What's Hot: The Bank of Japan can't let go

Veröffentlicht am 3. November 2023

Aneeka Gupta
Director, Macroeconomic Research

This week financial markets were dominated by central banks policy decisions. While the Federal Reserve (Fed) and Bank of England (BOE) kept rates on hold, the policy board of the Bank of Japan (BOJ) decided to further increase the flexibility in its yield curve control policy.

The BOJ previously set a strict cap of 1.0% for the 10-year Japanese Government Bond (JGB) yield. But it has now decided that 1% should be a “reference” (not a strict cap), which effectively allows the yield to rise above 1% when the BOJ thinks it is appropriate. The upper bound of 1% appears to be a level they can’t let go of. By doing so, the BOJ is choosing an exit path that gives them the maximum flexibility but minimum volatility around the Yen. We view this as a dovish move as consensus expectations were for the BOJ to move the cap to 1.25% rather than 1%.

Japan’s recovery remains on a narrow path

One of the reasons holding back the BOJ from normalisation of policy rates, is they still believe Japan’s recovery since the re-opening in October 2022 remains on a narrow path as it relies heavily on tourism, while the broader services sectors have yet to pick up significantly and manufacturing activity has been hampered by soft exports. Japan’s flash PMI readings1 for October showed us a bifurcated economy where the services sector is stronger than the manufacturing sector. Manufacturing PMI clocked in at 47.6, which is in contraction territory. Services PMI was 51.1, which is down from last month’s reading of 53.8 but is still in expansion territory, no doubt helped by fiscal stimulus and the accommodative monetary policy environment.

BOJ on the lookout for an intensified virtuous cycle between wages and prices

BOJ governor Ueda indicated that the BoJ will be monitoring the upcoming spring union-employer wage negotiations. A strong outcome could catalyse the earlier attainment of sustained inflation in Japan, but overall, Japan’s recovery isn’t strong enough yet for employers, especially small enterprises, to meaningful support wage hikes in the broad economy. While headline inflation bolted north of 4% in January 2023, it appears to have peaked and has begun receding. While core inflation remains around the 4% mark. The Producer Price Index (PPI) slowed to 2% annually in September suggesting a stabilization or even drop in CPI ahead.

Source: Bloomberg, WisdomTree, as of 31 October 2023 Historical performance is not an indication of future performance and any investments may go down in value.

The BOJ revised its outlook for core inflation (all items less fresh food and energy) to 3.8% in FY23, 1.9% for FY24 and 1.9% for FY25. The BoJ stated that the inflation uptick “needs to be accompanied by an intensified virtuous cycle between wages and prices”.

The Yen is unlikely to appreciate under BOJ’s policy change owing to the large gap in interest rates between the US and Japan. The direction of the Yen matters for Japanese equities owing to Japan high export tilt. The exporters stand to benefit amidst a weaker Yen.

Fire power abounds for Japanese equities

Japanese equities had a strong first half in 2023, attaining 33-year highs. Yet valuations at 15.7x price to earnings ratio (P/E), still trade at a 30% discount to its 15-year average providing room to catch up. More importantly, earnings revision estimates in Japan are currently the highest among the major economies. Earnings yield at 4.07% for the Nikkei 225 Index has been trending above bond yields 0.947% for 10 Year JGBs2, keeping the well-known TINA (There is no Alternative) trade alive in favour of Japanese equities.

Source: iQDatabase, IBES, WisdomTree as of 2 November 2023. Historical performance is not an indication of future performance and any investments may go down in value.

Tailwind from corporate governance reforms

Tokyo Stock Exchange’s (TSE) call for listed companies to focus on achieving sustainable growth and enhancing corporate value is beginning to bear fruit. The call was aimed at companies with a price to book (P/B) ratio below one. Those companies were asked to develop a plan for improvement, disclose and then implement and track its progress. The progress has been encouraging with 31% of companies on the prime market making a disclosure of their plan3.

Large companies with a price to book ratio below one have been more proactive with disclosure. Historically cash-heavy Japanese companies face increasing pressure to improve their numbers, possibly by funnelling historically high excess cash reserves into increased buybacks or dividends.

Source: FactSet, WisdomTree, as of 31 October 2023. Historical performance is not an indication of future performance and any investments may go down in value.

Conclusion

Inflation has been missing in Japan for more than a decade. So now that it has arrived aided by the post pandemic pick up of the Japanese economy, policy makers are not in a rush to obliterate it. With wage growth lagging behind inflation, the Bank of Japan does not appear ready to wean itself from Yield Curve Control until a more intensified virtuous cycle is observed between wages and prices. The BOJ’s policy decision this week is unlikely to allow the appreciation of the Yen, which should continue to provide a competitive advantage to Japanese exporters.

1 AuJibun as of 15 October 2023

2 Bloomberg as of 31 October 2023

3 Tokyo Stock Exchange as of 31 July 2023

Related blogs

+ A stock exchange policy update opens a compelling case for Japan

+ What's Hot: Corporate governance reforms are working for Japan

+ What's Hot: Bank of Japan sitting on the fence on easy policy exit

+ Yen's gains look capped

+ Markets embrace the Higher-for-Longer theme

Important Risks Related to this Article

IMPORTANT INFORMATION

Marketing communications issued in the European Economic Area ("EEA"): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as "WisdomTree" (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. Past performance is not a reliable indicator of future performance. Any historical performance included in this document may be based on back testing. Back testing is the process of evaluating an investment strategy by applying it to historical data to simulate what the performance of such strategy would have been. Back tested performance is purely hypothetical and is provided in this document solely for informational purposes. Back tested data does not represent actual performance and should not be interpreted as an indication of actual or future performance. The value of any investment may be affected by exchange rate movements. Any decision to invest should be based on the information contained in the appropriate prospectus and affer seeking independent investment, tax and legal advice. These products may not be available in your market or suitable for you. The content of this document does not constitute investment advice nor an offer for sale nor a solicitation of an offer to buy any product or make any investment.

