FIRST NEWS VOL 57, FEB 2025

EQUITIES FIRST® Progressive Capital

# JAPAN IN FOCUS: RATE HIKES IN 2024 AND 2025 OUTLOOK


## EXECUTIVE SUMMARY

- **Strong Stock Market Performance:** Japan's stock market saw remarkable growth in 2024, with the Nikkei 225 index achieving a 19% gain. Key factors such as a depreciating yen, corporate governance improvements and relatively accommodative monetary policy boosted investor confidence and propelled the market to record highs.
- **Shift in Monetary Policy:** The Bank of Japan marked a significant turning point in its monetary policy by raising interest rates twice in 2024, ending its negative interest rate policy. This reflects confidence in Japan's economic recovery and efforts to manage inflation sustainably.
- **Economic Resilience:** Despite global challenges, Japan maintained economic stability with strong export growth supported by a weak yen, robust tourism and increasing wages, contributing to positive market sentiment.
- **Rising Shareholder Returns:** Japanese companies accelerated share buybacks in 2024, reaching record levels. This shift highlights improved capital efficiency and corporate governance, with a growing focus on shareholder value.
- **Currency Dynamics:** The yen's depreciation against the dollar in 2024 enhanced Japan's export competitiveness but increased import costs, impacting the inflationary pressures.
- **2025 Market Outlook:** The outlook for 2025 and beyond indicates gradual interest rate hikes while sustaining economic momentum and inflation.

## JAPAN STOCK PERFORMANCE

**NIKKEI 225 INDEX**


## MARKET RALLY

In 2024, the Nikkei 225 index, a proxy for Japan's stock market, achieved a 19% gain, following a 28% increase in 2023. On July 11, 2024, it reached a historic peak of 42,224 points. Several factors contributed to this performance:

- The depreciation of the yen made Japanese assets more affordable, attracting foreign investors. In 2024, they purchased approximately 1.23 trillion yen (around USD 7.8 billion) in Japanese stocks. (Source: Reuters)
- Ongoing improvements in corporate governance and increased shareholder returns enhanced investor confidence, leading to higher stock valuations.
- Positive economic data, including wage growth and strong corporate earnings, signaled economic health, further boosting market sentiment.
- The Bank of Japan's accommodative monetary policy maintained low interest rates relatively, supporting equity markets.
- These elements collectively propelled the Nikkei 225 to its record-breaking performance in 2024.

Source: Bloomberg

## MARKET TURMOIL

In July 2024, the Bank of Japan raised interest rates for the second time this year, increasing the short-term rate to 0.25%. This unexpected move led to a rapid appreciation of the Japanese yen, which strengthened to 150 per US dollar.

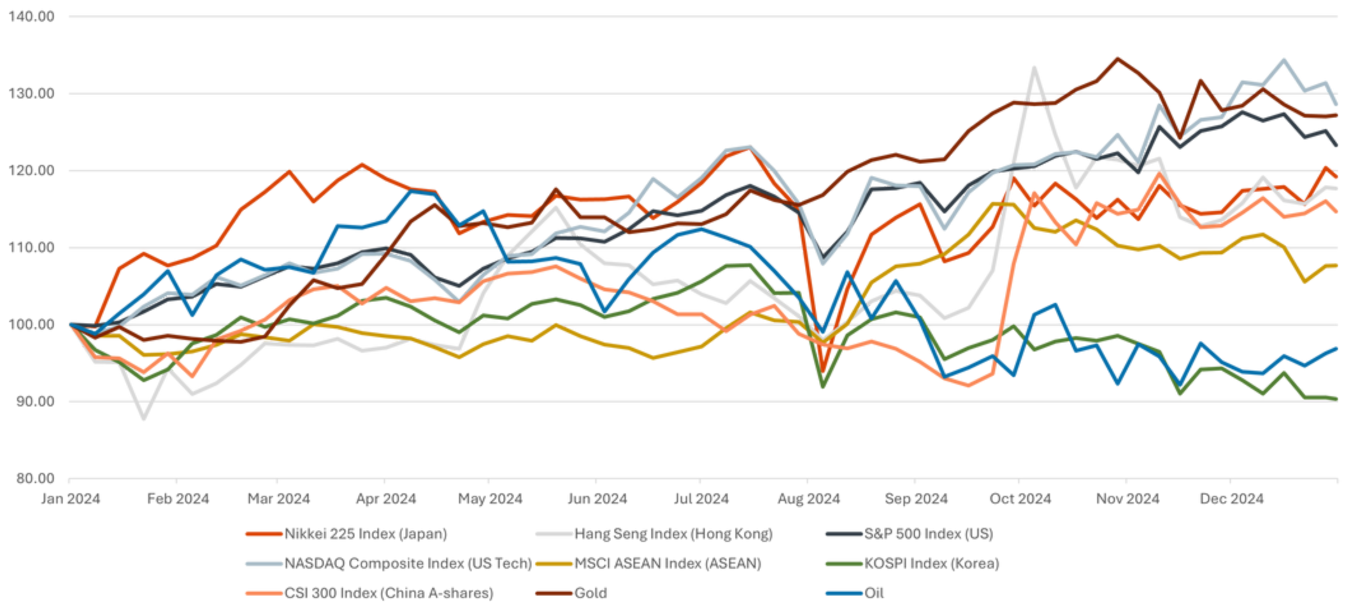
The sudden currency shift prompted investors to unwind yen carry trades, where they had borrowed yen at low interest rates to invest in higher-yielding assets abroad. The unwinding of these positions contributed to a significant sell-off in global stock markets, with Japan's Nikkei 225 experiencing its largest drop since 1987, plunging 12% on August 5.

However, the following day, the Nikkei rebounded sharply by 10%, as investors adjusted to the new monetary landscape.

A carry trade involves borrowing funds in a currency with low interest rates, such as the Japanese yen and converting them into a currency with higher interest rates to invest in assets that offer better returns. The profit arises from the difference between the low borrowing cost and the higher yields of the investments. This strategy is profitable as long as the low-interest-rate currency remains stable or depreciates. However, if the funding currency appreciates significantly, as the yen follow the rate hike, the cost of repaying the borrowed funds increases, potentially erasing profits and leading to substantial losses. This risk became evident in August 2024, when the yen's appreciation forced investors to unwind their carry trades, causing volatility in financial markets.

