Newsletter – Japan Capital Markets 2Q26

July 2026

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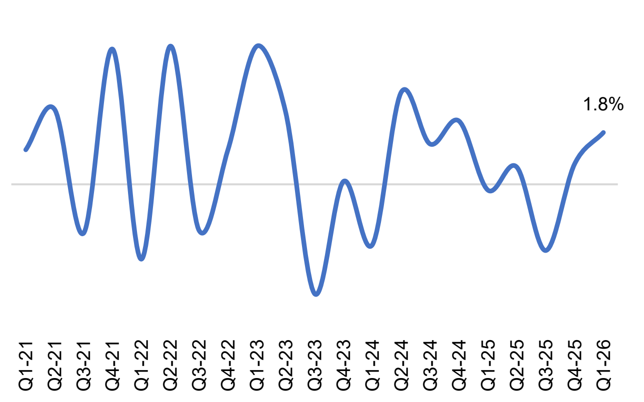
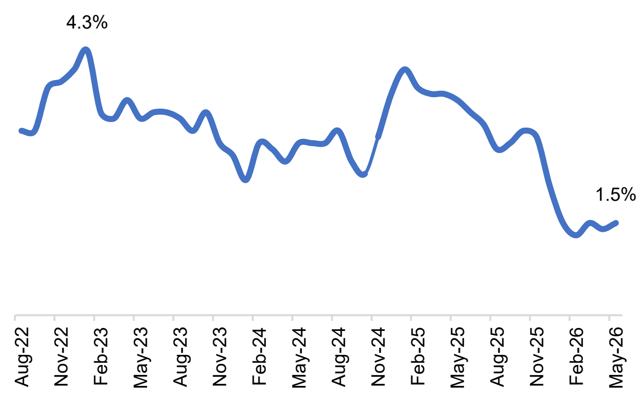
Japan Economic Indicators

Solid momentum in the economy, driven by AI-led investments and a manufacturing boom

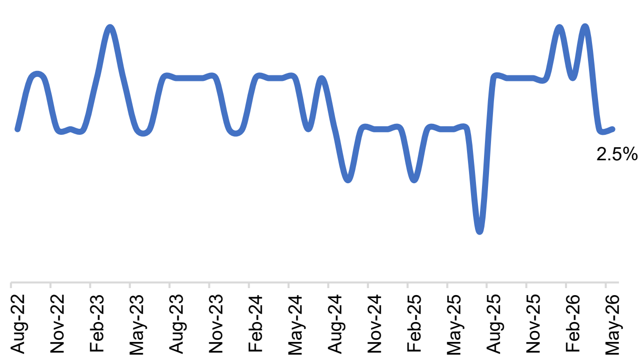
Real GDP annualized QoQ



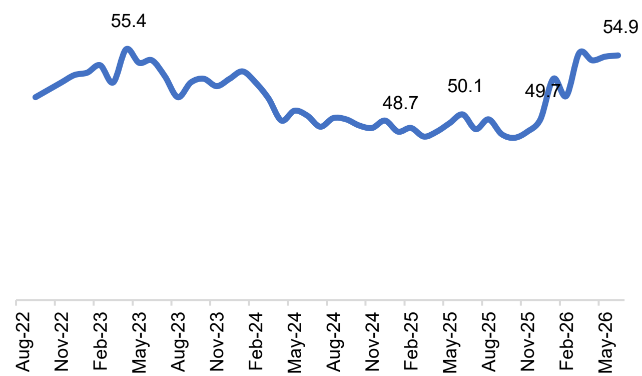
Core CPI



Unemployment Rate



Manufacturing PMI



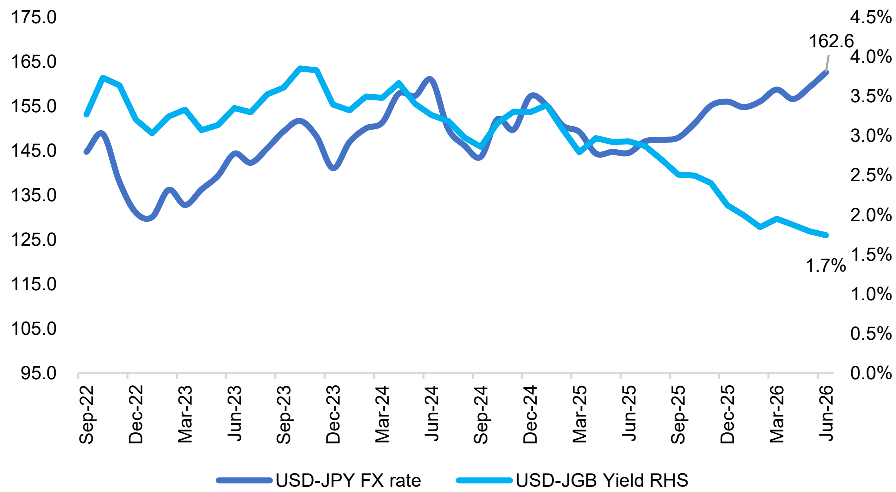
- In 2026 Japan's economy expanded modestly, with **real GDP growing 1.8%,** aided by private consumption, continued investment in AI, digital infrastructure, and semiconductors despite higher energy import costs.
- **Core CPI moderated to 1.5% YoY,** remaining below the BOJ's 2% target for a fifth consecutive month due to government fuel subsidies and favorable base effects.
- Labor market stayed exceptionally tight, with the **unemployment at 2.5%,** while the structural labor shortages continued to support solid wage growth and household spending.
- Manufacturing activity surged, with **PMI rising to 54.9,** the strongest quarterly expansion in over a decade, driven by AI demand and supply-chain stockpiling.

