Special Report

Japan Capital Markets Newsletter – Q4 2025

March 2026

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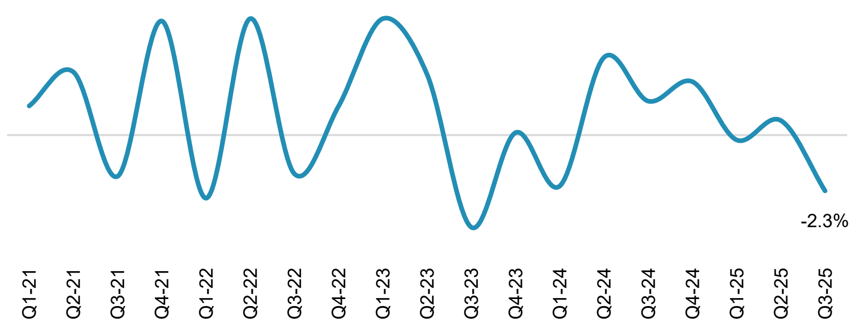
Japan's economy stabilized and modestly recovered in Q4 2025 after a prior contraction, with inflation cooling further and the labor market remaining tight

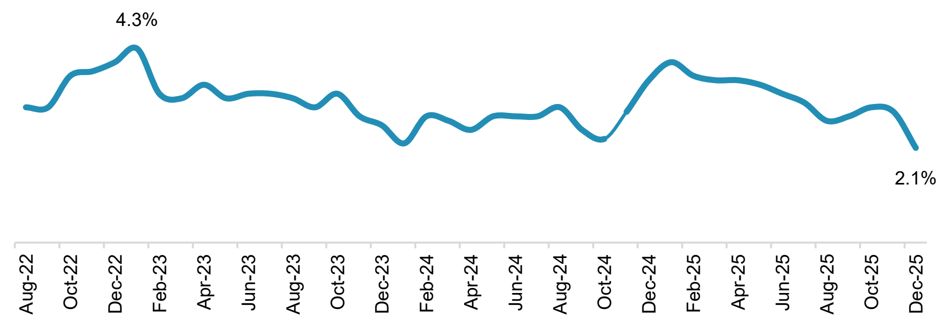
GDP stabilized in Q4, turning marginally positive after the Q3 contraction as residential investment, capex, and fiscal support offset weak exports.

Real GDP %



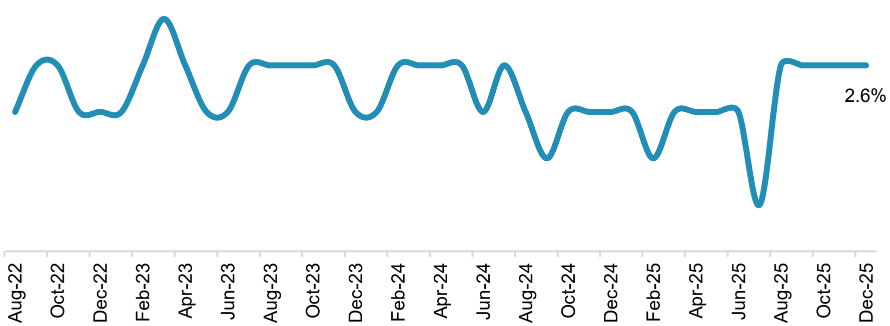
Headline inflation eased to 2.1% in Dec 2025, while core CPI moderated to 2.4% YoY, still above the BOJ's target amid softer food and energy prices.

Inflation



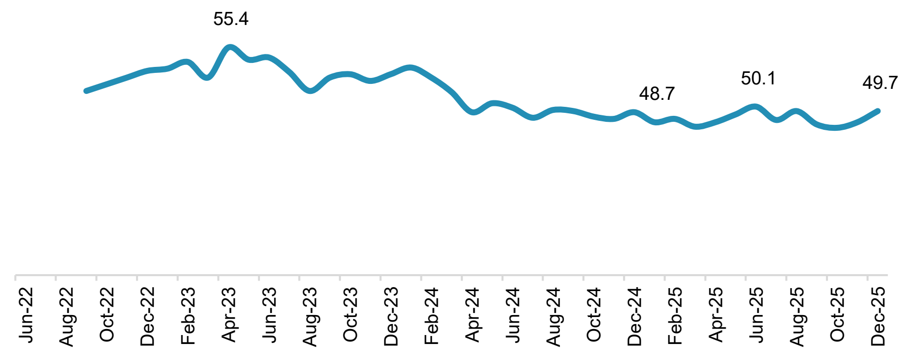
The labor market remained tight, with unemployment steady at 2.6% in December, signaling ongoing worker shortages.