An investment in exchange-traded products ("ETPs") is dependent on the performance of the underlying index, less costs, but it is not expected to match that performance precisely. ETPs involve numerous risks including among others, general market risks relating to the relevant underlying index, credit risks on the provider of index swaps utilised in the ETP, exchange rate risks, interest rate risks, inflationary risks, liquidity risks and legal and regulatory risks.

The information contained in this document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares in the United States or any province or territory thereof, where none of the issuers or their products are authorised or registered for distribution and where no prospectus of any of the issuers has been filed with any securities commission or regulatory authority. No document or information in this document should be taken, transmitted or distributed (directly or indirectly) into the United States. None of the issuers, nor any securities issued by them, have been or will be registered under the United States Securities Act of 1933 or the Investment Company Act of 1940 or qualified under any applicable state securities statutes.

This document may contain independent market commentary prepared by WisdomTree based on publicly available information. Although WisdomTree endeavours to ensure the accuracy of the content in this

document, WisdomTree does not warrant or guarantee its accuracy or correctness. Any third party data providers used to source the information in this document make no warranties or representation of any kind relating to such data. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.

This document may contain forward looking statements including statements regarding our belief or current expectations with regards to the performance of certain assets classes and/or sectors. Forward looking statements are subject to certain risks, uncertainties and assumptions. There can be no assurance that such statements will be accurate and actual results could differ materially from those anticipated in such statements. WisdomTree strongly recommends that you do not place undue reliance on these forward-looking statements.

WisdomTree Issuer ICAV

The products discussed in this document are issued by WisdomTree Issuer ICAV (“WT Issuer”). WT Issuer is an umbrella investment company with variable capital having segregated liability between its funds organised under the laws of Ireland as an Irish Collective Asset-management Vehicle and authorised by the Central Bank of Ireland (“CBI”). WT Issuer is organised as

an Undertaking for Collective Investment in Transferable Securities (“UCITS”) under the laws of Ireland and shall issue a separate class of shares (''Shares”) representing each fund. Investors should read the prospectus of WT Issuer (“WT Prospectus”) before investing and should refer to the section of the WT Prospectus entitled 'Risk Factors' for further details of risks associated with an investment in the Shares.

Notice to Investors in Switzerland – Qualified Investors

This document constitutes an advertisement of the financial product(s) mentioned herein.

The prospectus and the key investor information documents (KIID) are available from WisdomTree's website: **https:** //www.wisdomtree.eu/en-ch/resource-library/prospectus-and-regulatory-reports

Some of the sub-funds referred to in this document may not have not been registered with the Swiss Financial Market Supervisory Authority (“FINMA”). In Switzerland, such sub-funds that have not been registered with FINMA shall be distributed exclusively to qualified investors, as defined in the Swiss Federal Act on Collective Investment Schemes or its implementing ordinance (each, as amended from time to time). The representative and paying agent of the sub-funds in Switzerland is Société Générale Paris, Zurich Branch, Talacker 50, PO Box 5070, 8021 Zurich, Switzerland. The prospectus, the key investor information documents (KIID), the articles of association and the annual and semi-annual reports of the sub-funds are available free of charge from the representative and paying agent. As regards distribution in Switzerland, the place of jurisdiction and performance is at the registered seat of the representative and paying agent.

For Investors in France:

The information in this document is intended exclusively for professional investors (as defined under the MiFID) investing for their own account and this material may not in any way be distributed to the public. The distribution of the Prospectus and the offering, sale and delivery of Shares in other jurisdictions may be restricted by law. WT Issuer is a UCITS governed by Irish legislation, and approved by the Financial Regulatory as UCITS compliant with European regulations although may not have to comply with the same rules as those applicable to a similar product approved in France. The Fund has been registered for marketing in France by the Financial Markets Authority (Autorité des Marchés Financiers) and may be distributed to investors in France. Copies of all documents (i.e. the Prospectus, the Key Investor Information Document, any supplements or addenda thereto, the latest annual reports and the memorandum of incorporation and articles of association) are available in France, free of charge at the French centralizing agent, Societe Generale at 29, Boulevard Haussmann, 75009, Paris, France. Any subscription for Shares of the Fund will be made on the basis of the terms of the prospectus and any supplements or addenda thereto.

For Investors in Malta: This document does not constitute or form part of any offer or invitation to the public to subscribe for or purchase shares in the Fund and shall not be construed as such and no person other than the person to whom this document has been addressed or delivered shall be eligible to subscribe for or purchase shares in the Fund. Shares in the Fund will not in any event be marketed to the public in Malta without the prior authorisation of the Maltese Financial Services Authority.

For Investors in Monaco: This communication is only intended for duly registered banks and/or licensed portfolio management companies in Monaco. This communication must not be sent to the public in Monaco.