2027 Investment Outlook – Japan Equities

November 2026

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Key takeaways

- The Bank of Japan has moved away from more than a decade of accommodative monetary policy as underlying inflation has reached 2%, signalling a new era of inflation.
- The return of inflation has improved Japan's fiscal stability, giving Prime Minister (PM) Takaichi room to continue pro-growth policies to boost domestic demand for 2027.
- In the near term, shifting fears and hopes over artificial intelligence (AI) and semiconductor-related stocks are likely to remain a source of volatility. We seek to identify long-term winners as AI adoption broadens.

Japan is now in a new era of inflation

Bank of Japan's (BoJ) October 2026 monetary policy meeting was a pivotal moment. The BoJ moved away from more than a decade of accommodative monetary policy, introduced in 2013 as part of "Abenomics" – the initiative led by former PM Shinzo Abe that combined bold monetary policy, flexible fiscal policy and a structural growth strategy. In the press conference, Governor Kazuo Ueda confirmed that all nine Policy Board members agreed that Japan's underlying Consumer Price Index (CPI) inflation is broadly consistent with the BoJ's 2% price stability target. He added that the BoJ had sought to raise the underlying inflation rate toward 2%, but its objective has shifted to stabilizing it at around 2%, considering upside risks. While the government has yet to declare an end to deflation, in practice Japan has entered a new era of inflation.

The comeback of inflation has increased tax revenue and improved fiscal stability

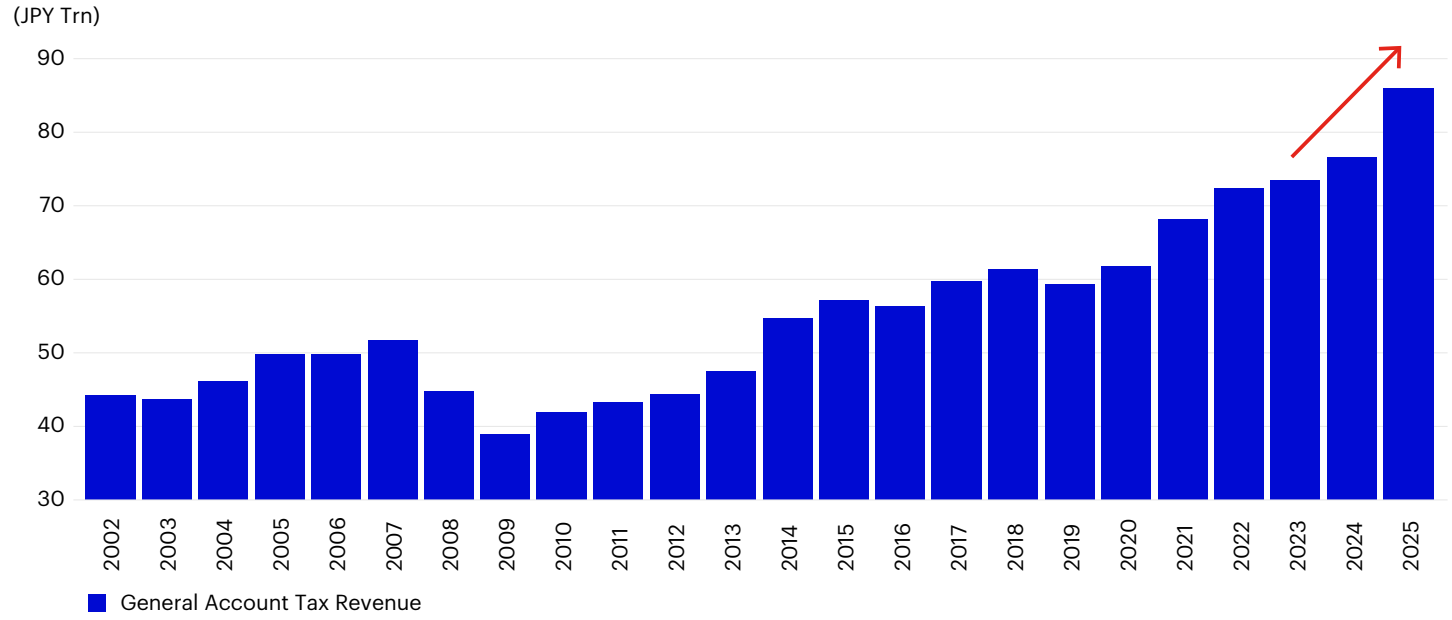
What does this mean for Japan? One notable outcome is an improvement in Japan's fiscal stability. Japanese companies have moved away from their deflationary norms, raising prices to pass through cost hikes and improve profitability. They have also raised wages for the past three years, helping a long-awaited wage-price virtuous cycle taking root. As a result, tax revenues have risen significantly, materially improving the country's primary balance.