## COMPARED TO OTHER ASSETS

**2024 ASSET PRICE PERFORMANCE (%) (REBASED)**




Japan's stock market demonstrated remarkable performance this year, positioning itself just behind traditionally strong performers like the US stock market and gold. It notably outpaced many other key stock markets in Asia, including those in Hong Kong, China A-shares, ASEAN nations and Korea. This strong performance was driven by a combination of economic and policy factors that worked in favour of Japanese equities.

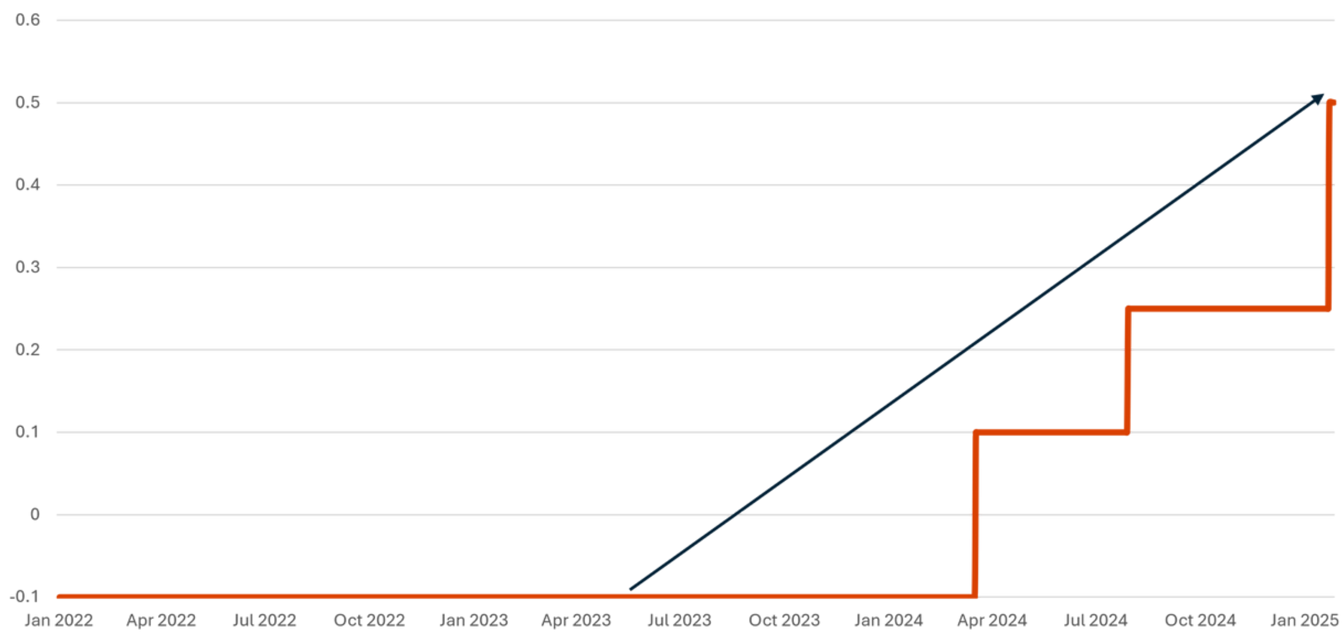
A key contributor was Japan's commitment to maintaining a low-interest-rate environment, which supported corporate growth and incentivized investments in the stock market. The weak yen further bolstered export competitiveness, making Japanese goods more attractive in international markets and driving export-led growth. Additionally, inflation in Japan remained relatively low and stable compared to other major economies, providing a favourable backdrop for economic expansion without eroding consumer and investor confidence.

The country's robust recovery in tourism also played a significant role. With the yen's depreciation making Japan a more affordable destination, international tourism surged, contributing to economic activity in key sectors such as hospitality, retail and transportation. This, coupled with strong export demand, added momentum to Japan's economic recovery, further lifting investor sentiment.

Source: Bloomberg

## JAPAN'S MONETARY POLICY SHIFTS IN 2024

**BANK OF JAPAN'S SHORT-TERM INTEREST RATE (%) (2022 - 2025)**




In 2024, Japan's monetary policy underwent a significant transformation. The Bank of Japan (BOJ) raised interest rates twice, marking the first increases in 17 years. In March, the BOJ ended its negative interest rate policy, adjusting the benchmark rate from -0.1% to a range of 0% to 0.1%. Subsequently, in July, the BOJ further increased the rate to 0.25%. This shift concluded Japan's era of negative interest rates, making it the last major economy to exit such a policy. These changes reflect the BOJ's growing confidence in the nation's economic recovery and its commitment to achieving sustainable inflation.