Source: *Aranca Research, Investing.com*

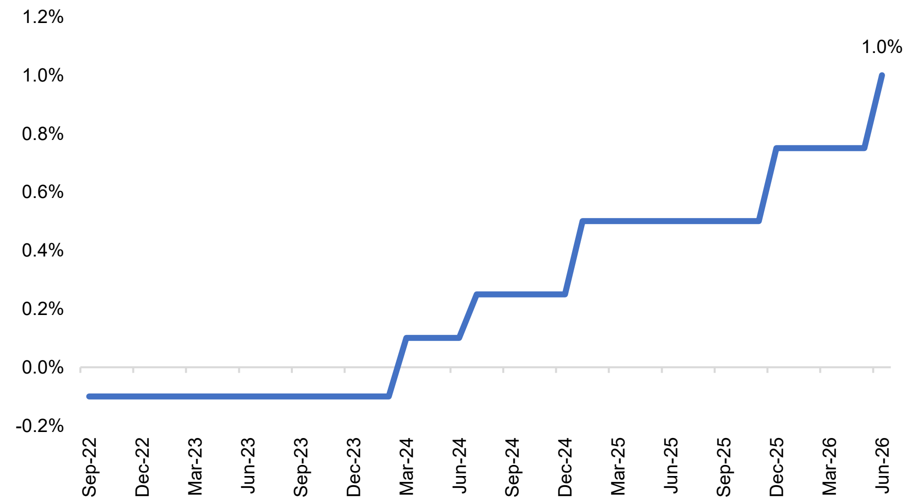
Japan Currency and Monetary Policy

BOJ Tightening, Yen Weakness, and Rising Bond Yields

USD-JGB Yield



Interest Rates



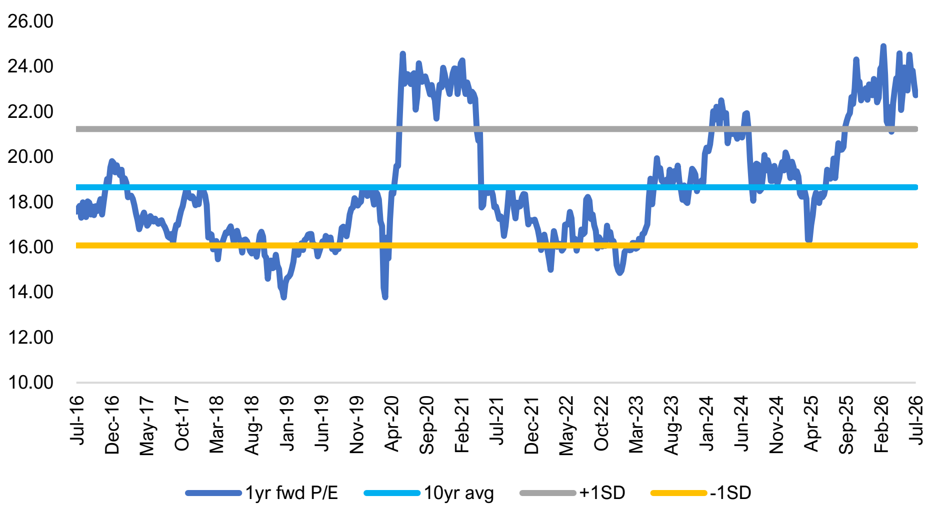
- Yen weakness persisted in Q2 2026, with USD/JPY nearing 162 despite the BOJ raising rates to 1.0%, underscoring insufficient tightening against global rate gaps and inflation and fiscal concerns.
- The 10-year JGB yield approached multi-decade highs, driven by reduced BOJ bond purchases and the government’s pro-growth fiscal stance.
- Negative real rates kept conditions accommodative, with markets pricing the policy rate at 1.25% later in 2026 and near 2.0% by end-2027.

