

**ECONOMIC RESEARCH – SEPTEMBER 2025**

**INVESTMENT INSIGHT**

**JAPAN**



- ✓ The bond market remains unattractive
- ✓ Interest rate differentials favorable to the yen
- ✓ Possible turning point for the Nikkei

**POSSIBLE TURNING POINT FOR THE NIKKEI**

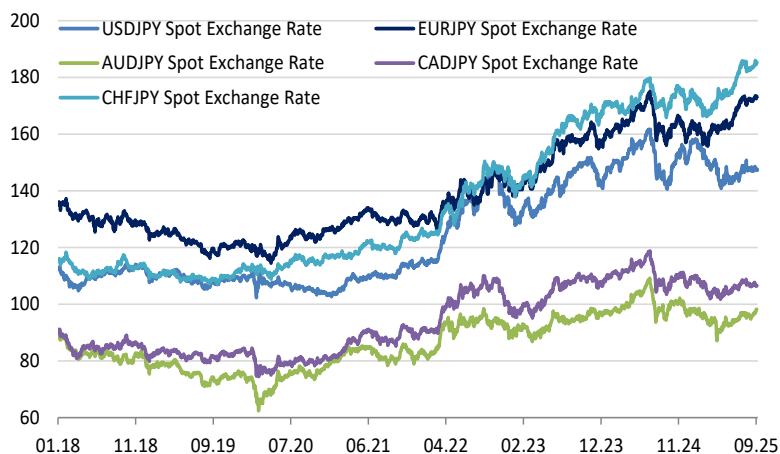
**Japanese bond market: minimal appeal**

The Japanese bond market has seen a paradigm shift following the Bank of Japan's (BoJ) formal end to yield curve control. This has allowed the yield on the 10-year government bond (JGB) to become more volatile and reflect economic fundamentals, but the market remains largely unattractive for foreign investors. The yields on offer are still significantly lower than those in other major economies, and the prohibitive cost of currency hedging often results in a negative overall return.

**Interest rate differentials favoring the yen**

The historical weakness of the yen is a direct consequence of the massive monetary policy and interest rate differential between the BoJ and other central banks. The market consensus is that this differential has peaked and is set to narrow, but the timing and extent of this convergence are a source of considerable uncertainty. The yen is likely to appreciate most against the US dollar, as each Fed rate cut, coupled with a less accommodative stance by the BoJ, will automatically reduce the appeal of carry trades. We anticipate a similar but less pronounced trend against the euro. The trajectory of the euro/yen will therefore depend on the relative speed of the European Central Bank's easing compared to the BoJ's normalization.

**Yen performance against major currencies**



Sources : Bloomberg, BBGI Group

## A pivotal moment for Japanese equities

The Japanese stock market is at an inflection point. After a remarkable performance, it is now caught between strong domestic tailwinds and increasingly strong international headwinds. The most likely scenario for the coming months is one of volatile consolidation, with the probability of a correction or stagnation slightly higher than that of another spectacular surge. A reversal of the “risk-on” mode, which has driven up growth stocks, could well turn into a “risk-off” over the summer if global economic conditions deteriorate.

## Fundamental strengths and structural reforms

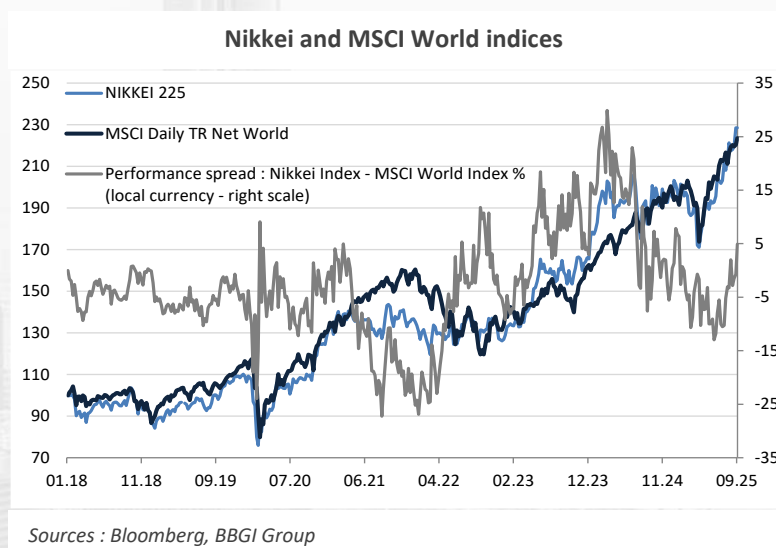
The Japanese market benefits from strong domestic support, and the ongoing paradigm shift towards moderate inflation is structurally positive for companies. They can more easily raise their prices and rebuild margins in an environment of growing nominal demand. Furthermore, reforms aimed at improving return on equity and unwinding cross-shareholdings continue to attract foreign investors, creating a major technical support for the market. These domestic factors provide a critical buffer against external shocks and underpin a solid long-term investment thesis for select companies.

## Valuation concerns and external risks

Fundamentally, the market is no longer as attractively valued. The Nikkei's price-to-earnings (PE) ratio is no longer significantly lower than that of the S&P 500, diminishing the potential for a revaluation-driven rally. Furthermore, the gradual strengthening of the yen, which is expected to occur as the BoJ normalizes policy, could lead to downward revisions in exporters' earnings forecasts. A significant correction in US markets, driven by growth fears, would also have a direct impact on the Japanese market.

## A shift towards defensive strategy

In this environment, we suggest a strategic rebalancing of portfolios towards more defensive sectors. Less volatile than growth stocks, they were also less penalized during the March-April downturn and are poised to become real safe havens within the market. We recommend that investors consider companies mainly exposed to the domestic market, such as those in financial services, real estate, telecommunications, and local consumer staples. This cautious stance is a more optimal strategy to account for the growing risks of consolidation and will likely outperform in an environment of heightened global uncertainty.



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