Unemployment rate %



Manufacturing PMI rose to 49.7 in Dec 2025, ending 5 months of contraction as new-order declines slowed and output stabilized.

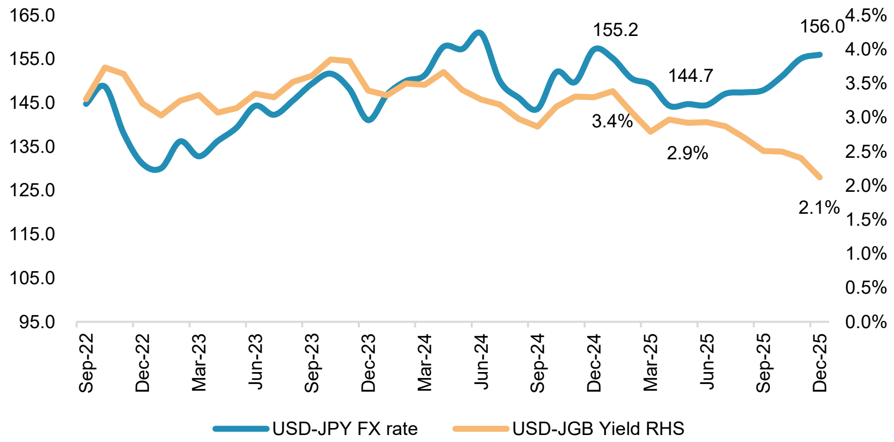
Manufacturing PMI

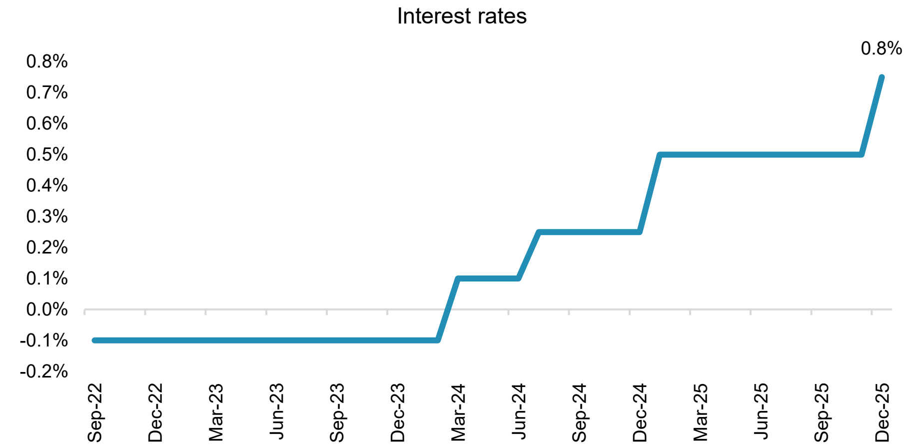


Source: *Government of Japan, Ycharts, Aranca Research*

Currency & Monetary Policy: Yen Weakness and Rising Yields Amid Gradual BOJ Normalization

Japan's Q4 backdrop featured a weak yen (USD/JPY ~155–156), rising bond yields, and a 25bps BOJ rate hike, with inflation still above target amid gradual policy normalization and fiscal risks.



