

Japan Investment Commentary and Market Outlook

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Market Movement	As at 30/01/2026
TOPIX Index	3,566.32 points (+4.6%)
Nikkei 255 Stock Average	53,322.85 yen (+5.9%)
Exchange rate	1 USD =154.78JPY

Japanese equities outperformed global markets in January, supported by resilient risk appetite and renewed policy momentum following speculation that Prime Minister Takaichi might dissolve the Lower House. This drove broad positioning around the “Takaichi trade,” particularly in defence, advanced materials, and investment-related sectors. Although China’s tightening of dual-use export controls, proposals for consumption-tax cuts, and a brief bout of yen appreciation following reported exchange-rate checks created temporary volatility through higher long-term yields and pressure on exporters, overall market conditions remained firm.

Domestic sentiment indicators, including the Economy Watchers Survey and the BOJ Opinion Survey, show improving forward expectations, supported by steady tourism demand despite fewer Chinese visitors, firmer household growth sentiment, rising real incomes supported by solid wage gains, and continued productivity-oriented investment amid labour shortages.

Note: Rates of increases and decreases are reflected in the performance of stock indices.

The decisive 8 February general election, which delivered an LDP single-party majority and a two-thirds majority for the ruling coalition, strengthened expectations for policy stability and faster execution of “Sanaenomics,” including investment promotion, defence-budget expansion, and possible zero-rating of the consumption tax on food and beverages.

Corporate earnings remain solid, with most TSE Prime Market companies reporting revenue and operating profit growth for the October–December quarter. Based on IBES consensus, FY2027 EPS of 248 implies TOPIX levels of around 4,000 at a 16× multiple and roughly 4,200 at 17×, assuming stable global conditions and no sharp yen appreciation. Investors will now watch the pace of the administration’s policy rollout, the trajectory of real wages, and the durability of corporate actions supporting the market’s re-rating.

Market Review

Japanese equities delivered a strong outperformance relative to global markets in January. The TOPIX rose 4.6% and the Nikkei 225 gained 5.9%, clearly exceeding the S&P 500's 1.4% increase and the STOXX 600's 3.2% rise. This performance reflected resilient risk appetite and a renewed sense of policy momentum, following speculation emerged on 9 January that Prime Minister Takaichi might dissolve the Lower House. The subsequent formation of a "Takaichi trade" drove broad-based strength across sectors, particularly in defence, advanced materials, semiconductors, and domestic investment beneficiaries.

The market nevertheless faced several countervailing developments. Early in the month, China's abrupt tightening of dual-use export controls on 6 January triggered a brief sell-off. Later in the month, proposals for consumption-tax reductions introduced both by a newly established centrist opposition alliance and by the Prime Minister herself raised concerns over unfunded fiscal expansion, pushing long-term yields higher and weighing on equity sentiment. On 23 January, reports that Japanese and US authorities had conducted coordinated exchange-rate checks prompted a short-lived bout of yen appreciation. This created a modest near-term headwind for exporters, although stabilisation in domestic yields provided a partial offset. Towards month-end, intervention concerns gradually eased, but profit-taking in AI-related names capped gains and left the overall market somewhat heavy despite otherwise resilient underlying conditions.

Macroeconomic environment

High-frequency data indicate a divergence between current sentiment and expectations. The Economy Watchers Survey for late December revealed a decline in the current conditions diffusion index, while the outlook index improved. Despite continued upward pressure on prices, there is little evidence that consumers' willingness to spend has materially weakened. The number of Chinese visitors has fallen amid deteriorating bilateral relations; however, tourism-related demand as a whole has remained robust. The BOJ's Opinion Survey similarly signals an improvement in consumer sentiment. Respondents have shown a more positive outlook regarding Japan's future growth potential, with an increase in those expecting higher growth and a

decline in those anticipating weaker growth. This has led to a notable narrowing of the negative Growth Potential DI and suggests a gradual strengthening of household growth expectations.

