

Navigating Japan Equities

Monthly Insights from Tokyo (August 2022)

A look at Abenomics without Abe and why wages are crucial for firms trying to pass on higher costs

5 August 2022

This month we take a look at the short and long term prospects of Abenomics without Abe. We also discuss the recent trend of an increasing number of Japanese companies passing on higher costs to consumers and whether this phenomenon can continue.

By Naoki Kamiyama, Chief Strategist

A look at Abenomics without Abe

The assassination of former Japanese prime minister Shinzo Abe in July had a profound impact across Japan. From an economic and financial market perspective, perhaps the biggest question is where Abenomics is now headed without Abe, who retained much political clout even after he resigned as prime minister in 2020. In the very short term, the legacy of Abenomics may remain intact, as the policies' main pillars, known as the "three arrows" consisting of monetary easing, fiscal policy and growth strategy, will be retained by the government of current prime minister Fumio Kishida for the fiscal year through March 2023. This is demonstrated by the government's annual economic guidelines which show that it intends to (1) continue to ask the Bank of Japan (BOJ) to keep monetary policy easy, (2) retain an expansionary fiscal policy and (3) pursue growth through structural reform (though Kishida's growth plan slightly differs from Abe's).

Long-term prospects for Abenomics still remain unclear. A reshuffle of the cabinet and the Liberal Democratic Party (LDP) leadership expected as early as end-August could still provide a hint. It will be worth focusing on changes to the position of Sanae Takaichi, the LDP's Policy Research Council chairperson. Takaichi was an Abe ally and a self-proclaimed successor of Abenomics. Whether she can retain a key party post may provide a crucial clue about Kishida's dedication to Abenomics in the long term. Even if Kishida sticks with the policies, Japan's growth story could change slightly. Abe tried to achieve growth through deregulation, but Kishida may opt to link fiscal stimulus to innovation, turning the focus away from the easing of regulations. From an investment perspective, Kishida's emphasis on linking fiscal spending with growth, focusing on areas like AI, could favour some sectors over others, although the overall impact on the broader market and the economy is unlikely to differ too much from the Abe era.

If Kishida decides to distance himself from Abenomics—which would become apparent if Takaichi's position within the LDP is diminished—the biggest risk from a market perspective would be the government steering away from expansionary fiscal policy due to the fact that many of Kishida's allies are proponents of fiscal discipline. One potential policy advocated by such proponents is to raise the capital gains tax, although the government would be limited to a modest increase as it also aims to encourage citizens to shift their savings into investments. Another focal point in the wake of Abe's death is monetary policy. Current BOJ Governor Haruhiko Kuroda's term expires in April 2023 and the Kishida cabinet will appoint a successor subject to parliamentary consent. While a BOJ governor favouring the continuation of easy monetary policy was preferred during the Abenomics era, Kishida may appoint a governor who favours policy normalisation. Kishida drifting away from Abenomics should not have a big impact on the economy and market, but it could still cloud investor sentiment by casting Kishida as an enigma. As such, how the cabinet and LDP leadership reshuffle pan out will be of keen interest to the markets.

Wages crucial to whether firms can pass on higher costs to prices in the long term

Recent data and polls suggest that an increasing number of Japanese companies are passing on higher costs—which many blame on a result of a rise in commodity prices and a weaker yen—to consumers. This represents a significant

shift, as Japanese companies, long stuck in a deflationary spiral, were initially hesitant at the outset of the recent inflation to transfer these costs to consumers. While some may conclude that Japanese companies setting aside long-held expectations that they would refrain from passing on higher costs represents a full-fledged path out of deflation, the phenomenon could turn out to be short-lived. This is because inflation in Japan could yet prove to be transitory. Japanese consumers are currently still purchasing discretionary items at higher prices, but such a trend could fizzle out and weaken inflationary pressure once consumers fully comprehend the relationship between their earnings and inflation. Moreover, consumer spending in Japan could be less sustainable than that in countries such as the US as the Japanese government did not provide as much monetary assistance to individuals as the US following the outbreak of COVID-19.

There are, however, some positive signs. For example, bonus payments have increased this year, as earnings by many Japanese companies have increased significantly thanks to strong exports. These increases in one-time income have allowed a number of consumers to maintain pace with inflation for now, in turn allowing companies to pass on higher costs. Wages will likely be key to whether companies can keep passing on higher costs in the longer term. Wages increased noticeably in the spring, when businesses and workers traditionally hold wage negotiations. Whether this trend will continue may depend largely on Japan's exports maintaining their current strength. Right now, any signs of strength ascribed to the Japanese economy is mostly confined to the recovery-from-the-pandemic narrative. A sustained rise in wages could help the economy enter a more long-term growth trajectory and dislodge Japan from deflation, although such a scenario remains a tentative one at this stage.

Market: Japan stocks lifted by government and BOJ policy expectations, firm US equities

Japanese equities ended July higher with the TOPIX (w/dividends) up 3.72% on-month and the Nikkei 225 (w/dividends) rising 5.35%. Although concerns of a slowdown in the US economy weighed on equities, the overall rise can be attributed to factors including expectations for policy continuity following the upper house election win by the LDP, rise in US equities and the BOJ's decision to maintain monetary easing. Of the 33 Tokyo Stock Exchange sectors, 28 rose with Marine Transportation, Services, and Precision Instruments among the most significant gainers. In contrast, 5 sectors declined, including Insurance, Electric Power & Gas, and Air Transportation.