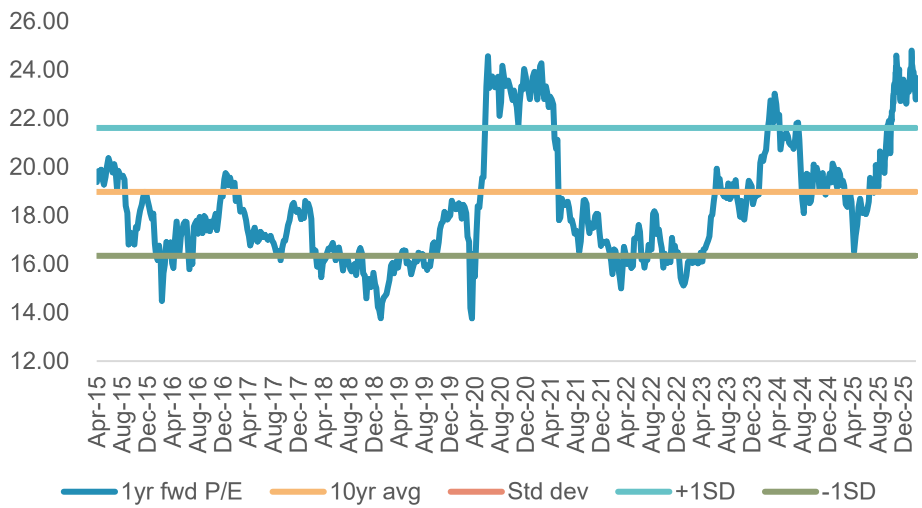


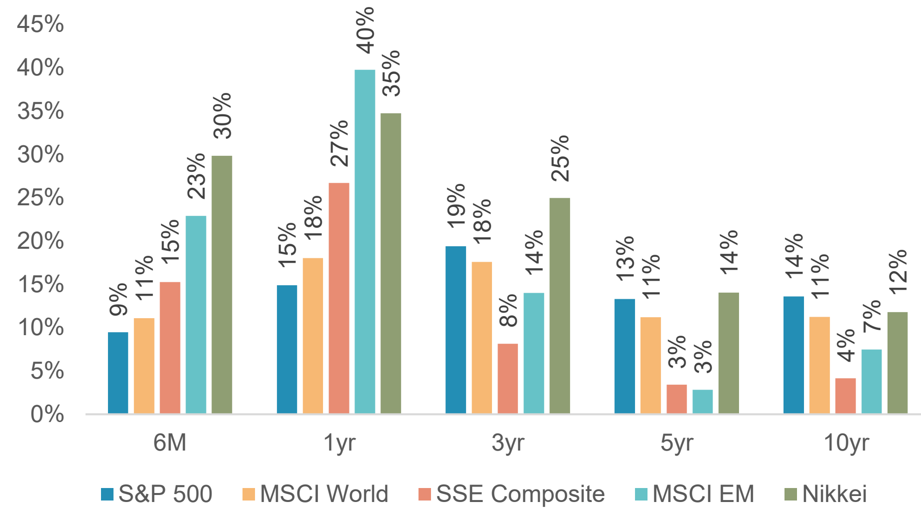
- The yen weakened further in **Q4 2025**, with **USD/JPY averaging 154.1 by December** (vs. **~150.5 in Q3**), driven by fiscal expansion concerns, high bond yields, and tariff uncertainty despite the Bank of Japan's (BOJ) rate hike, ending the year **~156** amid renewed carry trade pressures.
- **The 10-year Japanese Government Bond (JGB) yields** rose to **~2.0–2.1% by December**, hitting **multi-decade highs** and signaling expectations of BOJ normalization. Meanwhile, fiscal stimulus risks and political uncertainty pressured yields and yen stability.
- The BOJ raised its policy rate by **25 bps** to **0.75%** on **December 19**, the **highest in ~30 years**, continuing gradual normalization, with JGB tapering and ETF unwinds ongoing and scope for further hikes in 2026 if conditions allow.
- **Core inflation** eased to **~2.4% YoY by December** but remained above the **2% target**, supported by wage momentum and past cost pass-through. On the other hand, softer commodities and subsidies cooled headline inflation; **tariff risks** remain an upside concern.

Source: *YCharts, Aranca Research*

Japan Equities: Strong Q4 Growth on Governance Reforms and Earnings Momentum

Japanese equities ended Q4 on a strong note, supported by a reform-driven buybacks, resilient domestic demand, and a solid earnings momentum despite trade-related headwinds