Source: *Aranca Research, Ycharts*

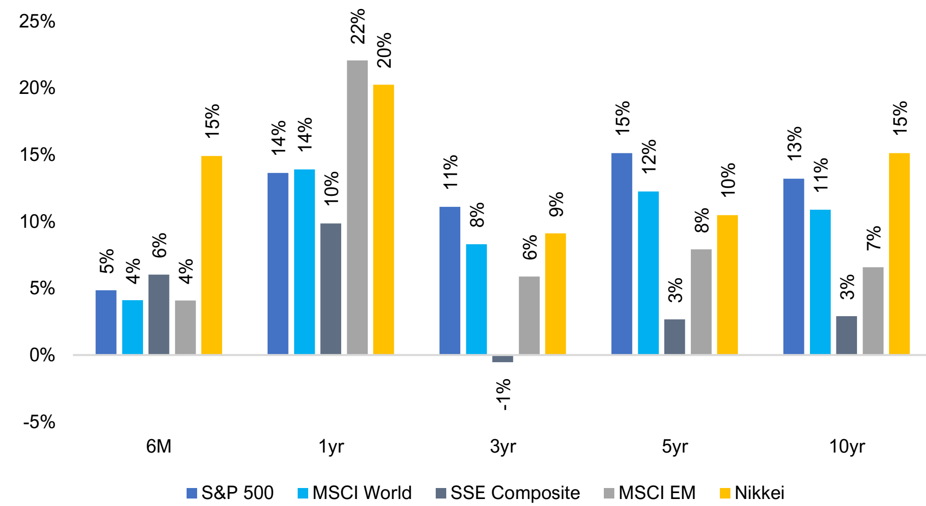
Japan Equity Market Analysis (1/2)

Record Highs Driven by the AI Supercycle and Strong Foreign Inflows

Japan Equity Market Valuation



Market Performance



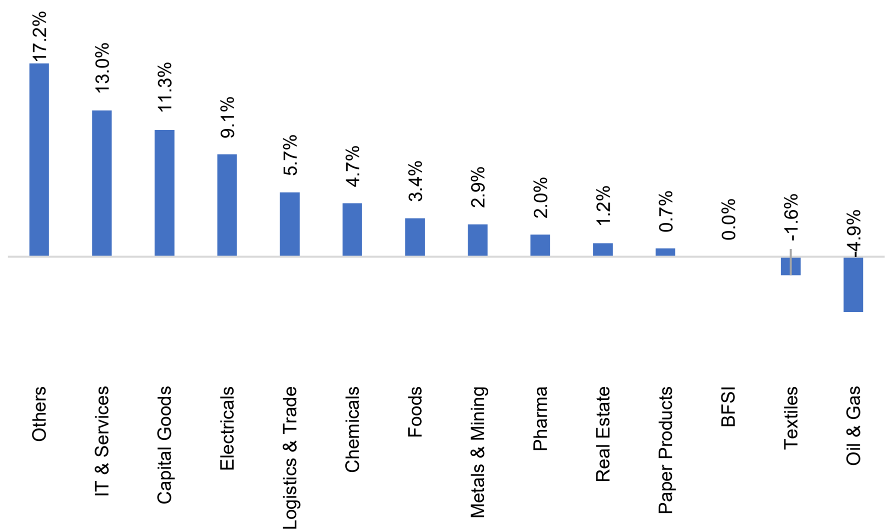
- Japanese equity markets reached **a record high** in Q2 2026, with the Nikkei 225 **surging past the historic 72,000 mark** in late June, supported by strong investor demand for Japanese AI, semiconductor, and data-center beneficiaries.
- Corporate profit margins expanded, led by export manufacturers that benefited from the favorable exchange rate alongside a global structural demand for domestic automotive equipment and precision electronics.
- Tokyo Stock Exchange-led governance reforms continued to support valuations as companies increased share buybacks, improved capital efficiency, and accelerated the unwinding of cross-shareholdings to enhance shareholder returns.

