

Japan Equity Strategy

BOJ policy change/outlook as expected; not a negative for Japanese stocks

Investment Strategy

BOJ policy change: in line with expectations

The BOJ announced a change in policy, but an expected one. We do not think this is a negative for Japanese stocks (although the Governor's press conference was not complete as of this writing; the BOJ's house view is in line with our economist's). The BOJ will end its purchases of ETFs (Exchange Traded Funds), but it had hardly made any such purchases over the last few years and share buybacks had already replaced the BOJ as the stable buyer of Japanese stocks. We therefore think the impact will be minimal.

Inflation regime: We remain bullish on Japanese stocks

With the BOJ's event having passed, the market is likely to turn its attention to wage inflation from Apr-Jun. The results of the Spring wage negotiations strongly suggest that real wage growth will turn positive, and if inflation stabilizes at around 2% it should boost the 2025 Shunto salary increase. After experiencing a large shift, wages tend not to return to their previous level. Meanwhile, as long as the BOJ's rate hikes are gradual, the real policy rate should remain at more accommodative levels than it was during the previous period of monetary easing. The inflationary environment has encouraged corporate reforms, and if shareholder payouts increase, we expect that would spark an inflow of funds into NISA (Nippon Individual Savings Account). The inflation regime should boost reform of both Japanese stocks and Japanese companies.

Wage inflation has positive implications for all domestic demand-driven sectors, including retail/services, IT services, real estate, and railways. Additionally, a significant unwinding of strategic shareholdings by the P&C insurers is likely to accompany corporate reforms, and this will provide business opportunities to the major brokerage firms. Although the market may see this change in monetary policy as ending positive catalysts for banking stocks, if the BOJ continues raising rates it will create significant earnings upsides. Of course, as long as the BOJ takes a gradual approach to raising rates, yen appreciation should be limited and without negative impacts on external demand-driven sectors (there are many sectors poised for strong earnings growth from both external demand and domestic demand in FY24, and we expect both to be favored by investors).

Exhibit 5 lists the stocks that have seen improvement in ROE and recurring profit relative to what they were prior to NIRP in FY15, have a P/B below 1.7x, and a P/E below 20x.

19 March 2024

Investment Strategy
Japan

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Timestamp: 19 March 2024 06:00AM EDT

BOJ policy change: in line with expectations

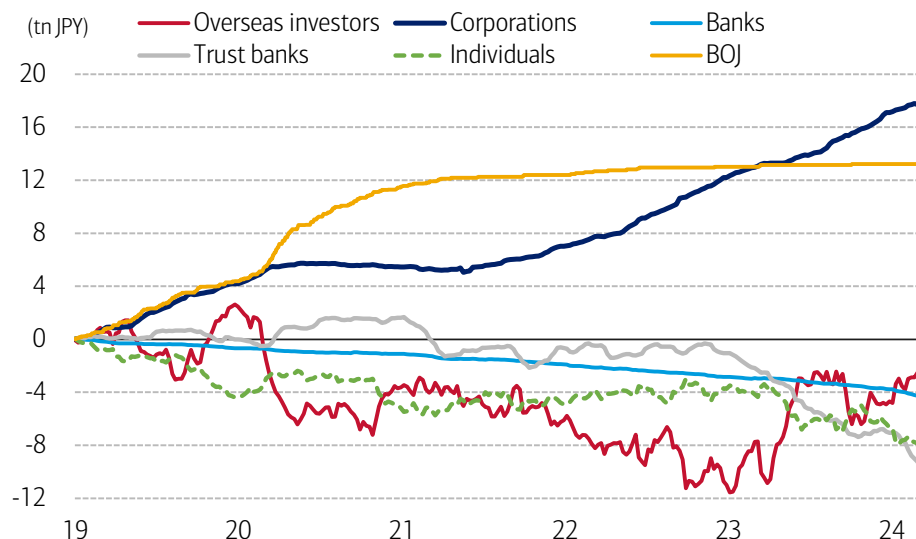
The BOJ decided to change policy on 19 March. The primary changes were (1) an exit from NIRP, raising the IOER to 0.1% and guiding the unsecured overnight rate to around 0-0.1%; (2) abandonment of YCC (Yield Curve Control), including continued purchases of long-term JGBs at roughly the same amounts as now, flexibly making more or less purchases as necessary in the event of a sharp increase in long-term yields; and (3) ending new purchases of ETFs and J-REITs. This is what our economist expected, and the BOJ's comment that the accommodative monetary environment will continue for the time being is reassuring. We do not think this is negative for Japanese stocks. Note that this report was written before the BOJ Governor completed his press conference. The BOJ's house view is in line with our economist's.