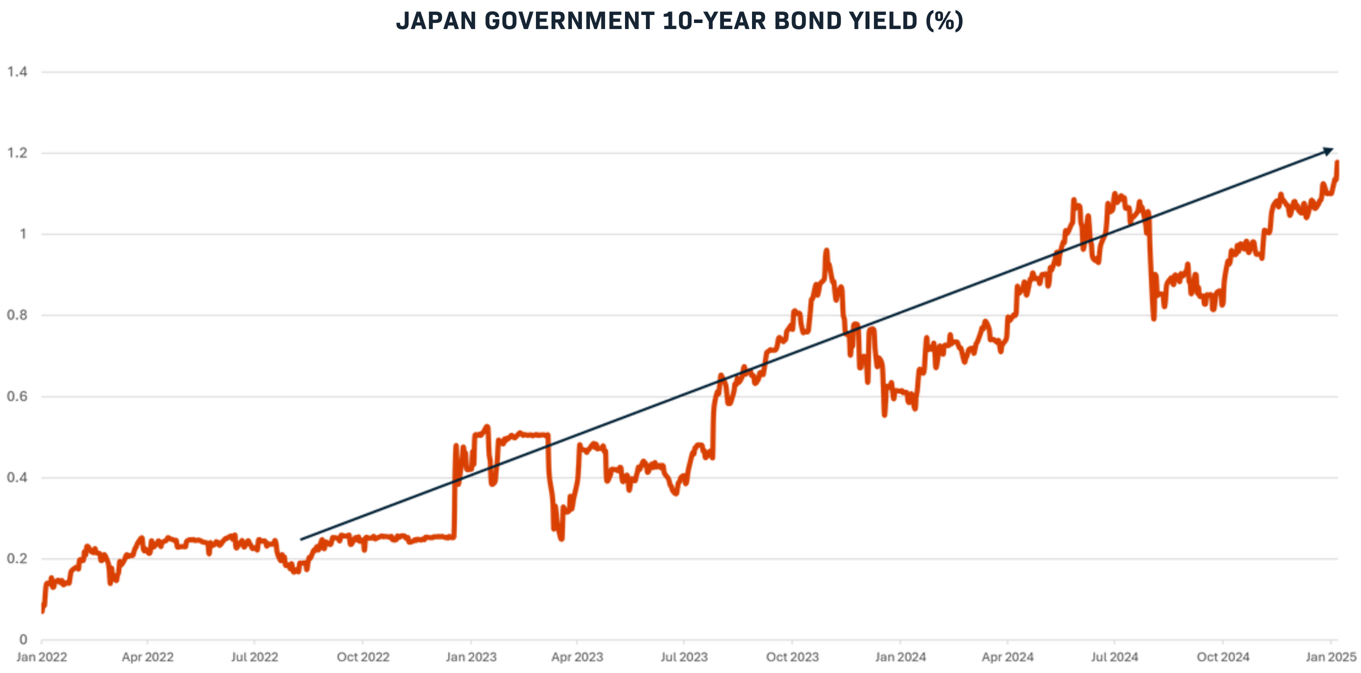
On January 24, 2025, the BOJ raised its key interest rate from 0.25% to 0.5%, marking the highest level since the 2008 financial crisis. Unlike the unexpected rate hike in July 2024, this increase was widely anticipated. The BOJ had signaled its intentions as early as December 2024, giving the markets ample time to digest. As a result, equity markets, including those in Japan, the United States and Hong Kong, responded with much greater stability compared to the volatility seen during the previous hike.

The current market consensus suggests that the BOJ may raise rates by another 25 basis points to 0.75% in the summer of 2025. Market also believes that the ultimate terminal rate could reach approximately 1.5%, at which point the BOJ is expected to pause further increases. This gradual and transparent approach reflects the BOJ's intent to balance inflation control with economic growth, ensuring minimal disruption to financial markets while steering Japan toward a more normalized monetary policy.

Source: Bloomberg


The current market consensus suggests that the BOJ is likely to continue its path of gradual interest rate hikes in 2025 and 2026. While the trajectory indicates steady increases, the magnitude of these hikes is expected to remain modest. This cautious approach reflects the BOJ's commitment to balancing the need to normalize monetary policy with the goal of supporting economic growth and managing inflation effectively. The key issue at this point is the extent to which the BOJ will raise interest rates in 2025 and 2026.

## JAPAN GOVERNMENT BOND YIELD (%)



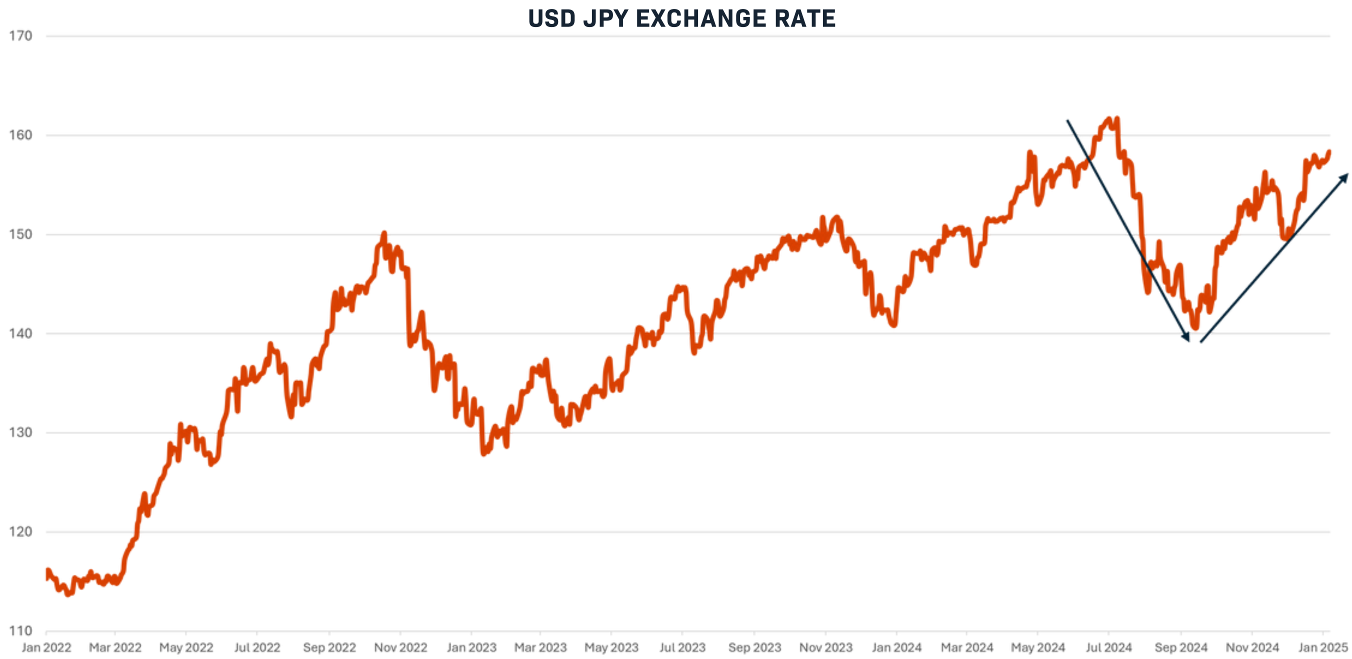

Source: Bloomberg

With rising interest rates in 2024, coupled with increasing wages and inflation, it is unsurprising to see that Japan's 10-year government bond yield has shown a steady upward trend since January 2023. This consistent rise reflects market sentiment gradually pricing in expectations for further monetary tightening by the BOJ. As inflation in Japan stabilizes above its long-standing target and wage growth accelerates, the likelihood of further interest rate hikes in 2025 becomes increasingly evident.

The upward trajectory of bond yields suggests that investors have anticipated shifts in BOJ policy, factoring in the possibility of higher borrowing costs in the near future. The bond market, often a forward-looking indicator, is effectively signaling that the current low-interest-rate environment may not be sustainable given the broader economic dynamics. This aligns with the BOJ’s evolving approach, as seen in 2024, where adjustments to monetary policy were already initiated to address inflation and economic stability.

