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Japan Monetary Policy Normalization and Equity Implications

BOJ rate path, yen dynamics, and Nikkei positioning

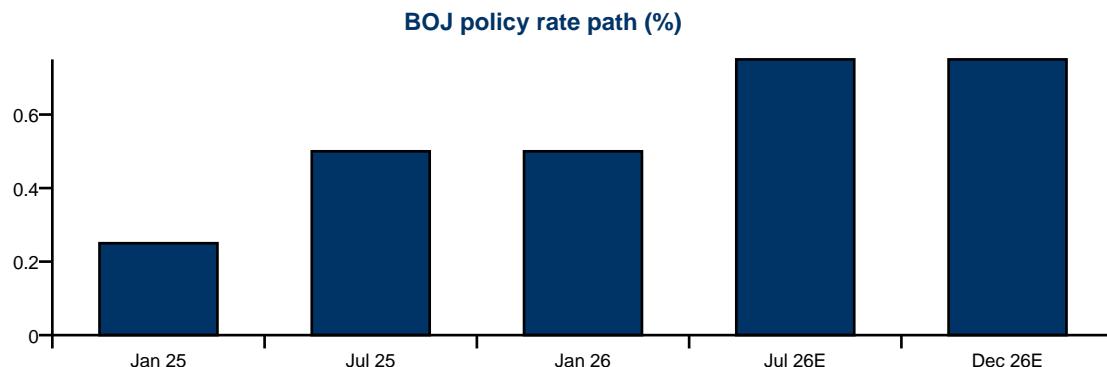
February 11, 2026

Executive Summary

Japan's monetary policy normalization continues to be a defining macro theme in 2026, with the Bank of Japan gradually raising its policy rate and adjusting yield curve control parameters. We assess the implications for the yen, Japanese government bonds, and the equity market. Our base case projects one to two additional rate increases in 2026, bringing the policy rate to approximately 0.75 percent by year end. We maintain a constructive stance on Japanese equities, favoring exporters with yen sensitivity and domestic banks benefiting from higher rates.

BOJ policy path and rate outlook

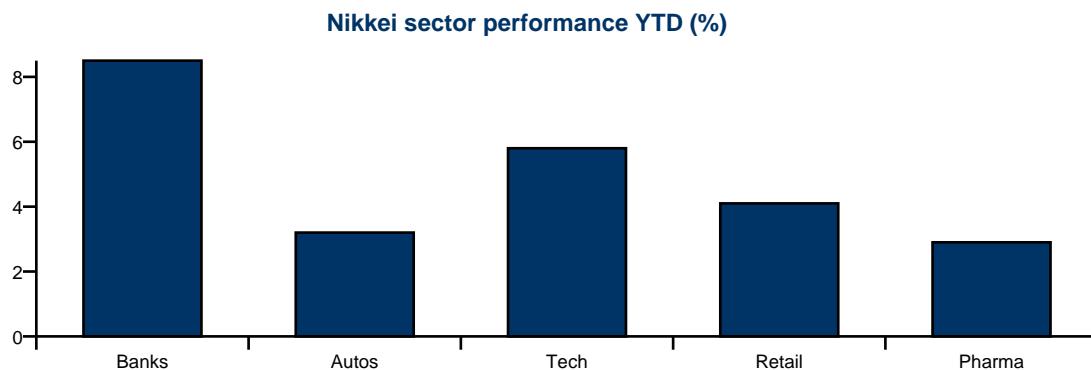
The Bank of Japan has moved away from its longstanding ultra accommodative posture, with cumulative rate increases and modifications to yield curve control reflecting confidence in the sustainability of inflation above the two percent target. We model the BOJ reaction function incorporating wage growth, services inflation, and global rate dynamics. Our base case projects a gradual path with one to two additional hikes in 2026, though the timing is data dependent. Market pricing has converged toward our expectation, and we discuss the scenarios that could lead to a faster or slower pace. Communication from BOJ officials has become more forward looking, and we parse the latest guidance for signals on the terminal rate. We also assess the implications for the JGB market and for the BOJs balance sheet normalization.



Source: J.P. Morgan Research. E = estimate. Overnight call rate.

Yen dynamics and FX implications

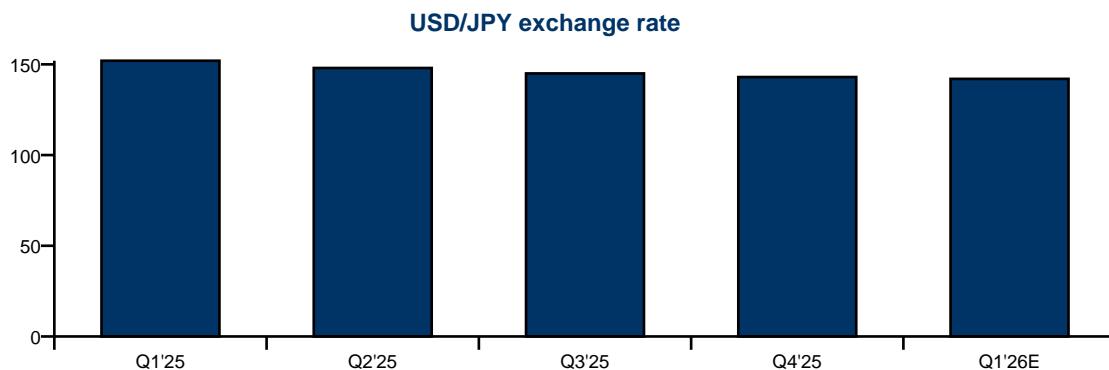
The yen has appreciated from its 2024 lows as rate differentials have narrowed, though it remains weak relative to historical averages on a real effective basis. We project a gradual strengthening toward the 140 to 145 range against the dollar by year end, contingent on our rate and growth assumptions. Carry trade unwinds remain a source of episodic volatility, and we discuss the positioning of leveraged accounts. The yen outlook is a key input to our equity sector views, as exporter earnings sensitivity to currency moves is significant. We provide updated FX forecasts and discuss the implications for hedging strategies. Corporate Japan has adapted to yen weakness over recent years, and a stronger yen would create both headwinds and tailwinds across sectors.



Source: J.P. Morgan Research. Year to date total return through Feb 2026.

Equity market and sector positioning

Japanese equities have delivered strong returns in recent years, supported by corporate governance reform, shareholder return programs, and foreign investor interest. We expect the Nikkei to remain well supported in 2026, though the pace of gains may moderate as valuation multiples approach fair value. Sector preferences reflect our macro views: we favor banks and financials benefiting from higher rates, and we maintain selective exposure to exporters with strong competitive positioning. Domestic consumption names may benefit from real wage growth, and we discuss the outlook for retail and services. Corporate governance improvements continue, with increasing buyback and dividend activity supporting equity returns.



Source: J.P. Morgan Research. E = estimate. Period average.

Risks and scenario analysis

Key risks to our constructive Japan view include a sharper than expected global slowdown that undermines export demand, a policy misstep by the BOJ that triggers excessive yen volatility, and a reversal of governance reform momentum. In our downside scenario, Nikkei could retrace to the 34000 to 36000 range, while our bull case sees the index reaching 45000 or above. We discuss the sensitivity of our estimates to key macro variables and provide a framework for portfolio positioning. Our recommendations are intended for global and regional equity investors and reflect a balanced approach to opportunity and risk.

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