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WWTD - FEATURE

Market Outlook 2023

JAPAN

Inflation beneficiary

INSIDE

Stable GDP

Expect +1% GDP growth in 2023

Inflation is a healthy problem

Rising inflation will help make Japanese wages more competitive

Japan could taper its YCC policy in 2023

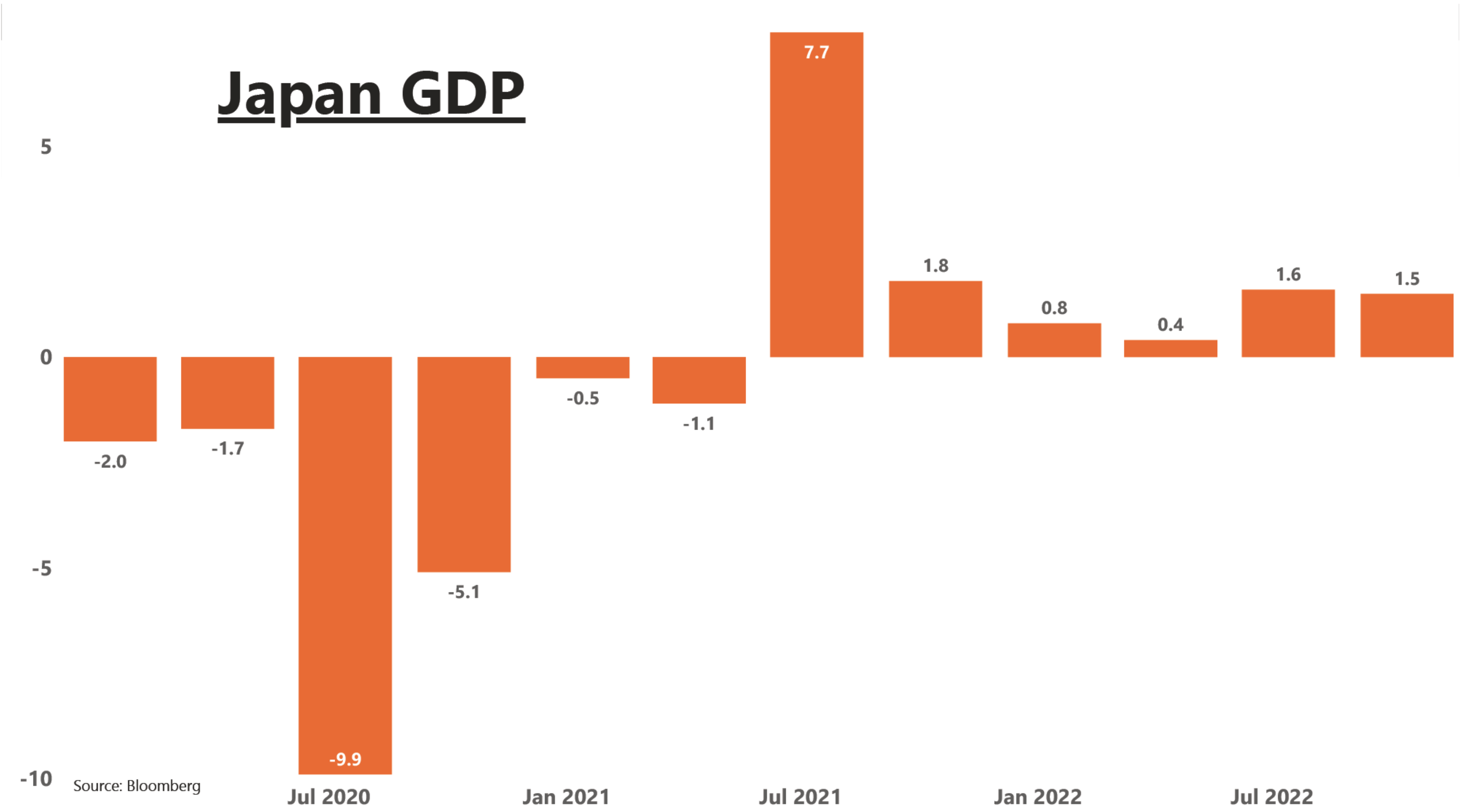
Yen could strengthen further if BOJ continues its tapering of its YCC policy

