The attractiveness of Japanese stocks under PM Takaichi

Analysis of macro and micro factors, including corporate governance, points to upside potential ongoing in listed Japanese companies

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Considering the macro environment, the Japanese economy is expected to continue its gradual recovery, supported by rising private consumption driven by increases in real wages and robust capital investment.

Corporate earnings remain solid and it is anticipated that wage increases will remain at a relatively high level driven by tight labour market conditions. Furthermore, capital investment is expected to continue its upward trend.

As labour shortages intensify, companies are expected to maintain aggressive capital investment strategies, aimed at enhanced productivity through labour-saving measures and digital transformation (DX). The Takaichi administration's tax breaks for capital investment are also expected to boost corporate willingness to invest.

The Liberal Democratic Party (LDP) secured a historic landslide victory in the Lower House election on 8 February 2026. Given the strengthening of prime minister Takaichi's influence within the LDP and the improved environment for the swift implementation of the administration's policies, Japan's political stability has increased. Fiscal expansionary policies are likely to continue.

"Measures to combat high prices (inflation control and expansion of consumer demand)" and "crisis management investment (strategic investment in AI, semiconductors, defence, energy, and security sectors)" are expected to stimulate corporate investment, government spending, and personal consumption.

Upward pressure on crude oil prices caused by concerns over the situation in the Middle East is expected to ease in response to administration measures to combat rising prices and the negative impact of high oil prices on households will likely be limited. Crisis management investments are expected to contribute to increased government spending and increased levels of corporate capital investment.

With the global AI and semiconductor markets set to continue growing, we believe that, supported by the administration's policies, Japan's AI and semiconductor industries will play a pivotal role in supporting the Japanese economy and stock market.

Earnings

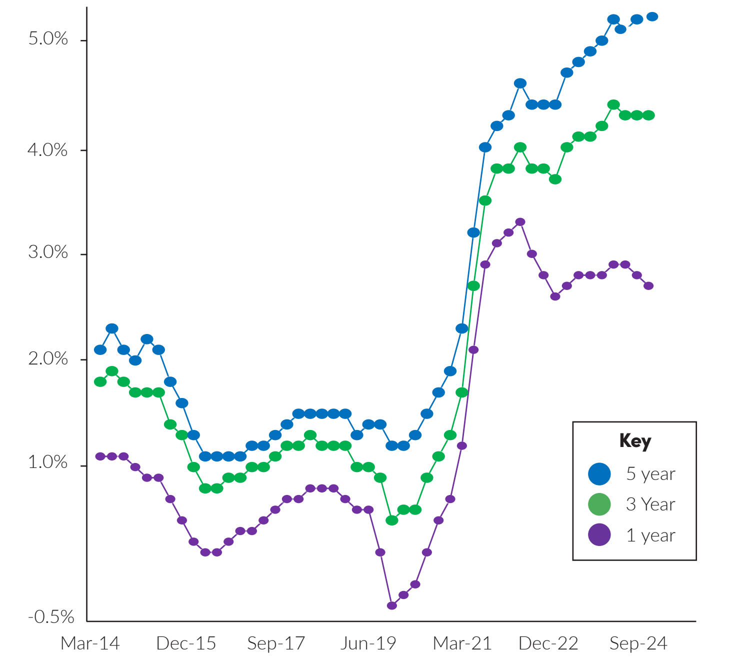
Japanese companies are expected to continue setting new record highs for earnings.

We forecast a significant increase in the TOPIX EPS for fiscal 2026, with an estimated year-on-year rise of approximately 13%.

In the manufacturing sector, the diminishing impact of Trump tariffs and the weaker yen environment are expected to support earnings. In the non-manufacturing sector, we anticipate that consumers' acceptance of price increases – driven by entrenched domestic inflation – will support earnings.

This has enabled companies to enhance their margins through price increases. According to the Bank of Japan's Tankan survey (December 2025), companies' sales price outlooks (across all sizes and industries) have been rising steadily over the past few years.

Exhibit 1: Outlook for Output Prices



Note: Universe is all industries, all enterprises; data as of Dec 2025.
Source: BOJ, MUFG: Trust Bank

As illustrated in Exhibit 1, the projection indicates an increase of +2.7% within the next year, +4.3% within the subsequent three years, and +5.2% within the following five years, when compared to current levels.

As Japan transitions from a deflationary to an inflationary economy, it is reasonable to expect an expansionary trend in the Japanese companies over the medium to long term.

BoJ/Rates/Forex

Amid a virtuous cycle of wages and prices in Japan, the Bank of Japan (BoJ) is expected to raise policy rates at a gradual pace of 0.25% every six months.

With two rate hikes in 2026, the BoJ terminal rate is likely to reach 1.25%. For the administration, which favours a high-pressure economy (low-interest-rate policy + aggressive fiscal policy), raising rates above 1.25% is considered unacceptable.