Against this backdrop, domestic economic conditions are expected to continue to be supported primarily by internal demand. Real incomes are being lifted by relatively strong wage settlements, while firms are pursuing labour-saving and productivity-enhancing investment in response to persistent labour shortages. Government measures aimed at mitigating the impact of high prices and providing incentives for capital expenditure also remain supportive. As a result, both private consumption and business investment are likely to remain key pillars of Japan's economic trajectory.

Inflation and Monetary Policy

Japan's core CPI (excluding fresh food) rose 2.4% year-on-year in December, representing a moderation to the mid-2% range. The slowdown can be attributed to declines in electricity, city gas, and gasoline prices, as well as reduced price momentum in food categories excluding fresh produce, including rice.

At its January meeting, the BOJ kept the policy rate unchanged at 0.75%. In its Outlook Report, the BOJ revised upward its projections for both FY2026 GDP growth and the inflation outlook. While headline CPI is expected to temporarily fall below 2% in the first half of this year due to government measures, the BOJ now assesses that the underlying inflation trend is likely to rise moderately—an upward revision from its previous view that inflation would "lose some momentum." The BOJ also noted that the recent depreciation of the yen could present upside risks to underlying inflation. The BOJ emphasised that the real policy rate remains highly accommodative and reiterated its intention to raise rates gradually as economic and price conditions evolve. Incorporating BOJ communication, the Tankan survey, and regional hearings, our Economic Research team expects rate rises to continue at roughly semi-annual intervals. Market pricing increasingly reflects the possibility of a move by April, although the risk of earlier tightening—should the yen depreciate rapidly—requires continued monitoring.

Market Outlook

The general election held on 8 February resulted in the Liberal Democratic Party securing a single-party majority, while the ruling coalition obtained a two-thirds majority in the Lower House. This outcome significantly strengthened the Takaichi administration's political foundation and has led to rising expectations that it may develop into a long-term government. In response, the equity market rallied immediately after the election, as investors anticipated policies aimed at enhancing Japan's supply capacity, including investment promotion measures, an expanded defence budget, and a proposal to reduce the consumption tax on food and beverages to 0%. Meanwhile, both the yen and long-term interest rates remained stable, suggesting that markets interpreted the policy implications in an orderly manner.

During the campaign, attention centred on how a potential consumption-tax reduction would be funded. Prime Minister Takaichi has stated that the matter will be examined by a newly created cross-party National Council. She also indicated that the government intends to rely on non-tax revenues and is not assuming the issuance of deficit-financing bonds. Post-election stability in both the foreign-exchange and JGB markets suggests that investors did not view the fiscal stance as excessively expansionary.

Since taking office in autumn 2025, Prime Minister Takaichi has accepted the BOJ's gradual normalisation of monetary policy. Her campaign comments perceived as welcoming a weaker yen attracted criticism, reinforcing her awareness of public dissatisfaction with yen depreciation. For this reason, we expect her administration to continue accepting a gradual rise in interest rates, though signals of any potential deviation from this stance should be monitored carefully.

Supported by political stability following the LDP's decisive victory, rising expectations for the acceleration of "Sanaenomics," resilient corporate earnings, continued progress in corporate reform, and the entrenchment of inflation, we maintain a constructive view on the equity market.

With approximately 60% of Tokyo Stock Exchange Prime Market companies having reported their October–December 2025 results, revenue growth and rising operating profits point to broadly solid corporate performance. According to IBES consensus forecasts, TOPIX EPS is expected to grow 6.6% in FY2025, 12.2% in FY2026, and 10.1% in FY2027. Equity markets typically discount earnings 12 months ahead.

Applying a 16× price-earnings ratio to the FY2027 consensus EPS of 248 implies a TOPIX level around 4,000, while a 17× multiple suggests a plausible upside scenario in which the index approaches 4,200 within this year. These valuation benchmarks assume a stable global economy, no extreme yen appreciation, and a balanced outlook for US equities.

Attention will now turn to the content and execution speed of the administration's growth and fiscal policies, the trajectory of real wages amid elevated living costs, and the sustainability of corporate actions that have supported the market's re-rating.

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