What’s hot: Central Banks - East raising and West cutting... China dithering

Pubblicato il 22 marzo 2024

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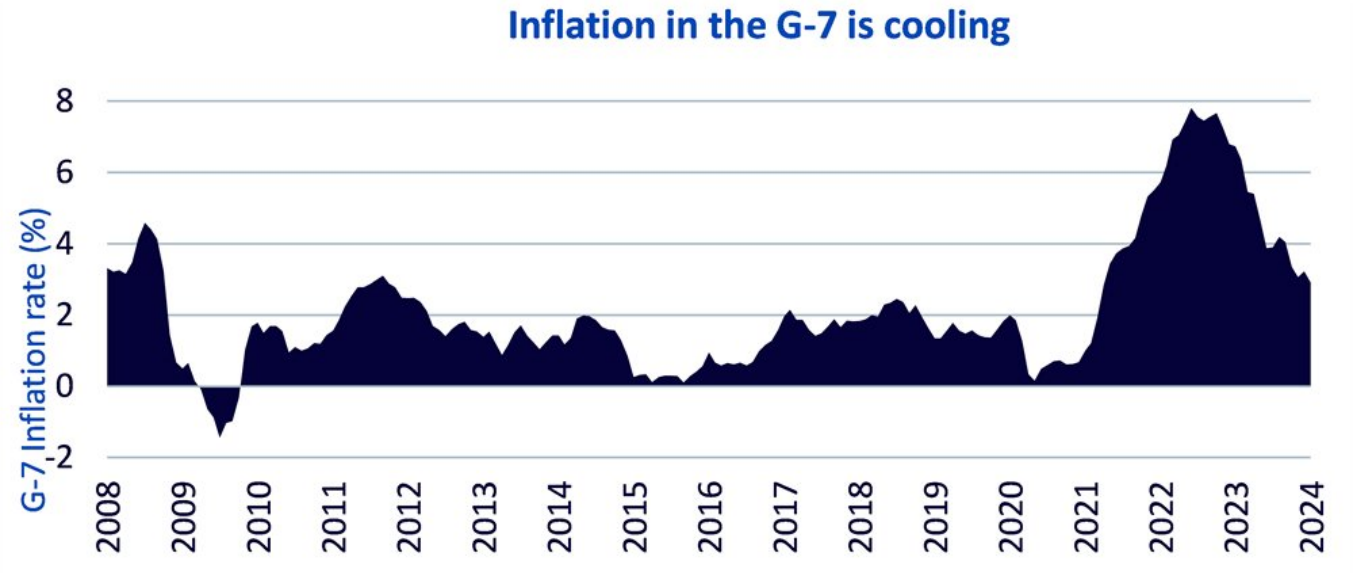
Punti chiave

- That last mile of inflation is causing more divergence across central banks globally.
- The BOJ embarked on a significant yet incremental step, exiting negative interest policy for the first time in 17 years.
- Japanese equities are likely to benefit from structural opportunities that may emerge from its exit from deflation.

This was a mammoth week for central bank policy decisions. On the one hand the Bank of Japan (BOJ) finally put an end to the world’s last negative rate regime, Taiwan’s central bank surprised markets by raising its policy rate by 12.5Bps while the Swiss National Bank (SNB) surprised markets with a 25Bps rate cut.

That last mile of inflation is causing more divergence across central banks globally with central banks in the east raising rates, the west embarking on rate cuts while China remains on the sidelines owing to concerns of a weaker Renminbi. There was no policy change from the Federal Reserve (Fed) with the target rate left at 5.25%-5.5%. The Fed updated their forecasts for showing significant upward revisions to growth but almost no change to unemployment and inflation, keeping the disinflationary trend in place. The Reserve Bank of Australia and the Bank of England kept rates on hold as broadly expected.