The above-noted policy change was seen as a done deal and already fully priced in to the market. Including the two changes to YCC made in 2023, the BOJ appears to be succeeding in normalizing its historic monetary policy. The inflationary environment that has enabled this seems to be having a positive impact on the market.

The BOJ will end its purchases of ETFs, but it had hardly made any such purchases over the last few years and share buybacks had already replaced the BOJ as the stable buyer of Japanese stocks. We expect the market impact to be minimal (Exhibit 1). The BOJ's acquisition of stocks as a "silent shareholder" had a worsening impact on governance and distorted the supply-demand structure, but share buybacks are symbolic of raising awareness of shareholder payouts and push ROE higher. Although there is a potential risk of ETF sales in the future, even if they do occur, BOJ Governor Ueda declared his commitment to doing what it takes to avoid disruptive market impacts (on 17 November 2023, speaking to the Lower Diet's Financial Affairs Committee). He also noted that one of the BOJ's options is to continue holding ETFs (7 June 2023, speaking to the same committee).

Exhibit 1: Cumulative investment flows by investor type

The BoJ's purchases are replaced by corporation's share buybacks



Source: BofA Global Research, QUICK

Note: "Overseas investors" include trading in both cash securities and futures.

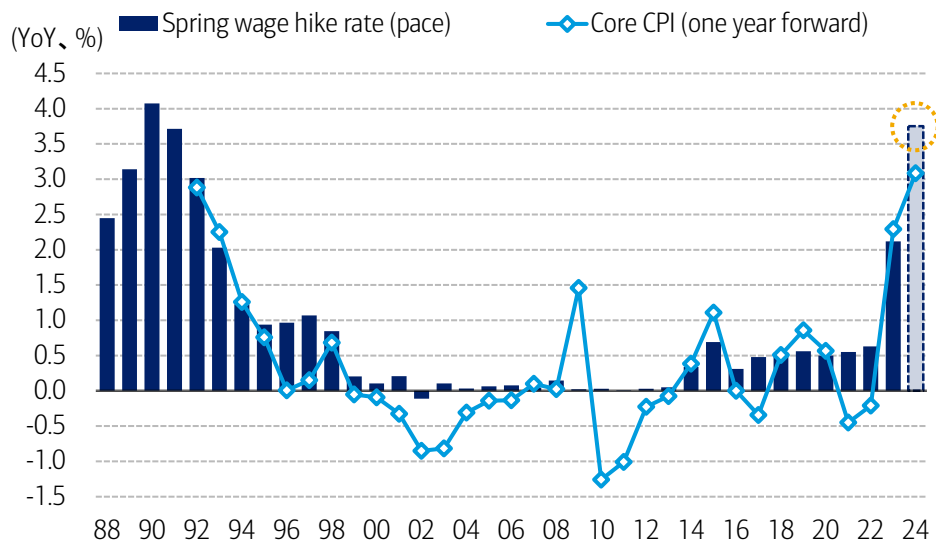
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Inflation regime: We remain bullish on Japanese stocks

With the BOJ's event having passed, the market will likely turn its attention to wage inflation from Apr-Jun. The surprising result from the Spring wage negotiations of a 3.7% base salary increase strongly suggests that real wage growth will turn positive (for details, see our 15 March [Japan Watch](#)). Consequently, if the core CPI stabilizes at around 2% in 2024, the Shunto wage increase, which is affected by the prior year's inflation rate, is likely to be high in 2025, as well (Exhibit 2). After experiencing a large shift, wages do not typically return to their previous level. When former Prime Minister Shinzo Abe implored companies to raise wages in 2014, the wage increase was seen as "Abe-made" and largely expected to be temporary, but wages remained high after shifting upward.