Given this backdrop, further rate hikes in 2025 would not come as a surprise. The rising yields underscore how the market is preparing for a tighter monetary policy, reflecting the BOJ's likely need to respond to ongoing inflationary trends, strong wage growth and a global shift toward higher interest rates.

## WEAK JAPANESE YEN




In 2024, the Japanese yen (JPY) experienced a notable depreciation against the USD. The USD/JPY exchange rate began the year at approximately 140 yen per dollar and reached a peak of around 161 yen per dollar in early July, indicating a weakening of the yen.

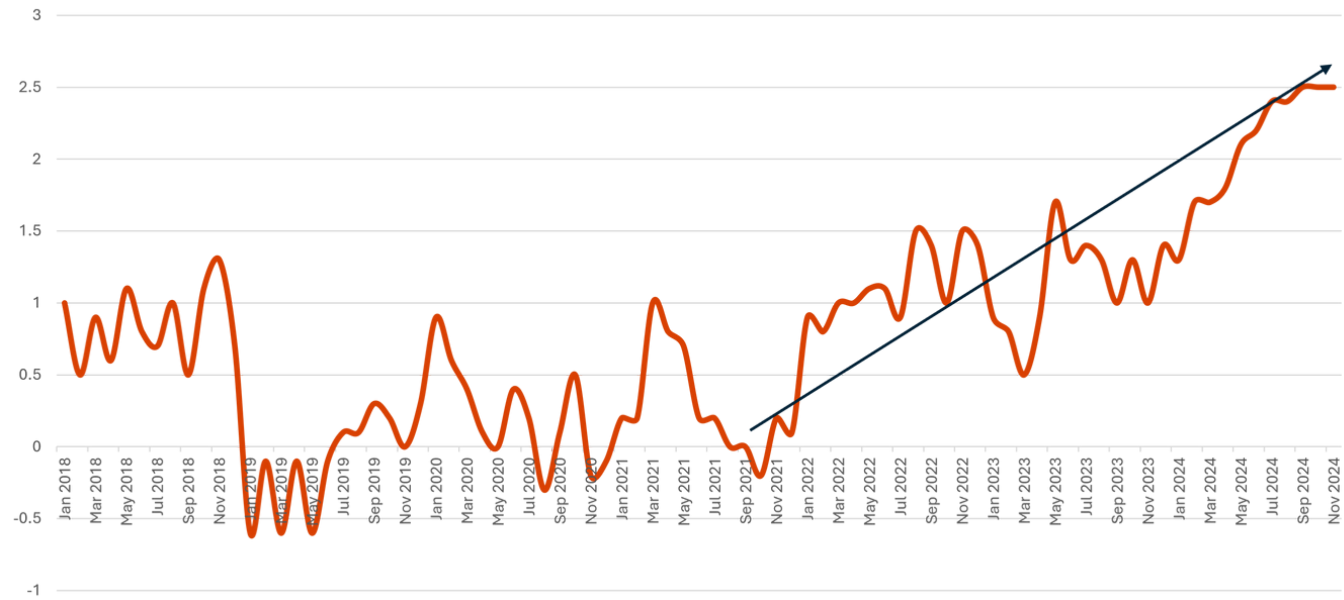
This depreciation was influenced by several factors, including divergent monetary policies between Japan and the United States. The US Federal Reserve maintained higher interest rates to combat inflation, attracting investors to USD-denominated assets. In contrast, the Bank of Japan's cautious approach to policy tightening contributed to the yen's weakness.

In July 2024, the BOJ raised its key interest rate to 0.25%, marking a significant policy shift aimed at curbing the yen's depreciation. This move led to a rapid appreciation of the yen, with the USD/JPY exchange rate strengthening from around 161 to 140 yen per dollar. However, in the subsequent months, the yen gradually depreciated again to 157 yen per dollar, influenced by factors such as the persistent interest rate differentials between Japan and other major economies, notably the United States. Additionally, the BOJ adopted a more dovish tone, indicating a cautious approach to further and more frequent rate hikes.