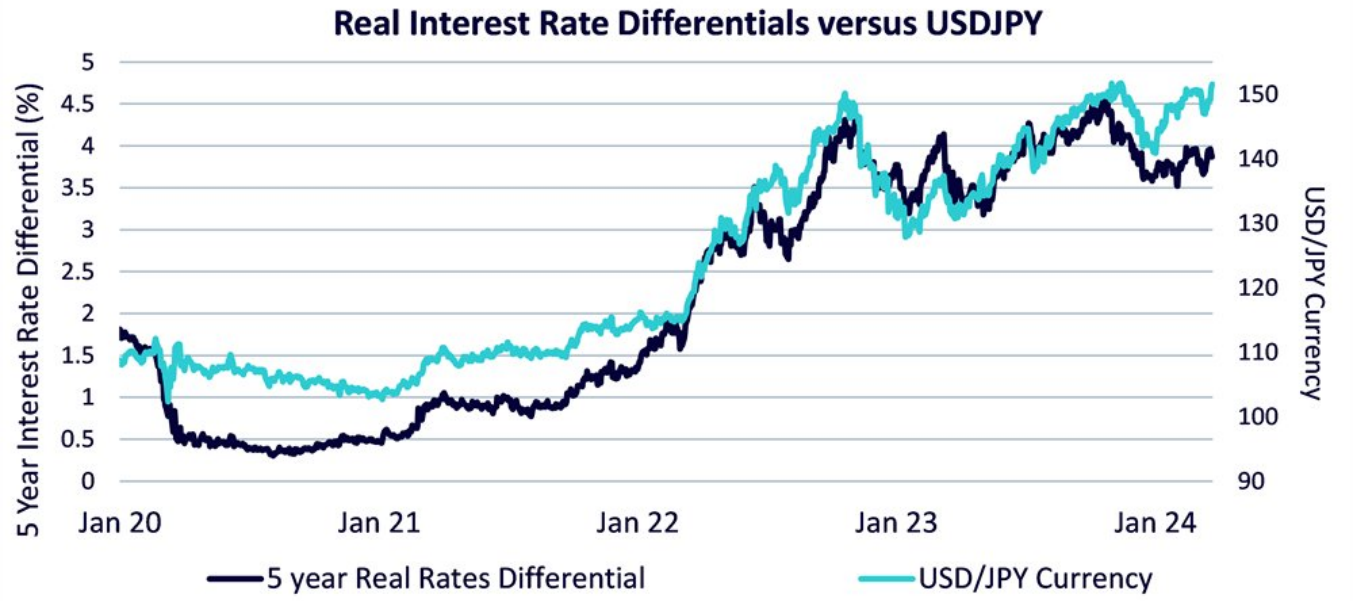


Source: Organisation for Economic Cooperation & Development, WisdomTree as of 21 March 2024. The G-7 includes – Canada, France, Germany, Italy, Japan, United Kingdom, and United States. **Historical performance is not an indication of future performance and any investments may go down in value.**

BOJ ends the world's last negative rate regime

The BOJ embarked on a significant yet incremental step, exiting negative interest policy for the first time in 17 years. Yet the market seemed to take this bold step in its stride. Neither the yen nor the Nikkei 225 Index displayed abrupt movements, and the Japanese government bonds (JGB) 10-year yields remained contained below 80Bps[1]. This is partly because the communication from the BOJ leaned on the dovish side as signalled by Governor Ueda, "it is necessary to maintain accommodative financial conditions". It's important to consider that shifting from negative to 0-10Bps overnight rates allows the BOJ to return to operating policy via short term rates instead of a set of unconventional policy tools and that these rates remain accommodative.

BOJ's policy normalisation came on the heels of the Shunto wage negotiations that agreed on a bumper wage hike by 5.28% for 2024[2]. The results of the spring wage negotiations suggest that real wage growth will turn positive, and if inflation stabilises around BOJ target of 2% it should support the 2025 Shunto salary increase. The BOJ remains in wait-and-see mode, particularly given the economic uncertainty coming not only from Japan but also from the global economy. Japan's economic growth is projected to continue moderately however slowing economic growth overseas could remain a potential drag. For now, the BOJ appears reluctant to signal further policy tightening and is likely to take a gradual approach to raising rates. This coupled with the Fed continuing to expect three cuts this year, should keep yen appreciation limited.



Source: Bloomberg, WisdomTree as of 21 March 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

Japanese equities outlook remains positive amidst a gradual rate tightening cycle

We continue to favour Japanese equities as structural opportunities emerge from its exit from deflation. The inflationary environment continues to support corporate reforms. In 2023, the Tokyo Stock Exchange's (TSE) corporate governance reform agenda focused on improving listed companies Price to Book (P/B) ratio, garnered a lot of attention. This was evident from the subsequent rise in payout ratio's by listed companies. Share buyback programs established in F3/24 (April 2023 through to March 2024) by companies listed on the TSE prime market totalled 9.4Trn[3], setting an all-time high. Should payout ratios continue to rise it should encourage inflows of funds into the revamped Nippon Individual Savings Account (NISA) as discussed here. With the launch of the new NISA program in 2024, the market has seen a preference for high dividend Japanese stocks.

TINA is alive in Japan

There is no alternative (TINA) but equities, the famous acronym over the past decade of lower interest rates, still remains intact in Japan. Equity risk premiums in Japan remain comparatively high at 2.86% versus -0.15% for US equity markets. After attaining a 34-year high[4], the prospect of Japanese equities remains promising owing to strong earnings growth. Japanese equities ended Q3 F3/24 with a 20% YoY increase in pre-tax profits[5]. Additionally, Japan has the highest 3-month earnings revision ratio globally.



Source: BofA, iQDatabase, WisdomTree, as of 21 March 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

We expect rising wage growth and higher inflation, to support a recovery in consumer demand. In addition, Japan's manufacturing and technology sectors stand to benefit from the growing structural demand for corporate spending on AI technologies and automation as they address demographic challenges.

Sources

[1] Bloomberg as of 19 March 2024

[2] Reuters as of 15 March 2024

[3] Bloomberg, Factset as of 14 February 2024

[4] Bloomberg as of 21 February 2024

[5] Earnings results of MSCI Japan for the July – September quarter, Bloomberg as of 31 November 2023

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