Exhibit 2: Shunto wage increase vs. the 1-yr prior core CPI

Spring wage hike rate tends to be influenced by the previous year's CPI



Source: BofA Global Research, RENGO, MHLW

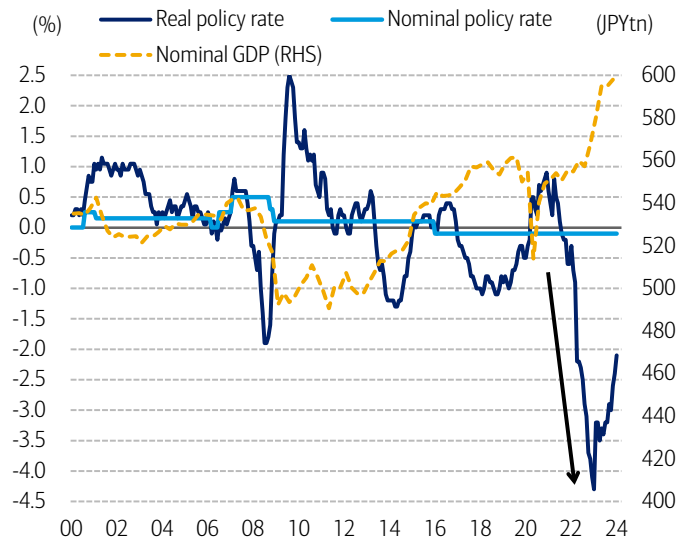
Note: We calculate the calendar average for the core CPI. For 2024, we use RENGO's first collected result.

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With the swap market pricing in a rate hike to 0.5% over the next two years, assuming a core CPI of 2%, this implies a real policy rate of only -1.5% over the next two years. This is a more accommodative level than what it was during continued monetary easing under deflation (Exhibit 3). Additionally, as long as the BOJ raises rates gradually, nominal GDP growth should remain consistently higher than the interest rate (Exhibit 4). This is an environment in which returns on real investments are always higher than funding rates, making it appropriate for companies to invest using leverage. This should be a positive for all risk assets.

Exhibit 3: BoJ policy rates vs. nominal GDP

The real policy rate remains deeply negative

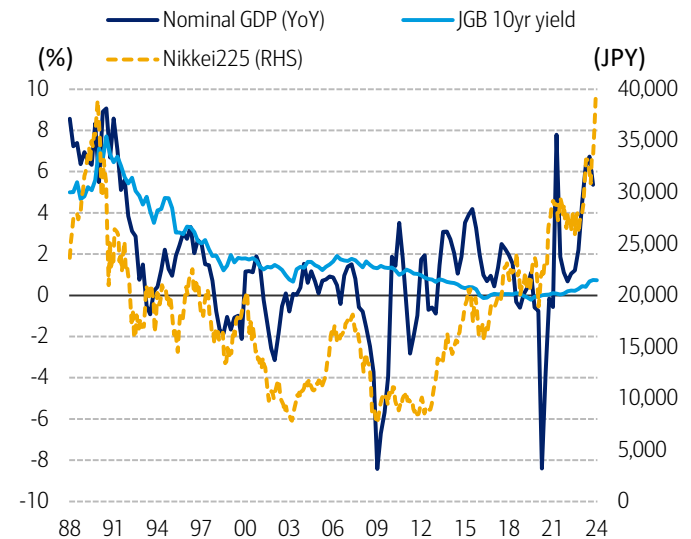
**Source:** BofA Global Research, INDB

Note: We calculate the real policy rate using the core CPI (excluding impacts from the consumption tax hike)