Source: Bloomberg

## RISING WAGES

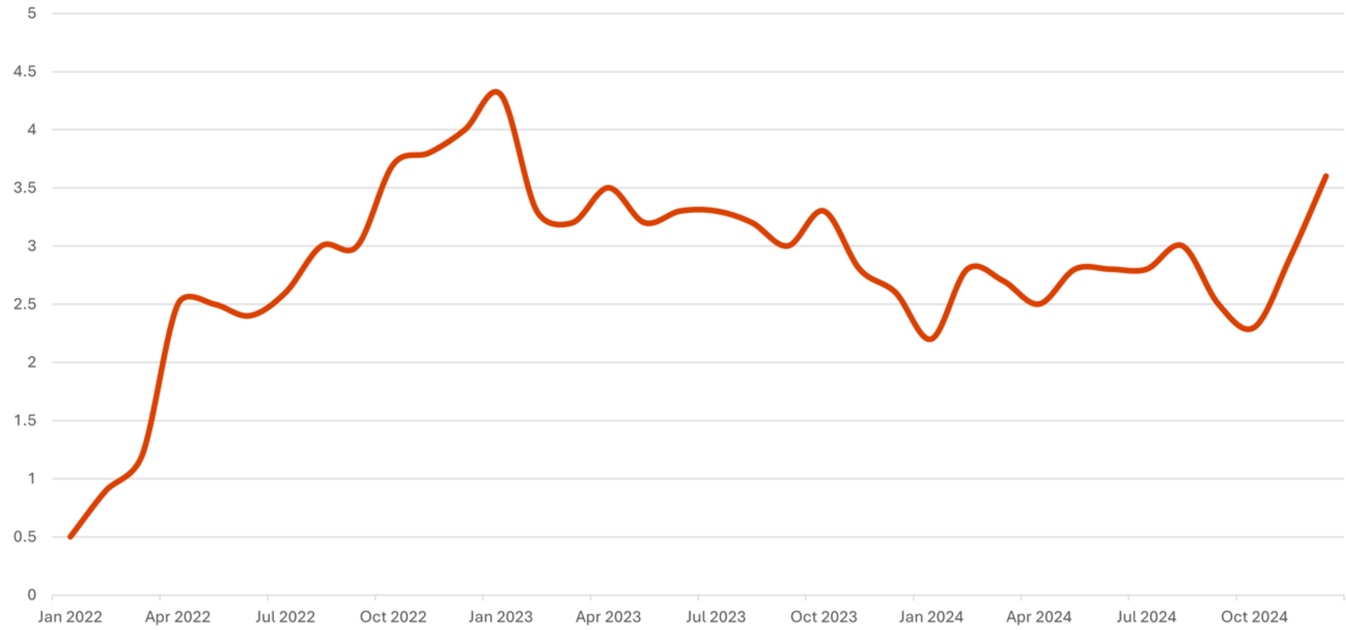
**JAPAN LABOUR STATISTICS AVERAGE MONTHLY CASH EARNINGS YOY (%)**




In 2024, Japan experienced a significant surge in wage growth, with average salary increases reaching levels not seen in over three decades. This upward trend was driven by a combination of factors, including a tight labor market, government initiatives advocating for higher pay, accommodative monetary policies and efforts by companies to attract and retain talent in a competitive environment. The substantial wage hikes not only enhanced household incomes but also played a crucial role in stimulating domestic consumption, thereby contributing to the Japan's economic growth.

## JAPAN'S INFLATION

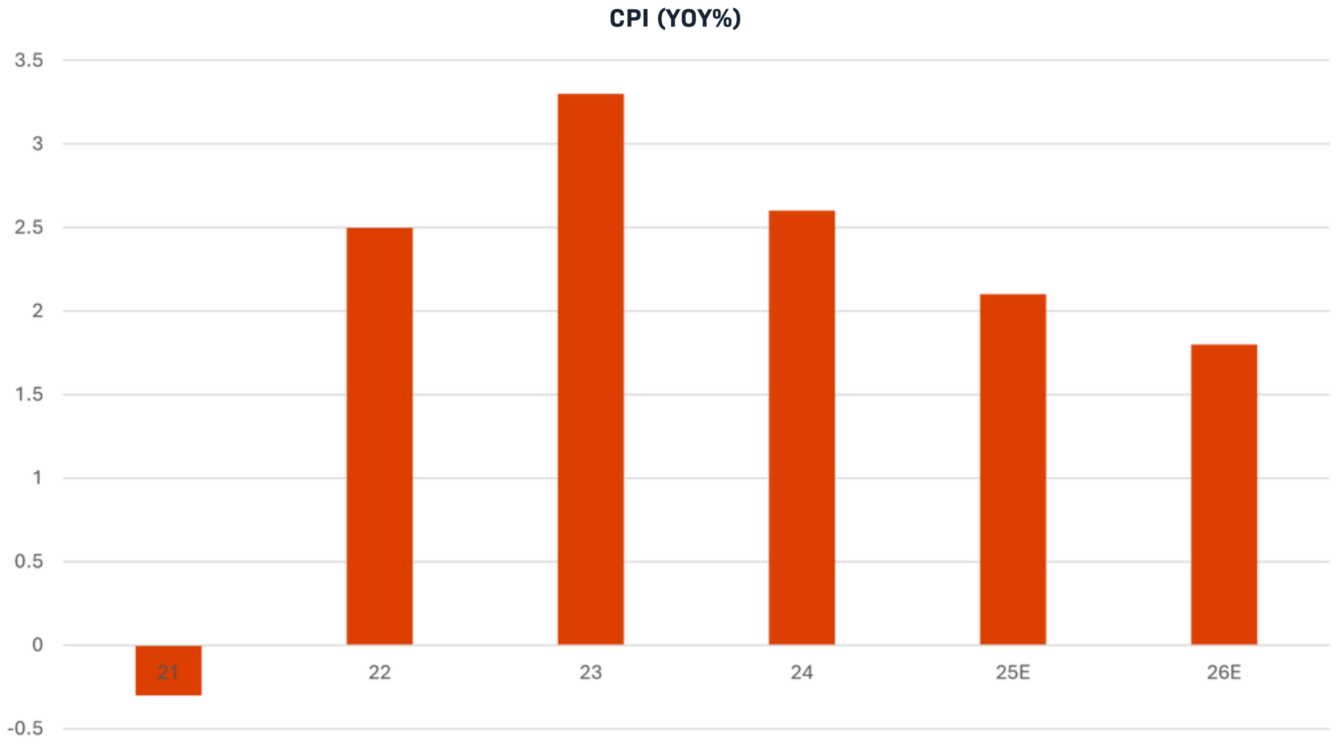
**JAPAN INFLATION RATE (%)**




Source: Bloomberg

In 2024, Japan's inflation rate exhibited a notable upward trend, reaching 3.6% in December, up from 2.9% in November. This increase was primarily driven by rising food prices and higher costs in sectors such as fuel, light and water charges. The BOJ's monetary policy adjustments, including ending the negative interest rate policy in March and raising short-term rates to 0.25%in July, aimed to achieve a sustainable 2% inflation target. These policy changes, along with a weakening yen that increased import costs, contributed to the observed inflationary pressures. Despite these developments, the inflation rate remained relatively moderate compared to global standards, reflecting Japan's ongoing efforts to balance economic growth with price stability.

The convergence of rising inflation, increasing wages and a depreciating yen is intensifying pressure on the BOJ to consider further interest rate hikes in 2025. Additionally, the BOJ has observed a broadening of wage hikes across Japanese firms, signaling a possibility for a near-term interest rate hike. The yen's depreciation has also been noted to increase import costs, contributing to inflationary pressures.