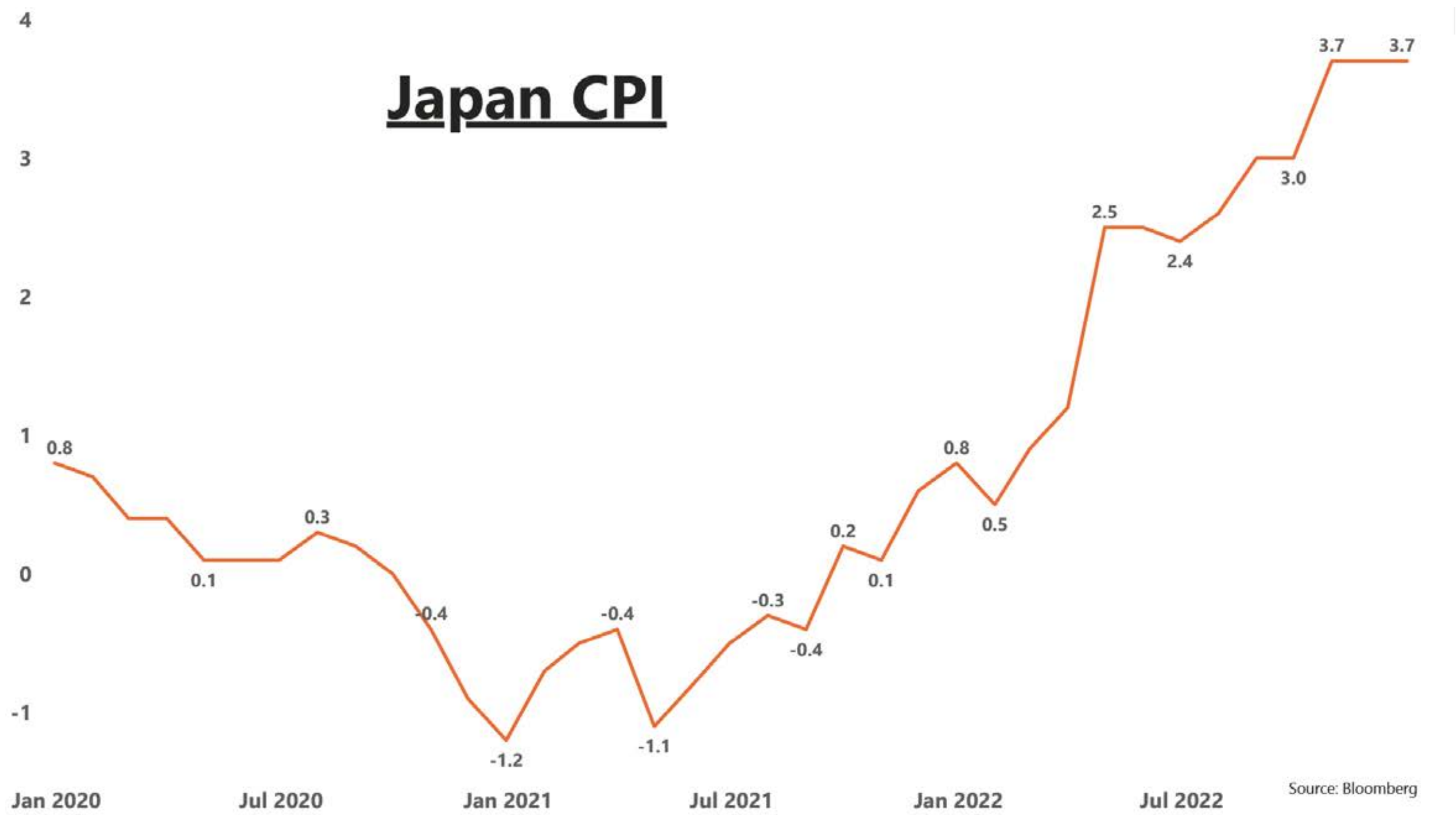
Shaking off the Deflation Devil

Deflation has plagued Japan for the past two decades.

Inflation is welcomed in Japan, unlike other developed countries. This is because Japan has faced deflation for the past two decades. In 1989, Japan had a catastrophic banking crisis and stock market crash. This resulted in low borrowing and high-risk aversion that is entrenched into the mindset of most Japanese.

With Japan stuck in a deflationary spiral for the past two decades, the return of inflation is embraced by policymakers. Hence, we believe that Japan is an inflation beneficiary, with strong upside potential for Japanese equities.