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Exhibit 4: Nominal GDP, JGB 10-yr rate and Nikkei 225

Nominal GDP growth has surpassed JGB 10-yr rate

**Source:** BofA Global Research, Bloomberg, Refinitiv

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Also important is that companies pursue more reform under inflation. The upcoming earnings season is likely to provide many more examples of this. The North American investors who we visited displayed their greatest level of interest in corporate reform (for details, see our 18 March [Japanese equity strategy](#)). Additionally, if FY3/24 results show an increase in shareholder payouts, it should create a virtuous cycle of funds flowing into NISA. The inflation regime should boost reform of both Japanese stocks and Japanese companies. We remain bullish on Japanese stocks.

Wage inflation has positive implications for all domestic demand-driven sectors, including retail/services, IT services, real estate, and railways. Additionally, a significant unwinding of strategic shareholdings by the P&C insurers is likely to accompany corporate reforms, and this will provide business opportunities to the major brokerage firms. Additionally, a significant unwinding of strategic shareholdings by the P&C insurers is likely to accompany corporate reforms, and this will provide business opportunities to the major brokerage firms (for details, see our 18 March report on the [Financial sector](#)). Of course, as long as the BOJ takes a gradual approach to raising rates, yen appreciation should be limited and without negative impacts on external demand-driven sectors (there are many sectors poised for strong earnings growth from both external demand and domestic demand in FY24, and we expect both to be favored by investors).

Since the BOJ introduced negative interest rates in January 2016, the zero rate deflationary economy led to a major drop in the valuation of value stocks. These stocks have the potential to regain their valuations. Exhibit 5 lists the stocks that have seen improvement in ROE and recurring profit relative to levels prior to NIRP in FY15, a P/B below 1.7x, and a P/E below 20x.

Exhibit 5: Stocks with improvement in RP earnings/ ROE changes post the introduction of NIRP in FY2015, P/B below 1.7x, P/E below 20x

P/B below 1.7, FY2 P/E below 20, RP growth (FY2) surpassed that in FY15 by 30%, ROE (FY2) > ROE in FY15, FY2 RP revisions above -2%