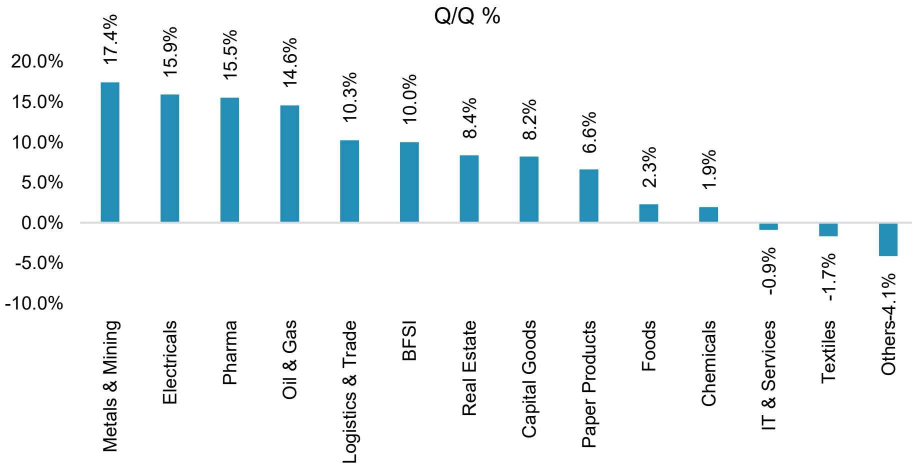


- Japanese equities rebounded strongly in **Q4 2025.** The **Nikkei 225** briefly fell below **48,000** in November on tariff implementation and fiscal uncertainty before recovering to close ~**50,500**, ending the year **well above Q3 levels** despite ongoing trade frictions.
- Exporters faced early-quarter pressure, but sentiment stabilized as a **moderately weaker yen**, **resilient domestic consumption**, and **fiscal support**, alongside the **US–Japan trade framework**, helped offset softness in autos and select export segments.
- Governance reforms, including the Price/Book >1x push, **sustained momentum in buybacks and cross-shareholding unwinds** while expanded Nippon individual savings accounts drove strong domestic retail inflows, particularly into **small- and mid-cap stocks**.
- **The corporate earnings outlook** remained constructive, with companies targeting **7–9% FY2025 earnings growth**, underpinned by strength in **technology and AI-related sectors** and improving confidence that reforms and domestic demand would support profits despite external uncertainties.

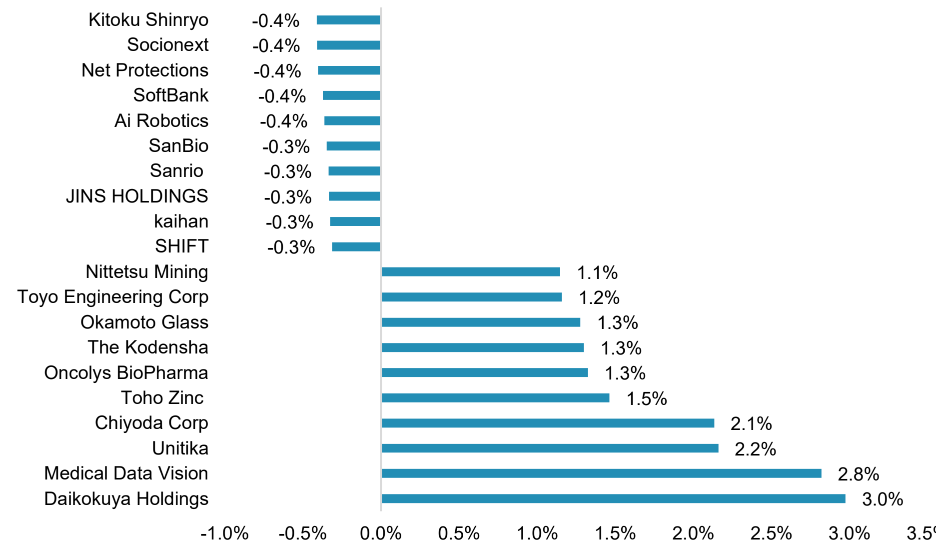
Source: *Bloomberg, Aranca Research*

Equity: Sectoral Performance

11 out of 14 sectors gained Q/Q in 4Q 2025 with the sharpest increases in Metals & Mining, followed by Electricals



The propensity of the top gainers was significantly higher than that of the top losers over the past three months



- Broad gains across Japanese sectors in Q4 2025, with 11 of 14 posting positive returns; Metals & Mining (+17%), Electricals (+15%), and Pharma (+15%) led the advance.
- IT services (-0.9%) and Textiles (-1.7%) were the laggards, reflecting profit-taking and weak overseas demand.
- Among individual names, Daikokuya Holdings (+3.0%) and Medical Data Vision (+2.8%) topped gainers, while Kioku Shinryo and Socionext declined ~0.4% each.
- Sector leadership likely to remain cyclical, with commodity-linked and capital-goods names benefiting from yen softness and export resilience.
- The rally was also supported by improving investor sentiment amid evolving political developments during the quarter.