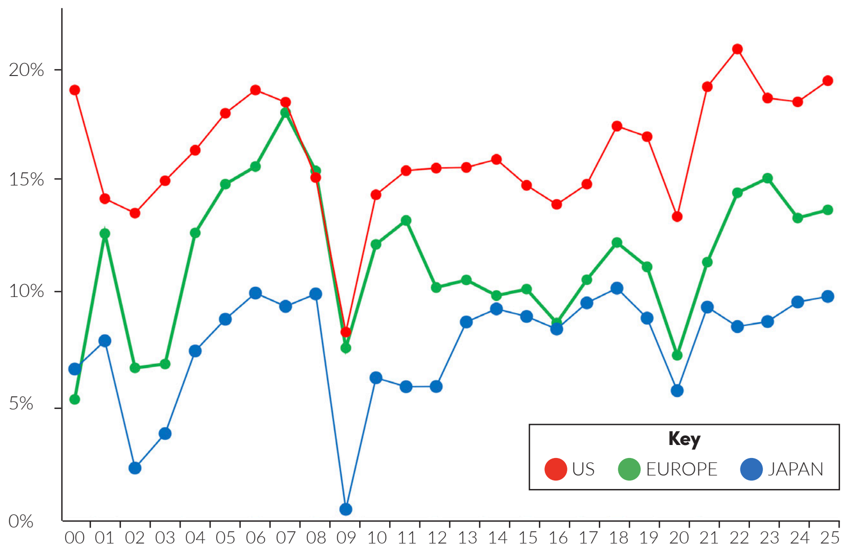
Conversely, given that the BoJ estimates the neutral rate to be between 1.0% and 2.5%, should inflationary pressures rise higher than expected due to a weak yen or high oil prices, the BoJ may be forced to raise rates prematurely to near the upper limit of the neutral rate range.

As the Bank steadily raises policy rates, we believe Japanese long-term interest rates are likely to rise gradually towards the mid-2% range. The expected increase in government bond issuance driven by the administration's expansionary fiscal policy, along with the BoJ's gradual reduction of bond purchases (quantitative tightening), will also contribute to a modest rise in long-term interest rates driven by supply and demand dynamics.

Given that the market has already priced in the BoJ's gradual rate hikes, the likelihood of a significant appreciation of the yen is low, and » we expect the USD/JPY to continue trading in a range centred around 155. In light of the expansionary fiscal policy under the Takaichi administration, the increasing investment by Japanese households in overseas assets, the widening of Japan's digital deficit, and the high attractiveness of yen carry trades, the likelihood of the yen remaining weak is likely to persist.

On the other hand, we do not anticipate a sharp depreciation of the yen due to the likelihood of potential currency intervention by Japanese and US authorities.

Exhibit 2: ROE of Large Companies in Major Regions



(Source) MUFG: Trust Bank, from FactSet
(Note) : Universes are TOPIX500 for Japan, S&P500 for the U.S. and STOXX600 for Europe.

Corporate governance

Corporate reforms at Japanese companies continue to progress.

The Tokyo Stock Exchange is calling on companies, particularly those listed on the Prime Market, to achieve a return on equity (ROE) of over 10%, which exceeds the cost of capital (approximately 8%). Furthermore, activists and Japanese institutional investors are urging companies to improve their ROE by more effectively utilising excess cash reserves. Activist campaigns in Japan have grown to become the second largest in scale after those in the United States, and proposals from activists are becoming increasingly likely to be accepted.

At present, the ROE of Japanese companies is less than 10%, which is lower than that of European and American companies (see Exhibit 2).

In order to improve ROE, the following strategies are being pursued: "growth investments (capital expenditures/M&A)", "share buyback/dividend increase", "unwinding of cross-shareholdings", or "sale or spin-off of low-profitability businesses". Consequently, the average ROE of Japanese companies is expected to rise towards 10%, approaching Western levels. With revisions to the Corporate Governance Code scheduled for the summer of 2026, Japanese companies will likely be required to make more effective use of their abundant cash reserves. Japanese companies have continued to increase their cash holdings, leaving significant room for effective utilisation of these funds. This is expected to lead to a sustained improvement in ROE for Japanese companies.

Risks

While we maintain a fundamentally bullish stance on the Japanese stock market, we believe it is particularly important to be aware of the following risks.

Firstly, there is a possibility that prolonged high oil prices, driven by concerns over the situation in the Middle East, could have a significant negative impact on the Japanese economy. The Middle East accounts for 95% of Japan's crude oil imports, therefore a blockade of the Strait of Hormuz would have a considerable impact on Japan's oil supply.

While Japan maintains approximately eight months' worth of oil reserves, ensuring energy supplies can be maintained for the time being, a prolonged blockade would likely lead to corporate profits being squeezed by high oil prices and negative effects on consumption through rising petrol prices.

Secondly, we can consider scenarios in which Japan experiences an adverse rise in interest rates.

One such scenario involves excessive yen depreciation and rising crude oil prices, which increase the risk of inflationary pressures. This could force the BoJ to implement unintended aggressive rate hikes, such as quarterly hikes exceeding market expectations. Furthermore, there is a possibility that the Takaichi administration will implement aggressive fiscal policies without regard for fiscal sustainability, significantly heightening concerns about fiscal deterioration.

Under these scenarios, Japanese long-term interest rates could rise above 3%, which would likely intensify concerns about negative impacts on economic activity and the sustainability of public finances. Should long-term interest rates surge, the Japanese market may experience a "triple dip" (falling stock prices, a weaker yen, and falling bond prices).

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