Source: *Aranca Research, Bloomberg*

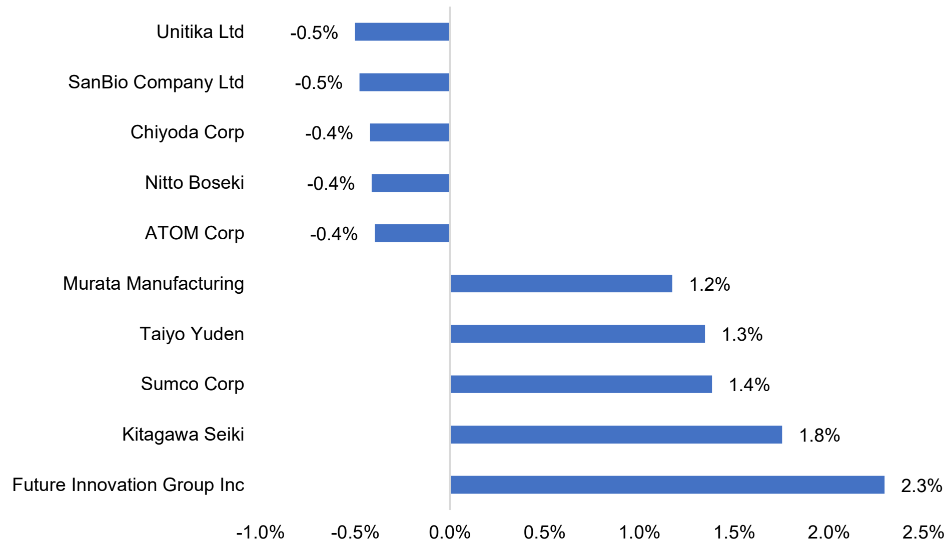
Japan Equity Market Analysis (2/2)

Record Highs Driven by the AI Supercycle and Strong Foreign Inflows

Japan QoQ Sectoral Performance



Top Gainers & Losers



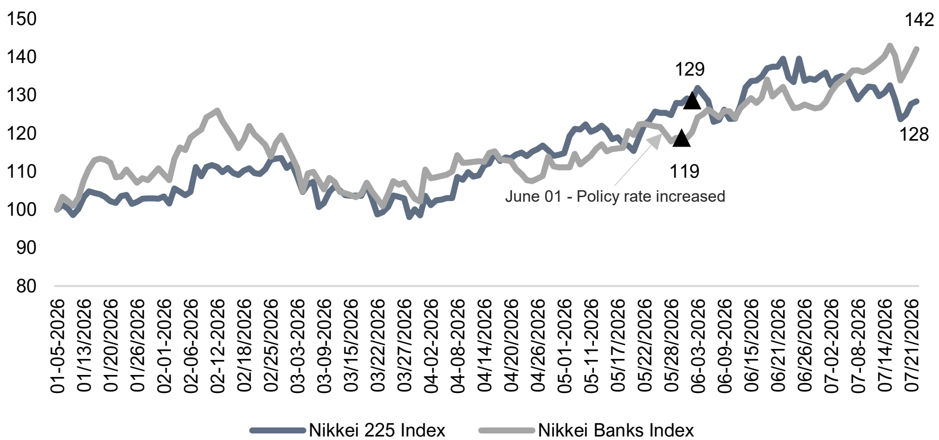
- Broad gains across Japanese sectors in Q2 2026, with 12 of 14 posting positive returns; IT & Services (+13%), Capital Goods (+11%), and Electricals (+9%) led the gains.
- Oil & Gas (-4.9%) and Textiles (-1.6%) were the laggards, reflecting profit-taking and weak overseas demand.
- Future Innovation (+2.3%) and Kitagawa Seiki (+1.8%) led gains, while Unitika and SanBio fell ~0.5% each.
- Sector leadership likely to remain cyclical, with commodity-linked and capital goods names benefiting from yen softness and export resilience.

Source: *Aranca Research, Koyfin*

Japan Earnings and Valuation Outlook

Higher Rates Strengthen the Earnings and Valuation Outlook for Japanese Banks

Japan Nikkei 225 vs Nikkei Banks Index



Scenario Analysis

BOJ policy-rate scenario	Estimated ROE for leading banks	Theoretical P/B at 8% WACC
1.00%	12-13%	1.50-1.63x
1.25%	13-14%	1.63-1.75x
1.50%	14-15%	1.75-1.88x

- **The BOJ's June 2026 rate hike to 1.0% marked an important policy milestone**, reinforcing Japan's transition away from ultra-easy monetary conditions. Banking stocks rallied sharply with the Nikkei Banks Index gaining ~20% through mid-July versus a ~1% decline in the Nikkei 225, as investors priced in wider net interest margins and stronger earnings.
- Further increase in the interest rate could lift the ROE of large banks, creating scope for higher P/B valuations.

Aranca view: Markets are likely to remain highly sensitive to inflation, wage growth and BoJ communication. While further normalization is expected to be gradual, higher interest rates should continue to support financial stocks and long-term bond yields. Additional upside for banks will depend on translating higher rates into sustained NIM and ROE expansion.

Source: *Aranca Research, Bloomberg*

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