Source: *JPX, Koyfin, Aranca Research*

Leadership Transition Created Political Uncertainty

Political developments in late-2025 and early-2026 formed an important backdrop to Japan's capital markets. Leadership uncertainty within the ruling Liberal Democratic Party (LDP) initially weighed on investor sentiment, but the eventual election outcome reinforced expectations of policy continuity, pro-growth reforms, and fiscal support

Sep 2025

- Prime Minister Shigeru Ishiba announced his resignation, following election setbacks and internal party pressure within the ruling Liberal Democratic Party (LDP).
- This triggered a leadership contest within the LDP, creating short-term political uncertainty.

Oct 2025

- Early-October: Sanae Takaichi won the LDP leadership election after a run-off vote against Shinjiro Koizumi, positioning her to become Japan's first female Prime Minister.
- Mid-October: The LDP-Komeito alliance fractured, prompting Takaichi to form a new coalition with the Japan Innovation Party.

Feb 2026

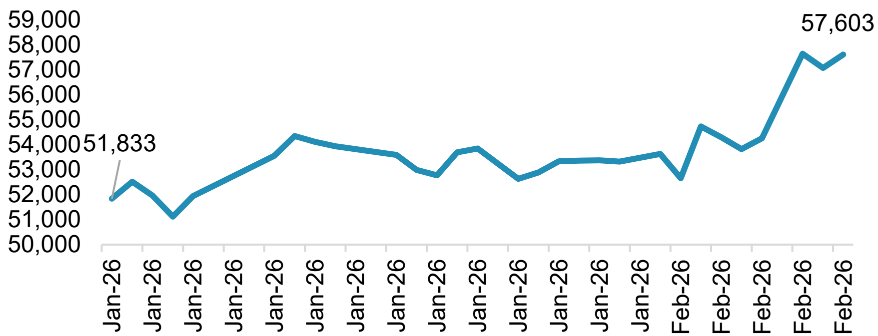
- PM Takaichi called a snap Lower House election to solidify her mandate.
- The LDP secured a landslide victory, winning 316 seats (a two-thirds supermajority with coalition partners), consolidating its political mandate.

Source: *Aranca Research*

Election Outcome Triggers Equity Re-Rating in Japan

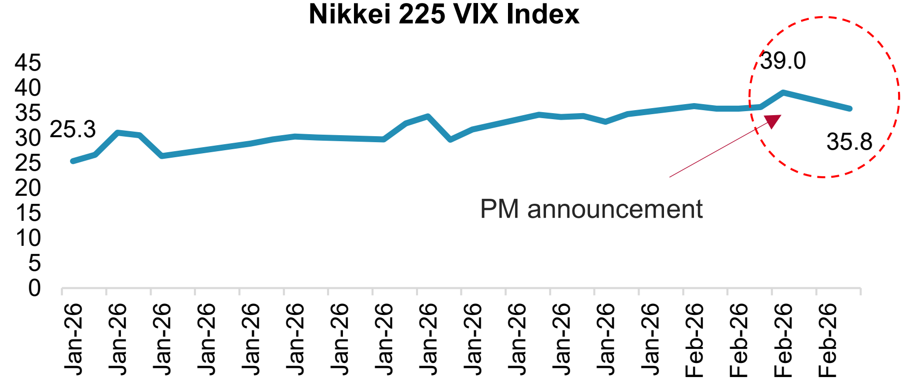
Takaichi's landslide win triggered an equity re-rating; The Nikkei Index moved 6.2% after the announcement, taking the index to all time high

Nikkei 225 Price



Implied volatility peaked pre-election and declined post result; The VIX index fell 9% after the announcement, moving to start of the year levels

Nikkei 225 VIX Index



- Takaichi's sweeping election boosted investor confidence and sent Japanese stocks to all time highs. Global markets have viewed this as a net positive in the short term because it reduces political risk, supports pro-growth policies and lifts risk assets.
- The outcome signals strong continuity in Japan's pro-growth economic framework, reinforcing expectations of sustained fiscal support, market-friendly reforms, and policy coordination rather than abrupt shifts. This continuity enhances medium-term earnings visibility and strengthens forward-looking investor sentiment.
- The equity markets responded with a broad-based rally, reflecting improved confidence in corporate profitability, capex, and domestic demand. Nikkei 225 implied volatility fell ~9% after the Feb 8 election result, retracing to early-January levels. This indicated a measurable compression in the political risk premium and improved investor confidence following Takaichi's landslide victory.
- Foreign capital inflows are likely to accelerate, supported by improved policy visibility, corporate governance reforms, and relative valuation attractiveness. Japan is increasingly positioned as a reliable developed-market destination for long-term institutional capital amid volatility in the US and China.

Source: *Aranca Research*

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