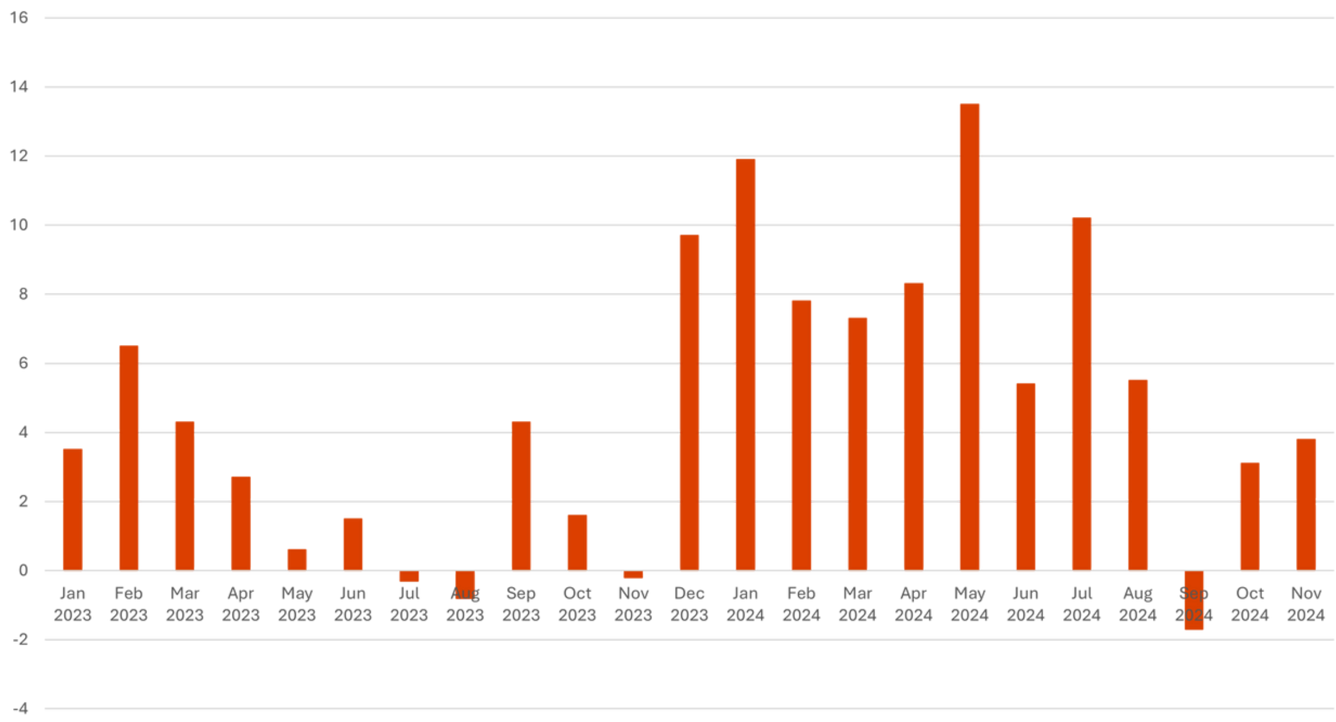



The current market consensus anticipates that Japan’s inflation will remain under control in 2025 and 2026, supported by the BOJ’s gradual approach to interest rate hikes. By carefully increasing rates over time, the BOJ aims to balance economic growth with price stability, ensuring that inflation does not spiral beyond its target while avoiding any abrupt disruptions to the economy.

Source: Bloomberg

## JAPAN EXPORT

**Japan Exports YoY (%)**




In 2024, Japan's export performance demonstrated significant strength, as reflected in the year-over-year (YoY) growth pattern. The year began on a positive note, with exports steadily increasing, supported by robust demand for Japanese goods in global markets. The weaker yen played a crucial role, making Japanese products more affordable and competitive internationally, particularly in sectors like automobiles, machinery and technology. While the pace of export growth moderated in the latter half of the year, the overall 2024 export performance remained resilient.

## TOURISM

In the first eleven months of 2024, Japan experienced a significant increase in tourism, welcoming approximately 33.4 million international visitors by November, surpassing the previous annual record of 31.9 million set in 2019.

This influx of tourists contributed to record-breaking spending. By the end of September 2024, international visitors had spent about 5.86 trillion yen (approximately USD 39 billion), exceeding the total spending of 5.3 trillion yen recorded in all of 2023.(Source: Reuters)

The weak yen played a significant role in making Japan a more affordable and attractive destination, leading to increased tourist arrivals and expenditures. This boost in tourism has had a positive impact on Japan's economy, elevating tourism to one of the country's leading export sectors.

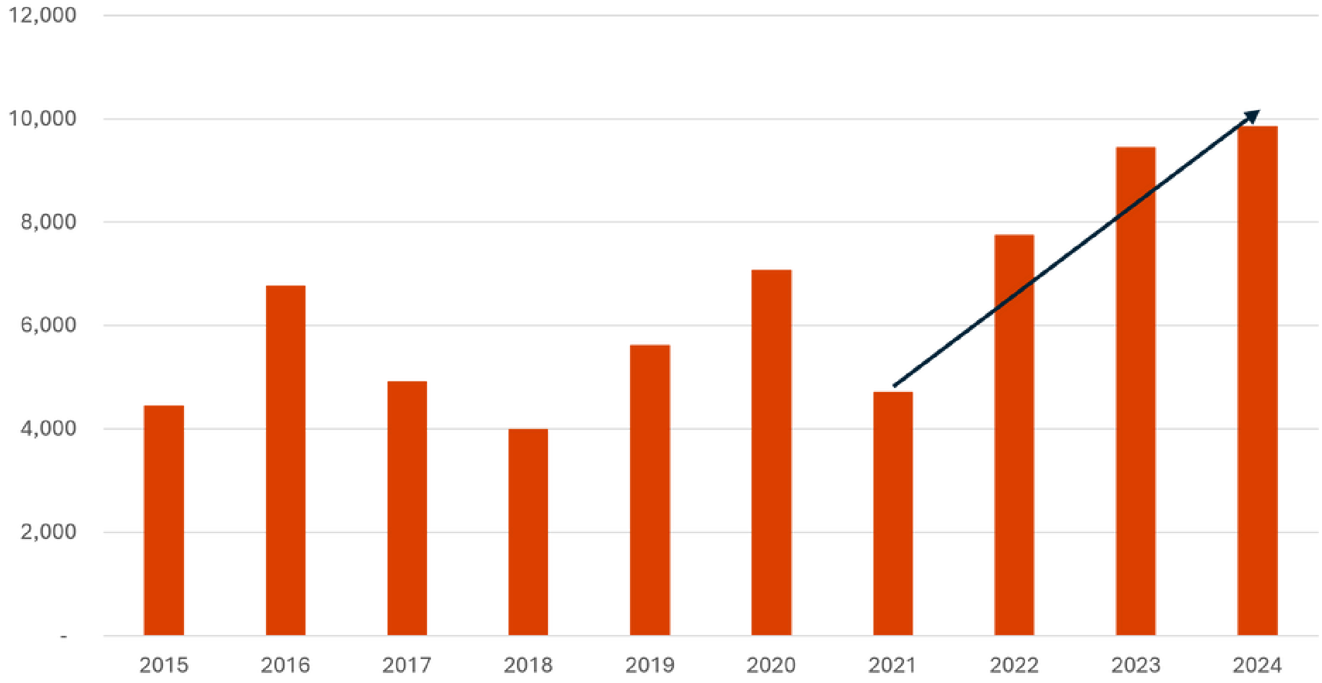
In addition, the Japanese government, under Shinzo Abe, actively promoted tourism by easing visa restrictions and investing in infrastructure, making travel easier and more accessible for international visitors. While the pandemic brought the industry to a halt, it has since recovered substantially. However, domestic tourism and outbound travel remain constrained by inflation and the yen's weakness.

