KENSHO INVESTMENT GROUP

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CEO Insight: Exit from quantitative easing in Japan no cause for concern for real estate investors

Japan's central bank is not being driven by rising prices but is cautiously and reliably striving to normalize monetary policy.

The Bank of Japan (BoJ) was the first central bank in the world to introduce quantitative easing. By buying government bonds, it lowered long-term interest rates and provided additional liquidity to the banking system. With this unconventional strategy, central bankers in Tokyo sought to combat Japan's stagnant prices and wages. Long-time BoJ Governor Haruhiko Kuroda took quantitative easing to the extreme by fixing the yield on 10-year Japanese government bonds (JGBs) through purchase bids at around 0% with a small margin of fluctuation.

Ironically, not the ten Kuroda years of expansionary monetary policy, but the consequences of the Covid pandemic and Russia's war against Ukraine drove up Japan's inflation rate since the beginning of 2022, as Kuroda recently admitted. His successor, Kazuo Ueda, has now begun to scale back the extreme monetary policy of his predecessor. At the end of October, the BoJ leadership allowed the 10-year yield to rise to 1% and above. Since then, this level has been considered a "reference" and is no longer actively defended. In effect, the BoJ has relinquished its control over the yield curve.

Some analysts and financial market participants now conclude that interest rates in Japan will also rise rapidly. But in my view, the Bank of Japan will not allow a major spike in 10-year yields. Citizens, banks, companies, and politicians in Japan will have to get used to interest rates again, but at a much slower pace than we have seen in Europe and the US. The era of negative interest rates will probably end in 2024, long-term rates will rise above 1%, but not to reduce inflation, but to return to a normal monetary policy. Investors in Japanese real estate can therefore continue to plan for leverage at favorable financing conditions.

The minutes of the latest BoJ meeting confirm this assessment: The central bank wants to prepare “the market for a ‘world in which interest rates’ exist since interest rates have been low for so long”. Governor Ueda's comments last week, which aimed to get the markets used to the idea of an imminent rate change without dramatizing the process, should also be seen in this context. This intention explains the bank's seemingly contradictory communication that it is sticking to the 0% target for the 10-year JGB yield while allowing it to rise to 1% or more.

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During his online interview at the FT Global Boardroom conference, Ueda pointed to the "serious challenge" of unwinding years of ultra-loose monetary policy. "When we normalize short-term interest rates, we will have to be careful about what will happen to financial institutions, what will happen to borrowers of money in general, and what will happen to aggregate demand," Ueda said. Moreover, it would be easier to fight excessive inflation than too little inflation. This is the main difference between Japan's monetary policy and Europe's: the Japanese central bank does not allow itself to be driven by imported inflation and remains reliable so that market participants and affected parties such as companies, investors, and borrowers can adapt to the changes.

Under Ueda, the Bank of Japan continues to work closely with the government. It has a strong majority in the Diet, and legislative announcements are implemented consistently and quickly. The financial regulatory policy remains on a shareholder-friendly course, aiming at further growth in institutional and retail investment. Tax hikes on capital gains, as in Europe and the United States, are not an issue, while higher equity allocation by individual investors is encouraged by raising the limit for capital gains and dividend tax-free investments from 6-8 million yen to 18 million yen (112,000 euros) and making them permanently tax-free. The government's promise that citizens will be able to double their investment income should not be jeopardized by hasty or drastic changes in monetary policy.

Ueda's ideal scenario is for the policy rate to rise above zero while inflation remains clearly positive. Wage growth remains a very important factor in the timing of his moves. However, Ueda's yardstick is not whether real wages are positive, which has not been the case for some time, but whether the central bank can assume that real wages are moving in a positive direction. There is growing evidence that they are. Regular wage growth rose to a four-month high of 1.5% in September, so the trend is upward as desired. Japan's largest business lobby group, Keidanren, is urging its member companies to increase wages by more than 4%.

With a 20-year history of quantitative easing, later imitated by the Federal Reserve Board and the European Central Bank, Japan has no choice but to slowly approach higher interest rates. For example, the largest commercial bank, MUFG, has started paying 0.2% instead of 0.002% interest on a 10-year deposit since early November. At such rates, the Japanese real estate market will remain an exciting area for foreign investors compared to other countries.

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