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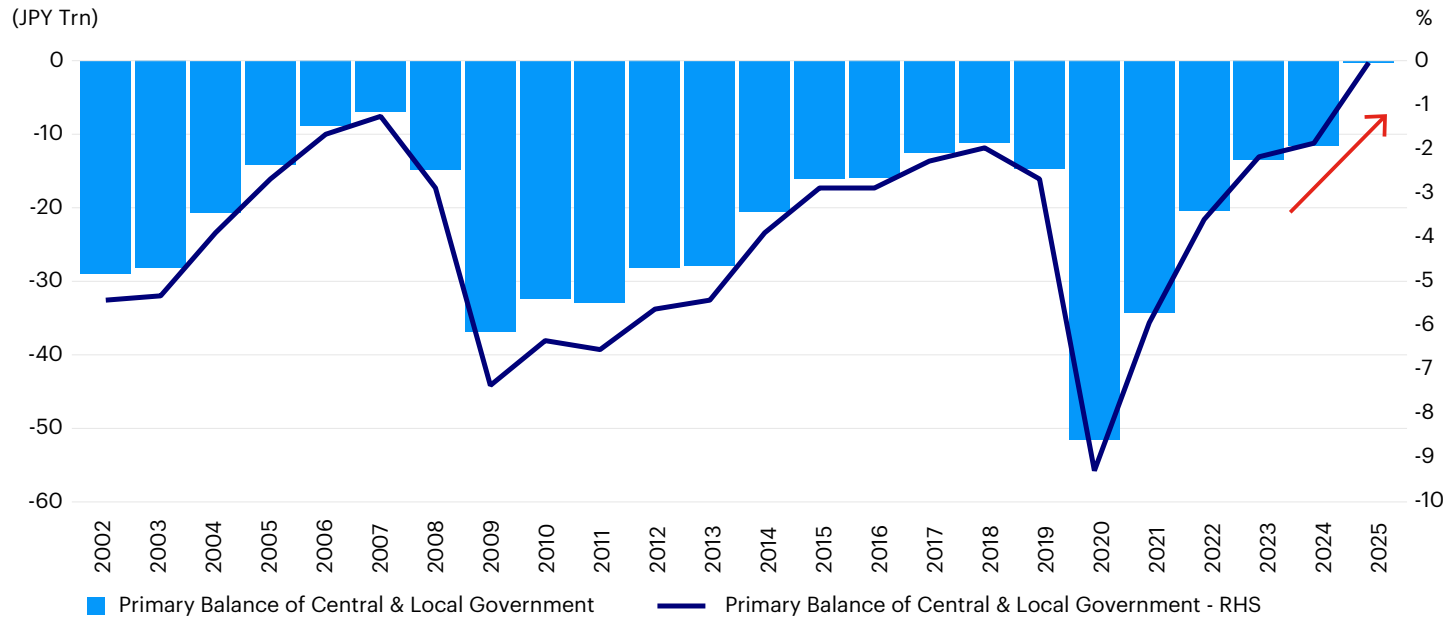
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Figure 1 – Tax revenue trend in Japan



Source: Ministry of Finance, data as of July 2026.

Figure 2 - Primary balance trend in Japan



Source: Cabinet Office, data as of July 2026.