Japan is well-positioned to remain a top global destination, but the government's target of 60 million visitors per year in 2030, compared to the current 33 million, will be challenging to achieve without significant public support. The Japanese government may be forced to scale back this target.

Source: Bloomberg

## RISING SHARE BUYBACK

JAPAN COMPANY SHARE BUYBACK (JPY BN)




With the ongoing improvement in corporate governance practices in Japan, listed companies have significantly accelerated their share buyback programs since 2021. This trend reflects a broader shift in the corporate mindset, where companies are prioritizing the efficient use of capital and enhancing shareholder value. The record levels of share buybacks this year underscore a commitment to returning profits to investors, signaling increased alignment with global best practices.

The Tokyo Stock Exchange has played a crucial role in driving this transformation by encouraging companies to optimize capital efficiency and reduce excessive cash reserves. Additionally, companies are responding to pressures from both domestic and international investors to improve shareholder returns through more proactive measures like share repurchases. The sell-off of cross-shareholdings, a long-standing feature of Japanese corporate structures, has also freed up additional resources, fuelling these buyback programs.

The accelerated pace of buybacks in 2024 demonstrates strong confidence among Japanese corporations in their financial health and future prospects. By reducing the number of outstanding shares, these buybacks enhance earnings per share and provide a direct boost to stock prices, further attracting investor interest. Overall, this growing trend highlights a maturing corporate culture in Japan, where businesses are taking meaningful steps to create long-term value for shareholders.

## NISA SCHEME

The Nippon Individual Savings Account (NISA) is a tax-advantaged investment scheme introduced by the Japanese government to encourage residents to invest in financial markets. Established in 2014, NISA allows individuals to invest in a variety of securities, such as stocks and mutual funds, without incurring taxes on dividends or capital gains up to a specified annual limit. This initiative aims to shift household savings from traditional bank deposits to investments, promoting greater participation in the financial markets and supporting long-term wealth accumulation.

In January 2024, the NISA program underwent significant enhancements to make it more accessible and beneficial for investors. Key changes include the introduction of two sections within the accounts: a tsumitate (regular investment) section and a growth section. The tsumitate section focuses on mutual funds and encourages regular, long-term investments with an annual contribution limit of 1.2 million yen (around USD 7,606). The growth section allows for a broader range of investments, including domestic and foreign equities, with an annual limit of 2.4 million (approximately USD 15,212) yen. These modifications aim to provide greater flexibility and encourage a culture of investment among Japanese residents, aligning with broader economic goals of stimulating market activity and fostering financial literacy.

Source: Bloomberg

## P/E RE-RATING

**NIKKEI 225 INDEX FORWARD 12-MONTH P/E (X)**


With the backdrop of a low-interest-rate environment, increasing share buybacks and the support of a weak yen, the Japanese stock market has seen a re-rating in 2024. The forward 12-month price-to-earnings (P/E) ratio for the Nikkei 225 index ranged between 16x and 23x, well above its historical average. This elevated range reflects the market's confidence in Japan's economic recovery and its corporations' ability to generate sustainable growth. Investors are valuing Japanese stocks at a premium, signaling optimism about earnings prospects and the broader structural reforms underway.

The higher P/E ratio also points to a shift in global sentiment toward Japan. Once considered a market affected by stagnation, Japan has increasingly positioned itself as a more dynamic and efficient economy. The surge in share buybacks demonstrates improved capital management, while the yen's weakness has bolstered export-driven industries, further strengthening corporate earnings. These factors, combined with growing investor faith in Japan's future, have propelled its stock market into the spotlight, attracting both domestic and international capital with renewed enthusiasm.

## 2025 PROSPECTS

The market expects 2025 to be a year of further interest rate hikes by the BOJ due to recent price escalations. However, real GDP growth for 2024 is expected to be negative for the first time in four years. Diminished consumer spending, exacerbated by rising prices and other contributing factors, is expected to significantly influence the pace of the BOJ's interest rate adjustments in 2025.

Conversely, Japanese equities exhibit a high sensitivity to exchange rate fluctuations, particularly the dollar-yen rate, as sectors, heavily reliant on foreign demand, constitute over half of the market capitalization of the Tokyo Stock Exchange Price Index (TOPIX). The market expects a gradual appreciation of the yen over the coming year, which is likely to adversely affect the earnings per share of TOPIX constituents through 2025.

In January, the BOJ reiterated its commitment to raising interest rates while carefully observing economic and price developments. Although a sharp yen appreciation is anticipated to be avoided, the expected exchange rate for companies hovers around 145-155 yen per dollar, necessitating close scrutiny of the exchange rate's impact on corporate earnings.

Source: Bloomberg

## SUMMARY

The Nikkei 225 index recorded strong gains in 2024, fuelled by a weak yen, low-interest rate environment, robust corporate governance reforms and record-breaking share buybacks that emphasized shareholder returns. The BOJ's monetary policy marked a pivotal shift with rising interest rate hikes with inflation control. Strong export performance, supported by the yen's depreciation and a surge in international tourism underscored Japan's economic resilience. Rising wages and controlled inflation further contributed to domestic stability, while higher P/E ratios reflected global confidence in Japan's growth prospects. The current market consensus has already considered the possibility of interest rate hikes in 2025 and 2026. But now, the critical issue remains is that to what extent will the BOJ increase interest rates in 2025 and 2026?