Code Name	Sector	Mkt cap (bn JPY)	Current P/B	P/B as of end-2015	% FY2 RP vs FY15	ROE (FY2, %)	P/E (FY2,x)	RP revision (FY2, vs. 3 months prior,%)	YTD return (vs. TOPIX, %)
9008 KEIO CORP	Land Transportation	529	1.3	2.0	38.5	8.3	16.6	23.1	-20.1
6481 THK CO LTD	Machinery	447	1.2	1.1	78.4	6.5	18.3	22.9	5.8
8630 SOMPO HOLDINGS INC	Insurance	2,986	1.2	1.0	89.2	12.5	10.2	21.2	18.0
8725 MS&AD INSURANCE GROUP HOLDIN	Insurance	4,099	1.1	0.8	76.2	11.0	11.1	17.7	24.5
5019 IDEMITSU KOSAN CO LTD	Oil & Coal Products	1,479	0.8	0.5	1160.3	9.3	9.0	17.2	18.3
9107 KAWASAKI KISEN KAISHA LTD	Marine Transportation	1,533	1.0	0.6	4477.0	9.0	11.7	17.0	-7.0
9101 NIPPON YUSEN KK	Marine Transportation	2,203	0.8	0.6	357.4	10.3	9.5	16.6	-13.7
8604 NOMURA HOLDINGS INC	Securities & Commodity Futures	2,825	0.9	0.9	80.8	6.4	13.7	14.5	32.6
5105 TOYO TIRE CORP	Rubber Products	418	1.1	1.9	54.9	14.1	6.8	14.1	0.0
1911 SUMITOMO FORESTRY CO LTD	Construction	892	1.2	1.2	524.5	13.4	7.7	13.4	-14.8
5201 AGC INC	Glass & Ceramics Products	1,165	0.8	0.7	111.2	6.8	11.1	12.6	-9.7
9202 ANA HOLDINGS INC	Air Transportation	1,537	1.5	1.5	38.0	12.9	12.1	12.2	-10.3
1928 SEKISUI HOUSE LTD	Construction	2,206	1.2	1.4	95.3	11.9	9.7	10.7	-8.0
9104 MITSUI OSK LINES LTD	Marine Transportation	1,715	0.8	0.5	592.5	10.5	7.9	10.5	-8.3
7272 YAMAHA MOTOR CO LTD	Transportation Equipment	1,396	1.2	2.0	125.5	15.0	7.3	9.8	-6.5
5411 JFE HOLDINGS INC	Iron & Steel	1,566	0.7	0.6	401.7	9.4	6.8	9.0	-1.2
5471 DAIDO STEEL CO LTD	Iron & Steel	401	1.0	0.8	118.6	9.0	11.0	8.3	4.8
2002 NISSHIN SEIFUN GROUP INC	Foods	616	1.4	1.6	93.9	7.7	17.3	7.7	-0.9
7203 TOYOTA MOTOR CORP	Transportation Equipment	59,713	1.5	1.4	115.3	13.9	13.0	7.5	22.7
3099 ISETAN MITSUKOSHI HOLDINGS L	Retail Trade	852	1.5	1.1	64.0	7.5	19.9	7.0	33.0
8058 MITSUBISHI CORP	Wholesale Trade	13,352	1.6	0.6	1657.8	11.6	12.8	6.7	36.7
3405 KURARAY CO LTD	Chemicals	536	0.7	1.0	36.1	7.8	9.4	6.2	-5.1
1944 KINDEN CORP	Construction	523	1.0	0.9	38.7	6.3	15.1	5.8	-0.0
2282 NH FOODS LTD	Foods	536	1.0	1.4	38.0	6.4	16.0	5.6	-4.5
6301 KOMATSU LTD	Machinery	4,140	1.5	1.2	169.6	13.2	11.0	5.5	3.6
5802 SUMITOMO ELECTRIC INDUSTRIES	Nonferrous Metals	1,774	0.9	1.0	38.7	6.9	12.5	5.5	13.3
8053 SUMITOMO CORP	Wholesale Trade	4,198	1.0	0.6	357.2	11.1	8.4	5.5	0.1
8031 MITSUI & CO LTD	Wholesale Trade	9,611	1.4	0.7	4645.6	11.9	10.7	5.1	10.4
5020 ENEOS HOLDINGS INC	Oil & Coal Products	2,113	0.7	0.7	210.4	7.4	9.4	4.7	11.5
8015 TOYOTA TSUSHO CORP	Wholesale Trade	3,295	1.5	0.9	558.9	14.2	9.5	4.1	2.7
5444 YAMATO KOGYO CO LTD	Iron & Steel	533	1.1	0.7	238.6	10.0	9.4	4.0	-0.3
6417 SANKYO CO LTD	Machinery	438	1.5	1.0	283.3	17.6	8.2	4.0	-13.4
5401 NIPPON STEEL CORP	Iron & Steel	3,428	0.7	0.8	261.1	10.0	6.9	3.5	-2.7
5334 NITERRA CO LTD	Glass & Ceramics Products	935	1.6	2.1	89.4	13.8	10.9	3.5	26.7
5021 COSMO ENERGY HOLDINGS CO LTD	Oil & Coal Products	616	1.1	1.1	512.3	12.3	8.6	3.3	12.4