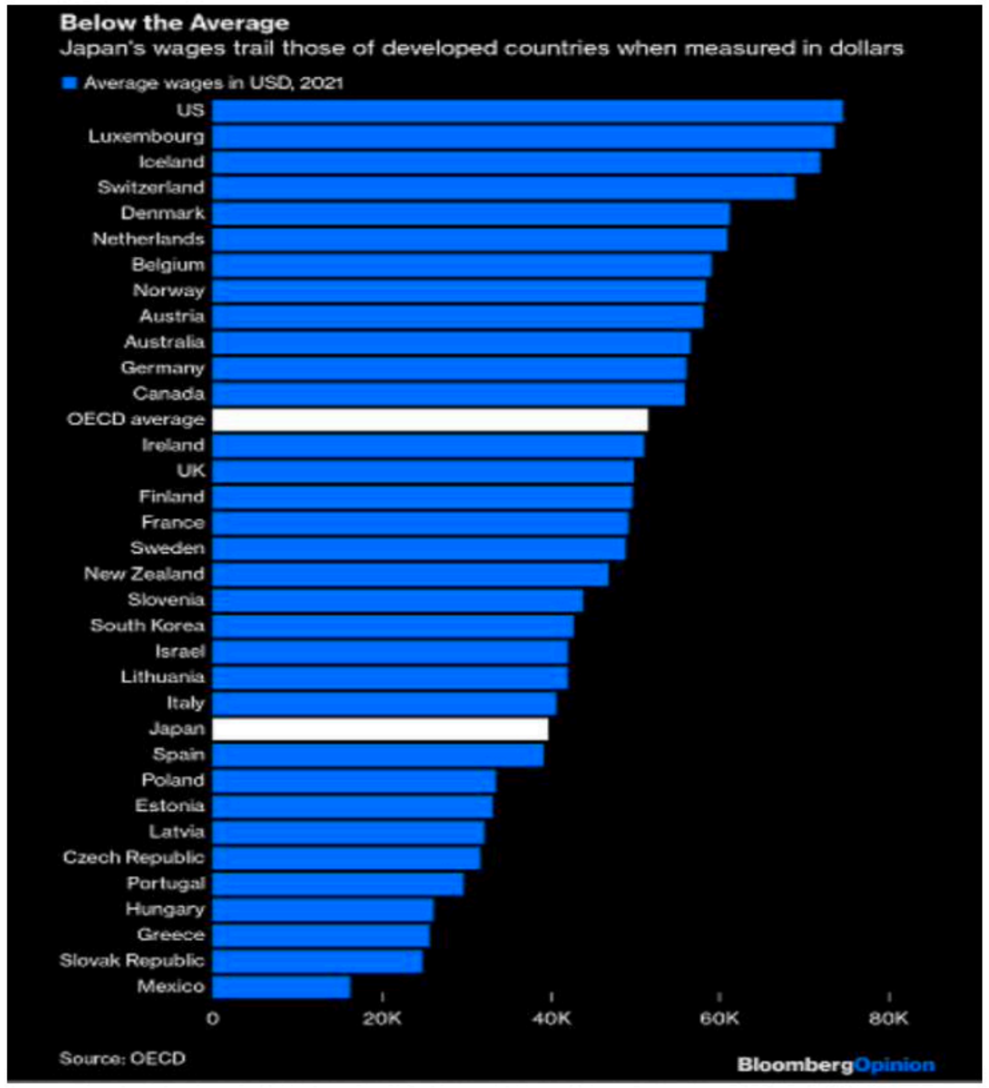
Stable GDP

We expect Japan GDP to be stable and trend at +1% in 2023, above its 10-year average of 0.6%.

The Japanese economy is in a much better position compared to other developed countries. After two years of strict COVID restrictions, Japan finally eased border control in October. This will encourage more inbound travels from tourists as well as boost economic activities domestically.

Inflation and Wage Growth still low

BOJ has consistently pointed towards weak wage growth as a reason to remain dovish. While CPI has soared to 3.7%, wage growth remained subdued at around 1.8%. This has allowed BOJ to continue pursuing a negative interest rate policy.



Inflation is a healthy problem

During the 1960s to 1980s, Japan had strong economic growth, and was poised to overtake the US as an economic powerhouse. But its economic ambition was curtailed during the stock market and banking crisis in 1989. Ever since the crisis, inflation in Japan has remained low, and even turned into deflation in the 2000s.