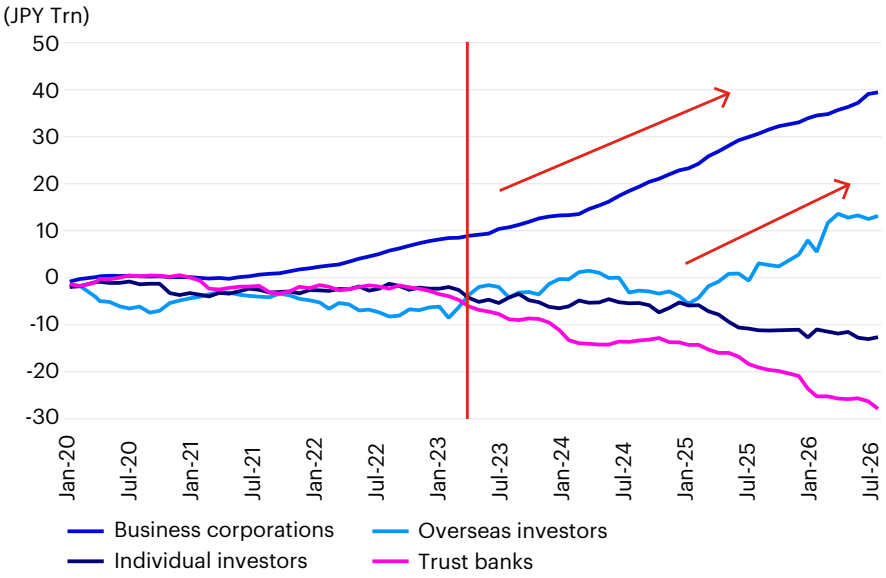
As in other developed economies, markets have been concerned about PM Sanae Takaichi's high-pressure economic policy, dubbed "Sanaenomics" – a mix of accommodative fiscal and monetary policy, stronger industrial competitiveness and enhanced defense capabilities. Bond and currency markets reacted in particular, putting upward pressure on Japanese bond yields and weakening the Japanese yen. That said, the improving fiscal stability is expected to give the government room to implement PM Takaichi's policies to some extent, including a two-year cut in consumption tax on food from April 2027 to boost domestic consumption.

At the same time, having faced substantial rises in long-term interest rates and currency depreciation since she took office in October 2025, PM Takaichi has recently toned down her reflationary stance and placed greater emphasis on fiscal discipline. The BoJ has also become more attentive to upside risks and aims to keep medium- to long-term inflation expectations from rising within its price stability target of 2%, helping ease market concerns that Japan's monetary policy is falling behind the curve. We believe these factors should support sustained economic growth in 2027.

Accelerated reforms are reshaping corporate governance and fund flows

A similar virtuous cycle is also building in corporate governance. Since 2023, the Tokyo Stock Exchange's (TSE) push to improve capital efficiency and share prices has been a structural game changer, prompting companies to increase shareholder returns and pay closer attention to their cost of capital and stock prices. Despite external uncertainties, notably heightened geopolitical tensions in the Middle East, and after sustained share price gains, share buyback announcements remain historically high. The TSE reforms, and the changes in corporate behavior that have followed, have attracted foreign investors, helping to sustain the historic rally in Japan equities until recently.

Figure 3 - Japanese equity trades by investor category



Source: Tokyo Stock Exchange, data as of 30 September 2026.
Note: Cash equities only

Our focus is long-term winners across sectors

In the near term, fears and hopes over AI and semiconductor-related stocks are likely to remain a risk and may continue to drive market direction and market leadership rotation. Since summer, the market has experienced increased volatility led by these stocks, fluctuating between concerns over the sustainability of massive AI infrastructure investment and the optimism over broadening earnings growth across manufacturers. In Japan, the AI and semiconductor ecosystem is not concentrated among hyperscalers or AI semiconductor chip and equipment makers but is spread across various manufacturing sectors. In the long run, we expect AI adoption to broaden and deepen, transforming society, as much as the internet did in the 2000s. Identifying long-term winners of these structural demand shifts across sectors is critical. Unlike earlier this year, we believe simply participating in the AI theme will no longer generate returns. Instead, bottom-up stock selection – identifying long-term winners caught in indiscriminate selloffs, as well as companies whose future products and services will benefit from AI's evolution – is critical to generating alpha in 2027.

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