

# Navigating Japan Equities: Monthly Insights From Tokyo (September 2023)

Assessing Japan's surprising 2Q GDP; the weak yen and its prospects in the months ahead

This month we take a closer look at Japan's 2Q GDP surge and analyse the factors that could offset a potential slowdown in exports; we also assess why the markets are less perturbed by a weak yen compared to a year ago and discuss the prospects of the currency strengthening in the months ahead.

By Naoki Kamiyama, Chief Strategist  
7 September 2023

## Taking a closer look at Japan's 2Q GDP surge

Thanks to strong exports, Japan's economy grew at an annualised rate of 6% year-on-year in the April-June period, roughly doubling market expectations. While the headline figure of 6% was impressive, a closer look at the second quarter gross domestic product (GDP) data shows that growth was lopsided, mostly accounted for by robust exports. In contrast, domestic demand, highlighted by a 0.5% annualised slip in private consumption, was weaker than expected. The latest GDP figures raise two questions: can we expect an eventual domestic demand recovery, and how will the economy cope if exports lose steam?

Weak domestic demand was not surprising given that consumers are still getting used to an inflationary environment, especially as inflation is rising at a faster pace than wages. However, two factors could lead to the increase in wage hikes shifting into another gear and overtaking the rate of inflation. The first is tight labour market conditions. Current demand for workers in export-oriented sectors is greater than supply and a similar phenomenon could emerge in sectors linked to domestic demand; this, in turn, is expected to accelerate the rise in wages. Second is the prospect of inflation decelerating as the impact from commodity and energy-related factors are beginning to show signs of decreasing, not only in Japan but globally. We may witness a robust post-pandemic recovery in domestic demand should the pace of wage hikes overtake that of inflation.

Japan's exports, while currently strong, could face a number of headwinds towards 2024. For example, the Federal Reserve (Fed) could go too far with monetary policy tightening and depress US consumer spending, in turn curtailing demand for Japanese goods. The resulting levelling off in exports will not be positive for the Japanese economy, but that could be offset by a recovery in domestic demand, which we think has yet to complete its comeback from pandemic-era restraints. We believe that as the labour shortage is resolved gradually over time, there will be a boost in private consumption. One point to remember, however, is that until recently Japan was steeped in a deflationary, defensive mindset. This means that there is some risk of companies refraining from active capital expenditure if exports level off; in addition, people could begin directing a greater portion of their income to savings instead of consumption if wages continue rising.

That said, increased wages and ensuing consumption, in our view, will be crucial if the economy is to make a full domestic demand-led, post-pandemic recovery. Increases in supply to meet higher consumption demand will create a virtuous cycle of tight labour conditions leading to higher wages and increased consumption. If such a cycle takes hold, Japanese stocks could make a renewed push higher. As mentioned previously in this series, bonuses paid out this winter could become a turning point.

## Why a weaker yen is not generating as much concern this time

The yen caused a significant stir in the markets nearly a year ago when it weakened beyond the 151 per-dollar mark to hit a 32-year low. Back then, the yen’s depreciation, which took place amid widening US-Japanese interest rate differentials, was blamed for a number of ills including a rising cost of imports. Japanese currency authorities eventually intervened in the market to prop up the yen. After appreciating for several months following the intervention, the yen has been weakening again as the Bank of Japan hints that it is not in a hurry to end its monetary policy easing. The yen is edging towards last year’s lows, but the currency’s losses have not generated as much alarm, and the market is seemingly less concerned about the authorities intervening.

One reason behind the market’s more sanguine view is that the recent depreciation so far has been taking place at a relatively gradual pace with the currency retracing levels already witnessed last year. The authorities tend to intervene primarily to reduce volatility in what can be dubbed as smoothing operations. We have yet to see the kind of volatility that gripped the dollar/yen last year and likely prompted the authorities to intervene. Another reason is that compared to a year ago, the prices of commodities have declined. A year ago, a rise in commodity prices and the yen’s weakening occurred simultaneously and was seen as a double blow for consumers. This time, however, lower commodity prices have helped offset the negative effects of a weaker yen, likely limiting calls for intervention.

Furthermore, the yen may not remain on the back foot versus the dollar indefinitely. This is because the Fed could halt raising rates as early as Q1 2024, removing support for the greenback. The yen could be reinforced by domestic factors as well; the chances of inflation becoming a well-entrenched economic phenomenon are increasing, with rising wages providing support. If the rise in wages equal or exceed the inflation rate, that may help trigger a full-fledged recovery in domestic consumption; this in turn will lead to greater capex and boost demand for funds, ultimately pushing up yields and causing the yen to appreciate.

## Market: Japan stocks mixed in August with losses pared as US policy woes ease

The Japanese equity market was mixed in August, with the TOPIX (w/dividends) rising 0.43% on-month and the Nikkei 225 (w/dividends) falling 1.60%. The market was bearish up until mid-month due to factors including a major rating agency downgrading US debt and concerns regarding an economic slowdown in China stemming from the announcement of lower-than-expected macro indicators. In the latter half of the month, Japanese stocks rebounded to an extent as excessive anxieties surrounding US monetary tightening dissipated following US Federal Reserve Chair Jerome Powell’s speech at the Jackson Hole Economic Policy Symposium, which was largely in line with expectations.

Of the 33 Tokyo Stock Exchange sectors, 24 sectors rose, with Marine Transportation, Mining, and Oil & Coal Products posting the strongest gains. In contrast, 9 sectors declined, including Precision Instruments, Electric Appliances, and Air Transportation.

### Exhibit 1: Major indices

Index	Mth-end	1-mth	3-mth	6-mth
Nikkei 225	32,619.34	-1.7%	5.6%	18.9%
JGB Yield	0.651	+0.039	+0.215	+0.146
JPY/USD	145.92	2.6%	4.2%	6.7%
JPY/EUR	158.67	1.1%	6.2%	9.3%
MSCI World	2,986.02	-2.6%	6.6%	10.0%
Valuation	Mth-end	1-mth	3-mth	6-mth
TOPIX	2,332.00	0.4%	9.5%	17.0%
Div. Yield (e)	2.3%	2.5%	2.6%	2.8%
Price/Earn (e)	14.3	13.5	13.0	11.6
Price/Book	1.3	1.2	1.1	1.1

Source: Bloomberg, as at 31 August 2023

### Exhibit 2: Valuation and indicators

Valuation /indicator	Mth-end	3-mth	6-mth	1-yr	5-yr
<b>TOPIX</b>					
Div. Yield (e)	2.3%	2.5%	2.6%	2.8%	2.1%
Price/Earn (e)	14.3	13.5	13.0	11.6	14.1
Price/Book	1.3	1.2	1.1	1.1	1.4
Daily Turnover	75	78	70	64	54
Market Cap.	843	826	726	675	683
<b>MSCI World</b>					
Div. Yield (e)	2.1%	2.2%	2.3%	2.4%	2.4%
Price/Earn (e)	17.8	16.8	16.2	14.2	16.5
Price/Book	2.9	2.7	2.6	2.4	2.4

Source: Bloomberg, as at 31 August 2023

**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:** 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.

**Luxembourg and Germany:** This document is communicated by Nikko Asset Management Luxembourg S.A., which is authorised and regulated in the Grand Duchy of Luxembourg by the Commission de Surveillance du Secateur Financier (the CSSF) as a management company authorised under Chapter 15 of the Law of 17 December 2010 (No S00000717) and as an alternative investment fund manager according to the Law of 12 July 2013 (No. A00002630).

**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.