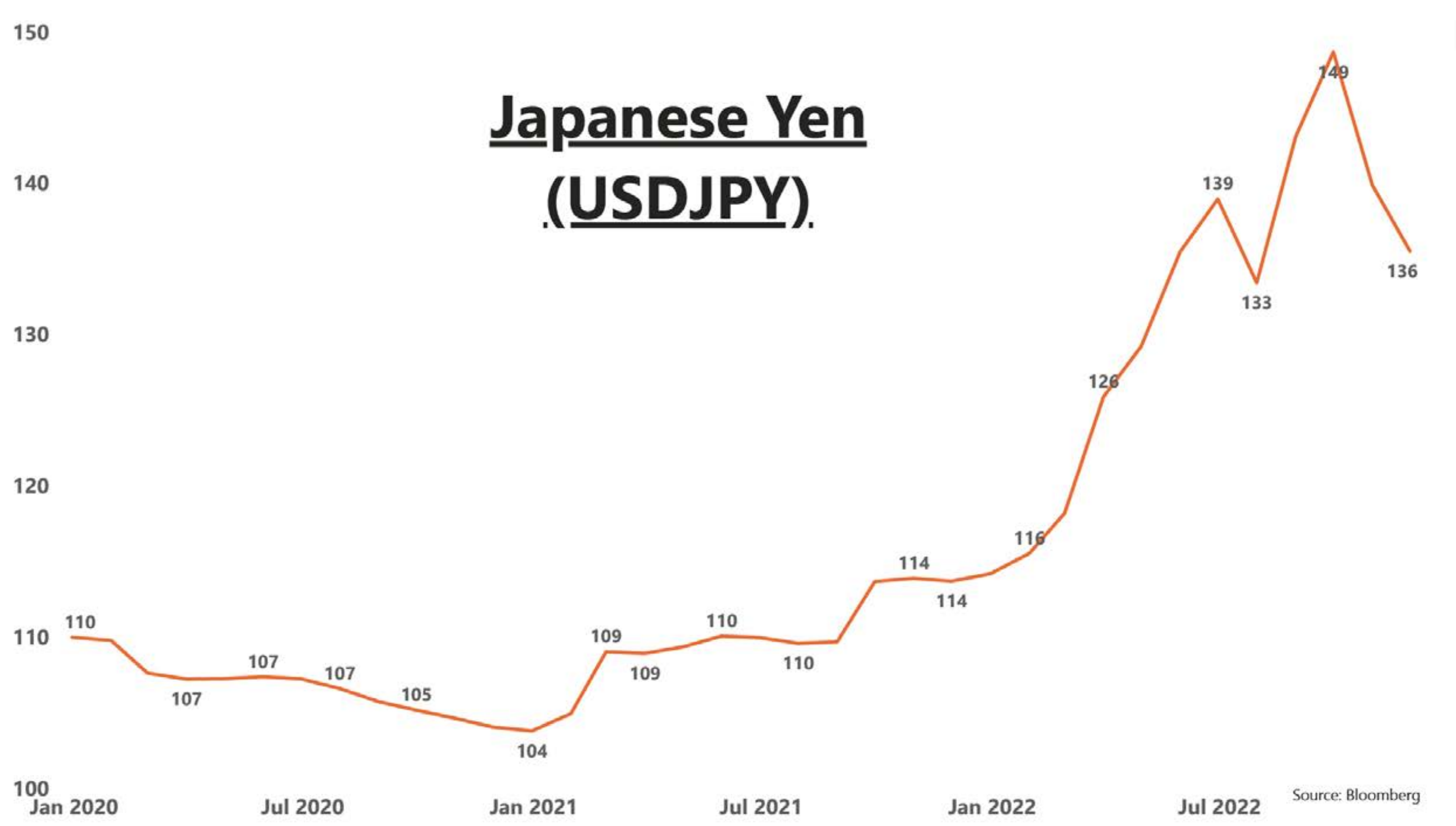
Globally, Japan's wages are ranked poorly when compared to those in developed countries. In fact, it is more lucrative to "flip burgers" in the US than working at a megabank in Japan.

"Better to Flip Burgers than work at a Megabank."
- Gearoid Reid

This weak yen makes the wages of Japan's long-suffering workers seem absurdly low.