Exhibit 1: Major indices

Index	1-mth	3-mth	6-mth	1-yr	5-yr
Nikkei 225	5.3%	3.6%	3.0%	1.9%	42%
JGB Yield (%pt)	-0.05	-0.05	+0.01	+0.16	+0.18
JPY/USD	-2.3%	2.8%	15.4%	21.5%	21%
JPY/EUR	-4.0%	-0.6%	5.6%	4.6%	4%
MSCI World	7.9%	-1.8%	-10.2%	-10.5%	40%
TOPIX	3.7%	2.1%	2.3%	2.1%	20%
TPX-100 (Large)	3.9%	1.3%	1.2%	3.6%	26%
TPX-400 (Mid)	3.4%	3.5%	4.3%	-0.2%	12%
TPX-Small	3.6%	3.7%	3.9%	-1.1%	7%

Source: Bloomberg, as at 29 July 2022

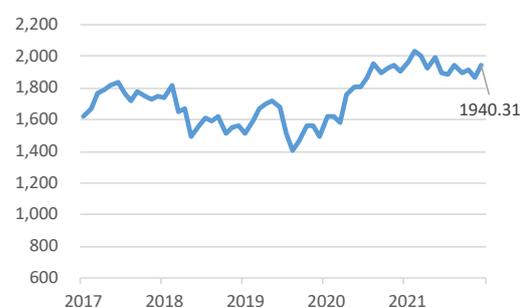
Exhibit 2: Valuation and indicators

Valuation /indicator	Mth-end	3-mth	6-mth	1-yr	5-yr
TOPIX					
Div. Yield (e)	2.5%	2.5%	2.3%	2.1%	2.1%
Price/Earn (e)	12.4	12.3	13.5	14.7	14.5
Price/Book	1.2	1.2	1.2	1.3	1.3
Daily Turnover	53	60	60	59	51
Market Cap.	713	700	695	728	606
MSCI World					
Div. Yield (e)	2.1%	2.1%	1.9%	1.8%	2.5%
Price/Earn (e)	16.2	16.5	18.4	20.2	17.3
Price/Book	2.7	2.7	2.9	3.2	2.2

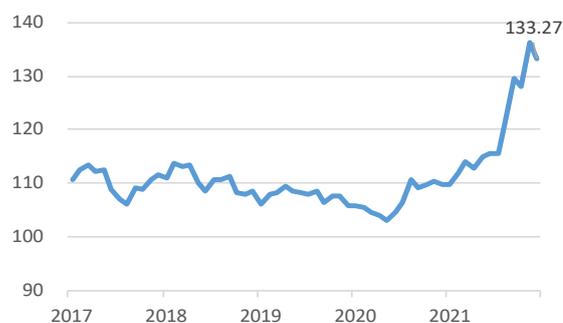
(e) stands for consensus estimates by Bloomberg. Turnover and market cap in JPY trillion. Source: Bloomberg, as at 29 July 2022

Exhibit 3: Major market indices

TOPIX



USD/JPY



Source: Bloomberg, as at 29 July 2022

Important information: This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (**Nikko AM**) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute personal investment advice or a personal recommendation and it does not consider in any way the objectives, financial situation or needs of any recipients. All recipients are recommended to consult with their independent tax, financial and legal advisers prior to any investment. This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this document will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual securities, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association.

United Kingdom and rest of Europe: This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority (the FCA) (FRN 122084). This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the FCA in the United Kingdom, and is directed at professional clients as defined in the FCA Handbook of Rules and Guidance.

United States: This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

Singapore: This document is for information to institutional investors as defined in the Securities and Futures Act (Chapter 289), and intermediaries only. Nikko Asset Management Asia Limited (Co. Reg. No. 198202562H) is regulated by the Monetary Authority of Singapore.

Hong Kong: This document is for information to professional investors as defined in the Securities and Futures Ordinance, and intermediaries only. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

New Zealand: This document is issued in New Zealand by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562). It is for the use of wholesale clients, researchers, licensed financial advisers and their authorised representatives only.

Kingdom of Bahrain: The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Kuwait: This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

Kingdom of Saudi Arabia: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Holdings group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

Oman: The information contained in this document neither constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree 80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article

139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

Qatar (excluding QFC): The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

United Arab Emirates (excluding DIFC): This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.

Republic of Korea: This document is being provided for general information purposes only, and shall not, and under no circumstances is, to be construed as, an offering of financial investment products or services. Nikko AM is not making any representation with respect to the eligibility of any person to acquire any financial investment product or service. The offering and sale of any financial investment product is subject to the applicable regulations of the Republic of Korea. Any interests in a fund or collective investment scheme shall be sold after such fund is registered under the private placement registration regime in accordance with the applicable regulations of the Republic of Korea, and the offering of such registered fund shall be conducted only through a locally licensed distributor.