3289 TOKYU FUDOSAN HOLDINGS CORP	Real Estate	722	1.1	1.1	102.6	9.3	10.2	3.0	7.7
4088 AIR WATER INC	Chemicals	531	1.2	1.6	118.3	10.6	10.6	2.5	7.0
5406 KOBE STEEL LTD	Iron & Steel	809	0.8	0.6	355.2	8.9	8.5	2.5	-4.3
8253 CREDIT SAISON CO LTD	Other Financing Business	532	0.8	0.8	73.9	7.9	10.1	2.5	3.3
9142 KYUSHU RAILWAY COMPANY	Land Transportation	542	1.3	1.3	83.7	9.9	12.3	2.5	-0.6
3861 OJI HOLDINGS CORP	Pulp & Paper	611	0.6	0.8	76.9	6.8	8.9	2.3	-2.4
8002 MARUBENI CORP	Wholesale Trade	4,116	1.3	0.7	544.1	14.3	8.6	2.3	-2.5
6201 TOYOTA INDUSTRIES CORP	Transportation Equipment	4,710	1.0	1.0	85.9	5.8	18.0	2.2	15.0
8060 CANON MARKETING JAPAN INC	Wholesale Trade	570	1.3	0.9	105.1	8.5	14.3	2.1	-10.1
7751 CANON INC	Electric Appliances	5,814	1.3	1.4	30.7	8.7	18.8	2.0	7.5
8802 MITSUBISHI ESTATE CO LTD	Real Estate	3,251	1.5	2.3	78.9	7.9	18.3	1.7	17.6
7912 DAI NIPPON PRINTING CO LTD	Other Products	1,344	1.0	0.7	81.1	6.8	17.5	1.5	-5.1
4613 KANSAI PAINT CO LTD	Chemicals	535	1.5	1.9	50.5	11.4	15.3	1.5	-21.9
6113 AMADA CO LTD	Machinery	596	1.1	1.0	40.0	8.1	14.3	1.5	2.5
2768 SOJITZ CORP	Wholesale Trade	867	1.0	0.6	218.6	10.9	8.1	0.9	9.7
7267 HONDA MOTOR CO LTD	Transportation Equipment	9,412	0.7	1.0	149.7	9.2	8.8	0.9	9.8
8804 TOKYO TATEMONO CO LTD	Real Estate	432	0.9	1.0	196.5	9.3	8.7	0.9	-10.2
8801 MITSUI FUDOSAN CO LTD	Real Estate	3,862	1.4	1.6	58.8	7.3	16.2	0.9	15.7
8306 MITSUBISHI UFJ FINANCIAL GRO	Banks	18,753	1.0	0.7	36.6	7.7	12.8	0.7	11.6
6448 BROTHER INDUSTRIES LTD	Electric Appliances	669	1.1	1.0	38.7	8.3	11.9	0.4	2.7
9432 NIPPON TELEGRAPH & TELEPHONE	Information & Communication	16,462	1.7	1.1	48.4	13.7	12.7	-0.2	-10.0
3382 SEVEN & I HOLDINGS CO LTD	Retail Trade	5,625	1.5	2.1	49.0	8.6	18.1	-0.4	-0.1
4203 SUMITOMO BAKELITE CO LTD	Chemicals	409	1.5	0.7	218.9	8.7	16.5	-0.5	6.2
8227 SHIMAMURA CO LTD	Retail Trade	577	1.4	1.7	45.6	8.6	13.9	-0.7	-1.3
6305 HITACHI CONSTRUCTION MACHINE	Machinery	947	1.3	1.0	555.4	13.7	9.2	-1.5	5.1
1925 DAIWA HOUSE INDUSTRY CO LTD	Construction	2,865	1.2	2.0	73.4	11.4	10.3	-1.6	-12.1

Source: BofA Global Research, QUICK

Note: Universe consists of TOPIX stocks with mkt cap above 400 bn JPY, screened based on the following conditions: P/B below 1.7, FY2 P/E below 20, FY2 RP growth surpassed that in FY15 by 30%, FY2 ROE > ROE in FY15, FY2 RP revisions above -2%; listed in descending order of FY2 RP revision. Estimated value is based on QUICK consensus. This is a screen and not a recommended list either individually or as a group of stocks and options. Investors should consider the fundamentals of the companies and their own individual circumstances / objectives before making any investment decisions.

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R1} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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