Yen could strengthen further

At the end of 2022, BOJ made a surprise decision to increase the upper bound of its target for 10-year Japanese government bond yields to 0.5% from 0.25%. This could lead to more tapering in its Yield Curve Control (YCC) policy with the further increase of the upper bound target. This will result in more strengthening of the Japanese Yen.



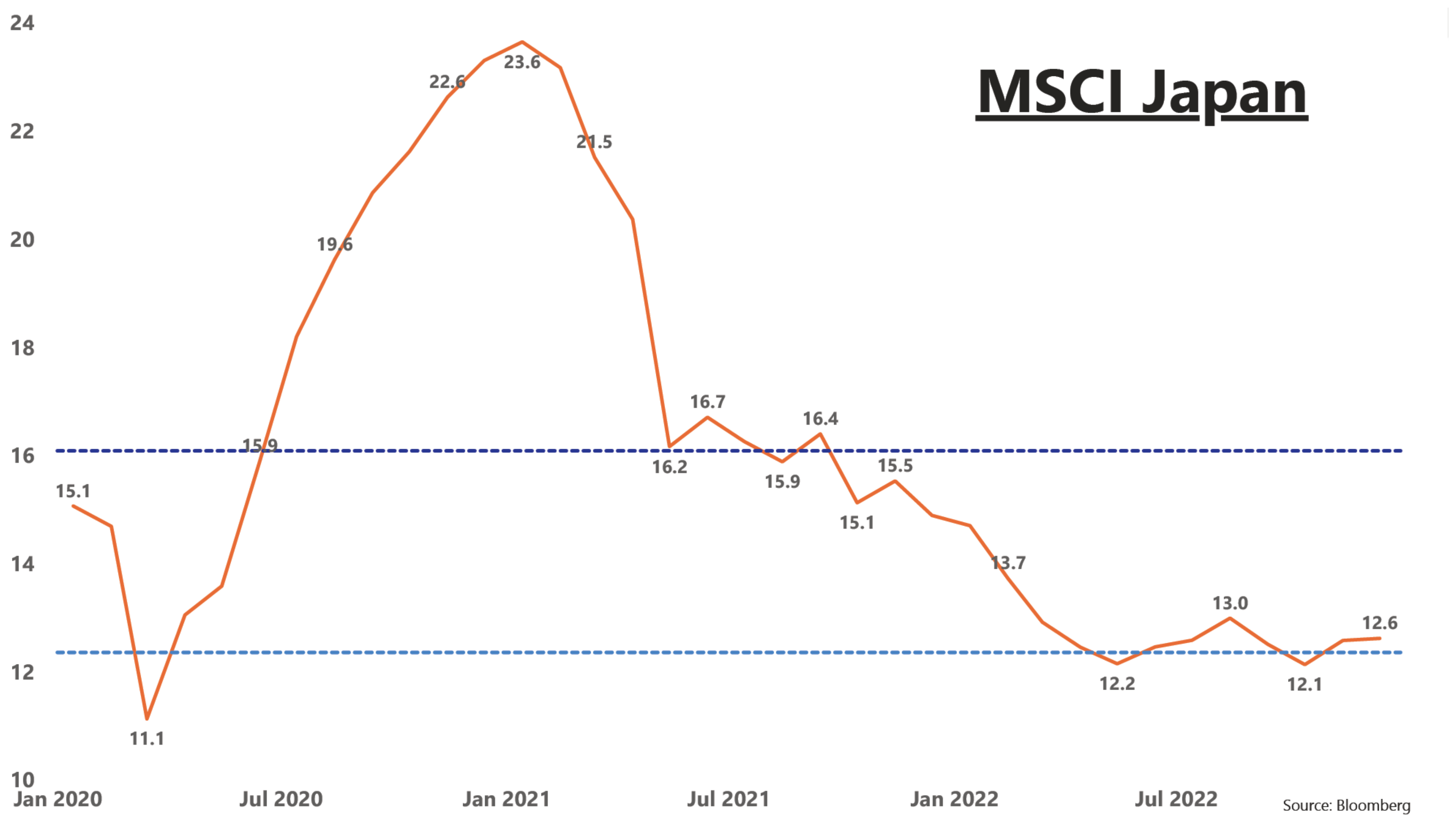
Upside potential for Nikkei 225 Index

Our 2023 target for MSCI Japan Index is 1364. This represents a P/E of 14.2.2x, 0.5 standard deviation below its 3- year mean P/E.