## ADVANTAGES OF EQUITIESFIRST'S LENDING MODEL IN JAPAN

EquitiesFirst utilizes the high liquidity of Japan's stock market to provide loans against over 2,000 qualified stocks. These loans offer competitive interest rates (1.50% to 3.00% in USD or JPY) and favourable loan-to-value ratios of 60-70%, complemented by borrower-friendly margin call thresholds. A key feature of EquitiesFirst's lending model is the provision of non-recourse loans, which require no personal guarantees and allow flexible use of funds. In cases of default, EquitiesFirst opts not to pursue repayment, which underscores the firm's commitment to providing adaptable financial solutions to its clients.

Source: Bloomberg

# CONTACT US



## GORDON CROSBIE-WALSH

CEO Asia

+852 3958 4589

gcrosbie-walsh@equitiesfirst.com

## BANGKOK

+66 2059 0242

THinfo@equitiesfirst.com

## HONG KONG

+852 3958 4500

HKinfo@equitiesfirst.com

## SHANGHAI

+86 21 5117 5896

info@equitiesfirst.com

## BEIJING

+86 10 5929 8686

info@equitiesfirst.com

## SEOUL

+82 2 6370 5180

info@equitiesfirst.com

## SINGAPORE

+65 6978 9100

SGinfo@equitiesfirst.com

## DISCLAIMER

**China, Hong Kong and Singapore -** Equities First Holdings Hong Kong Limited holds a Hong Kong Securities and Futures Commission Type 1 License and licensed in Hong Kong under the Money Lenders Ordinance (Money Lender's Licence No. 1659/2024). EquitiesFirst ("EquitiesFirst" refers to Equities First Holdings LLC, and all subsidiaries of such company in all countries where they are engaged in business activities of any nature). This document is prepared by EquitiesFirst. It is not intended as an offer to sell securities or a solicitation to buy any product managed or provided by Equities First. It aims to provide general information on the EFH loan facility which is not authorized for retail use in Hong Kong and is only available for Professional Investors. This document is not directed to individuals or organizations for whom such offers or invitations would be unlawful or prohibited. Past performance is not a guarantee or a reliable indicator of future results. All investments contain risk and may lose value. The information contained herein may be incomplete or incomprehensive. Accordingly, the information is qualified in its entirety by the terms applicable to the facility as set out in its constitutive documents (Loan Documents) and should be read together with such Loan Documents. This presentation has been prepared without consideration of the investment objectives, financial situation, or particular needs of any individual investor. You should consider your own investment objectives, financial situation, and particular needs before taking any action with respect to a financial product referred to in this presentation. In preparing this presentation, EFH is assuming your organization is capable of evaluating the merits and risks of any financial transaction described herein and its suitability for your organization's purposes and its legal, taxation, accounting, and financial implications and that in making this evaluation you are not reliant on any recommendation or statements made by EFH. Before entering into any transaction EFH strongly encourages you to independently assess these things and fully understand the transaction in its entirety. EFH does not act as an adviser in any capacity and strongly recommends all borrowers seek independent advisement when assessing the transaction and its suitability. To the extent it is permitted by applicable law, Equities First, its affiliates, and any officer or employee of Equities First or its affiliates do not accept any liability whatsoever for any direct or consequential loss arising from the use of this presentation or its contents, including for negligence. Trading in equities, futures, options, commodities, currencies, or derivatives can have risks and is not appropriate for all persons. Under some market conditions, it may be impossible to liquidate a position. Copyright protections exist in this presentation. The contents of this presentation are strictly confidential and may not be disclosed, reproduced, distributed, or published by any person for any purpose without the expressed written consent of EFH, LLC. EFH makes no guarantee, representation, or warranty and accepts no responsibility or liability as to its accuracy or completeness. Expressions of opinion are those of Equities First only and are subject to changes without notice. Further information is available upon request.

**Thailand -** EquitiesFirst ("EquitiesFirst" refers to Equities First Holdings LLC, and all subsidiaries of such company in all countries where they are engaged in business activities of any nature). The foregoing is intended solely for certain, or certain class of, recipient who is qualified to independently consider and act on the information provided herein pursuant to laws and regulations applicable to such recipient. As such, the information provided herein is for information purposes only and does not constitute an offer to sell (or solicitation of an offer to purchase) the securities or investments referenced herein, to participate in any particular trading strategy, or to provide any particular advisory services ("Offer"), in any jurisdiction in which such Offer would be illegal. Any Offer shall only be made through the relevant offering or other documentation which sets forth its material terms and conditions pursuant to applicable laws and regulations. The foregoing and any non-public information contained therein are confidential and have been provided solely for the benefit of the intended recipient and for the limited purpose of the potential transaction that the intended recipient has already discussed with the Company. Except with the Company's prior written consent, such confidential information may not be shared with any party other than with professional advisors and affiliates of the intended recipient, in which case the information may be shared for such limited purpose and on a need-to-know basis. If you are not the intended recipient of the foregoing, any disclosure, copying, distribution or use of its content is strictly prohibited. The foregoing does not provide or purport to provide investment advice and has been prepared by the Company based on or derived from sources the Company reasonably believes to be reliable. The Company has not independently examined or verified the information provided herein and no representation is made that it is accurate or complete. Before acting on any information, the recipient is thus encouraged to seek independent financial and/or legal advice. Opinions and information herein are subject to change without notice.

**South Korea -** The foregoing is intended solely for sophisticated investors, professional investors or otherwise qualified investors who have sufficient knowledge and experience in entering into securities financing transactions such as securities repo or securities loan transaction. It is not intended for, and should not be used by, persons who do not meet that criteria. Information provided herein is for information purposes only and does not constitute an offer to sell (or solicitation of an offer to purchase) the securities or investments referenced herein ("Offer"). Any such Offer shall only be made through a relevant offering or other documentation which sets forth its material terms and conditions. The foregoing does not provide or purport to provide investment advice, nor does it provide or purport to provide any legal or financial advisory or other professional advice or services which are regulated in jurisdiction in which EquitiesFirst (Equities First Holdings, LLC and its subsidiaries) operates, does business, resides, including, Republic of Korea or that may otherwise have regulatory authority over EquitiesFirst. The foregoing has been prepared by EquitiesFirst based on or derived from sources EquitiesFirst reasonably believes to be reliable. However, EquitiesFirst has not independently examined or verified the information provided herein and no representation is made that it is accurate or complete. Opinions and information herein are subject to change without notice.