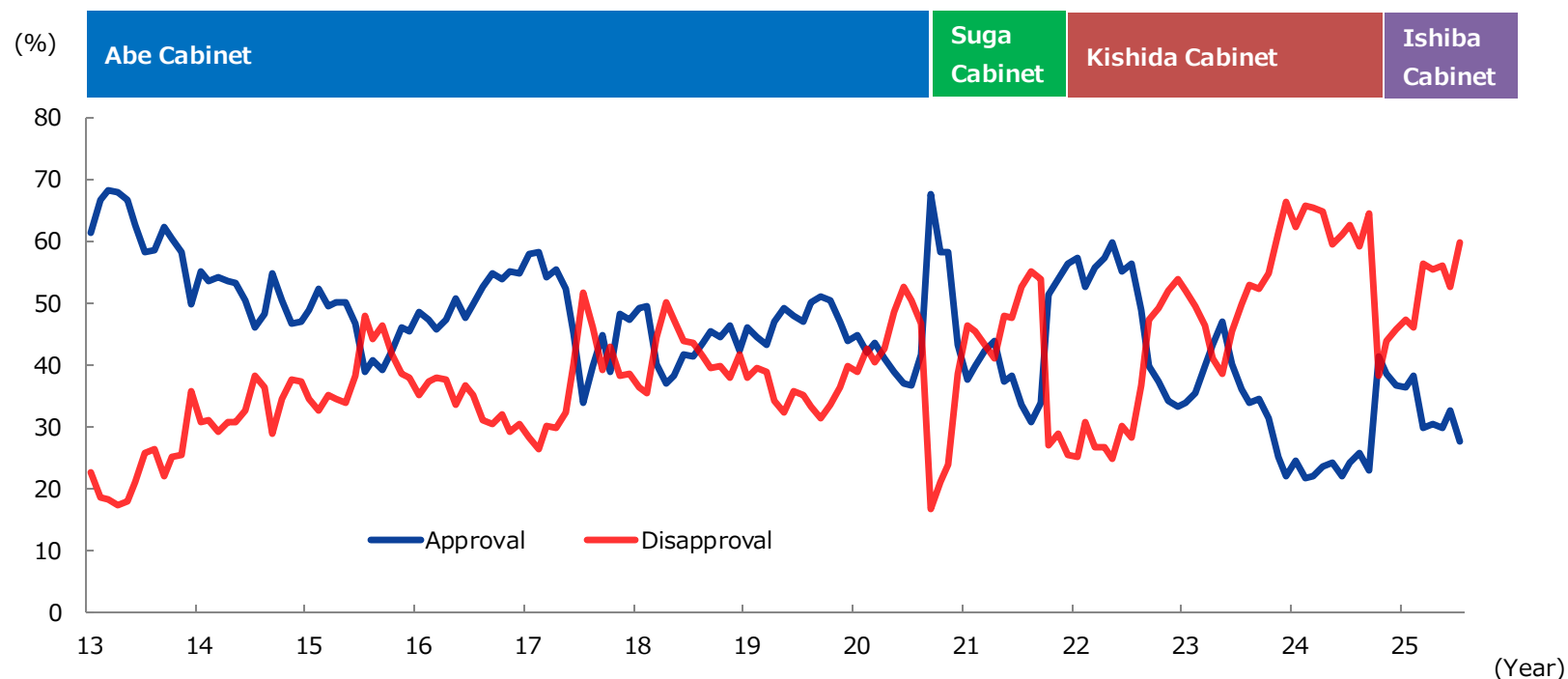
Retail Sales (Dec. 2019 = 100)



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

PM Ishiba and Ruling LDP Suffer from Falling Approval Ratings

Cabinet approval rate



Note: Data is from January 2013 to July 2025.

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

Schedule of Major Events

Year	Month	Date	Event
2025	August	15	Release of 2025 Q2 GDP
	Septemebr	8 18-19	Revision of 2025 Q2 GDP Monetary Policy Meeting
	October	29-30	Monetary Policy Meeting
	November	17	Release of 2025 Q3 GDP Cabinet approval of economic measures
	December	8 18-19	Revision of 2025 Q3 GDP Monetary Policy Meeting Cabinet approval of the initial budget for FY 2026 and the outline for tax reform
2026	January		Ordinary Diet Session Monetary Policy Meeting
	February		Release of 2025 Q4 GDP
	March	31	Revision of 2025 Q4 GDP Release of the results of spring negotiations of Trade Union Confederation Monetary Policy Meeting Enactment of the FY 2026 budget and tax-related bills Expiration of the term of the Bank of Japan's Noguchi Policy Board member
	April		Monetary Policy Meeting
	May		Release of 2026 Q1 GDP
	June	29	Revision of 2026 Q1 GDP Cabinet's decisions on "Big-boned policy" Monetary Policy Meeting G7 Summit End of the ordinary Diet session Expiration of the term of the Bank of Japan's Nakamura Policy Board member

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

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