



CIO Memo

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Key takeaways

- The Bank of Japan raised its policy rate from 0-0.1% to 0.25% today and announced additional quantitative tightening plans.
- Japanese equities reacted positively to the rate hike and JPY appreciated today. The 10-year JGB yield rose slightly.
- Despite the recent corrections, we remain quite constructive on Japanese equities, and we reiterate our top sector picks including Consumer Discretionary, IT and Banks.

1. What happened?

The Bank of Japan (BoJ) raised its policy interest rate by 15 bps amid the still weak JPY and higher domestic inflation. This moved the target rate from 0-0.1% to 0.25%. This is the second time that the BoJ has raised its policy rate, with the first hike in March 2024 bringing an end to the BoJ's negative rate policy. While the move was expected by some, it went against the consensus view of the BoJ leaving interest rates unchanged at this meeting.

Alongside the rate hike decision, the BoJ also announced a quantitative tightening plan to halve its monthly bond buying from JPY6tn per month to JPY3tn by January-March 2026. Monthly purchases of Japanese government bonds (JGBs) will be cut about JPY400bn each calendar quarter, allowing enough flexibility to support stability in the JGB market.

The move came after robust wage growth propped up services prices with the largest base pay hikes seen in three decades. Inflation has remained above the BoJ's 2% target for more than two years. Tokyo Core CPI (ex. fresh food) for July rose 2.2% YoY while Nationwide Core CPI was up 2.6% YoY. In its statement, the BoJ said that "service prices have continued to rise moderately" and that higher wages were already reflected in higher selling prices. Furthermore, import price inflation turned positive again compared to the same period last year, which could become upside risks to Japan's inflation. The BoJ expects Japan's CPI inflation to come in at around 2.5% for the fiscal year 2024, and around 2% for the following two fiscal years.

On the economic side, the BoJ said that Japan's business fixed investment was rising moderately with improving corporate profits. Household consumption was still resilient despite the higher inflationary pressures. Public sector investment has been flat while housing investment was relatively weak.

Japan: Rate hike with higher inflation

2. How did markets react?

Japanese equities reacted positively to today's BoJ rate hike. The benchmark Nikkei 225 Index rose 1.49% to 39,102, while the Topix Index rose 1.45% to 2,794. JPY appreciated 1.47% against USD today to 150.5, as of 6 pm Singapore Time, the strongest level since March this year. The 10-year JGB yield rose to 1.06% today, compared to 1.0% at yesterday's close.

3. What does it mean for investors?

At this meeting the BoJ's main reason for the hike was that data is still on track for the sustainable and stable achievement of its inflation target of 2%. This 15 bps rate hike was higher than the BoJ's usual pace in the past of 10 bps hikes. The BoJ is maintaining a data-driven stance, striking a similarly cautious tone as at its previous meeting, emphasising the risk management rationale for its rate hike decision at the initial stage of the hiking cycle.

Another key trigger for the BoJ is the weak JPY that is weighing on consumption. Prices re-accelerated despite recent moderation. Coupled with a weak JPY, upside risks to prices drew the attention of the BoJ, with a greater risk of inflation overshooting its forecast. Higher prices could affect household consumption patterns despite the recent wage growth. The rate hike was thus a move to arrest the JPY's decline and to address the upside risk to prices.

With the current interest rate at 0.25% and CPI inflation above 2%, Japan's real interest rate remains in very low negative territory. We therefore believe the BoJ has scope to continue hiking rates. In our base case, we expect the BoJ policy rate to go up to 0.5% by June 2025. Having said that, we expect BoJ monetary policy to remain accommodative in the near term, considering the uncertainty and downside risks to growth, including soft export recovery and slow consumption growth.

The JPY has been appreciating since July 11 following a repricing of rate cuts by the Fed. Despite the recent appreciation in the JPY, the profitability and business outlook of Japanese companies remain positive as the JPY is still at historically low levels.

We remain quite constructive on Japanese equities because of the resilient corporate fundamentals, still accommodative monetary policy and attractive valuations. We reiterate our top sector picks including Consumer Discretionary, IT and Banks.



Glossary

The **Bank of Japan (BoJ)** is the central bank of Japan.

The **consumer price index (CPI)** measures the price of a basket of products and services that is based on the typical consumption of a private household.

The **Federal Reserve (Fed)** is the central bank of the United States. Its Federal Open Market Committee (FOMC) meets to determine interest rate policy.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

JGB stands for Japanese government bonds.

JPY is the currency code for the Japanese yen, the Japanese currency.

Japan's **Nationwide Core CPI** measures the price of a basket of products and services that is based on the typical consumption of a private household, excluding fresh food.

Nikkei 225, or the Nikkei Stock Average, more commonly called the Nikkei or the Nikkei index, is a stock market index for the Tokyo Stock Exchange.

Tokyo Core CPI measures the price of a basket of products and services that is based on the typical consumption of a private household, excluding fresh food, excluding fresh food in Tokyo.

Tokyo Stock Price Index, commonly known as **TOPIX**, along with the Nikkei 225, is an important stock market index for the Tokyo Stock Exchange in Japan, tracking all domestic companies of the exchange's Prime market division.

USD is the currency code for the U.S. Dollar.

YoY refers to year-on-year which compares data in a given month from the immediately preceding year.



Historical performance

Performance	31.7.2019 – 31.7.2020	31.7.2020 – 31.7.2021	31.7.2021 – 31.7.2022	31.7.2022 – 31.7.2023	31.7.2023 – 31.7.2024
Topix	-4.4%	27.1%	2.1%	19.7%	20.3%
Nikkei 225	0.9%	25.7%	1.9%	19.3%	17.9%
USD/JPY	-2.7%	3.6%	21.5%	6.7%	5.6%
JGB	-1.3%	0.5%	-0.7%	-0.4%	-2.2%
Topix Banks	-21.7%	26.8%	17.0%	49.4%	48.4%
Topix IT	13.6%	39.5%	-4.9%	24.9%	24.6%
Topix Cons. Disc.	-5.3%	41.8%	2.6%	20.1%	10.2%

Source: LSEG Datastream, Deutsche Bank AG. Data as of July 31, 2024.



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