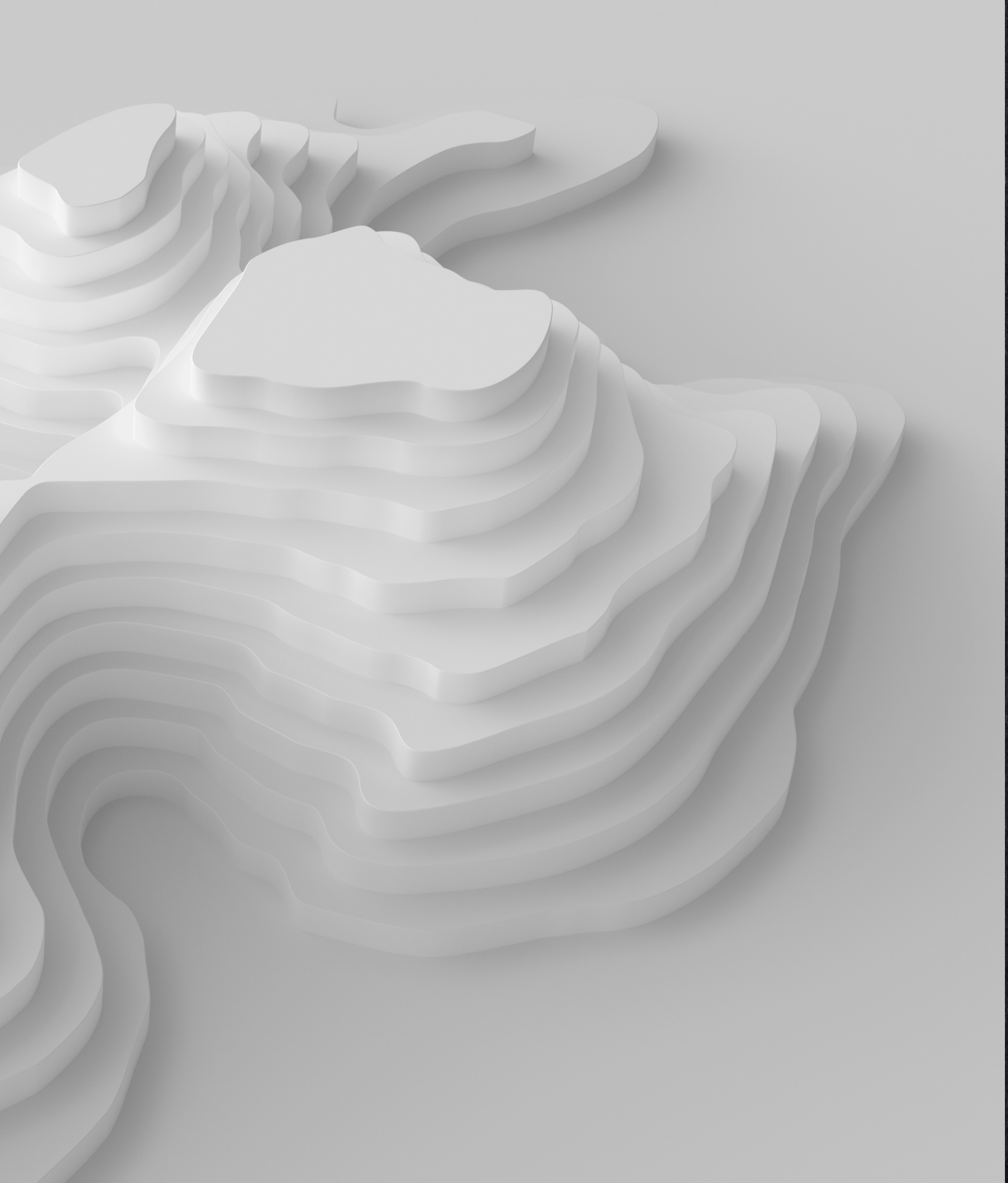
MSCI Japan Index is trading at 12.6x forward P/E, more than 1 standard deviation below its 3-year mean P/E.

We believe that the Japanese equities will be supported by stable economic growth and corporate earnings.

Key drivers include:
1) Economic reopening
2) Accommodative financial conditions
3) Benign wage inflation
4) Proactive fiscal policy



Source: Bloomberg



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