



# Japan equity outlook 2024

Domestic consolidation, long-term reform measures ahead

By the Japan Equity Team  
December 2023

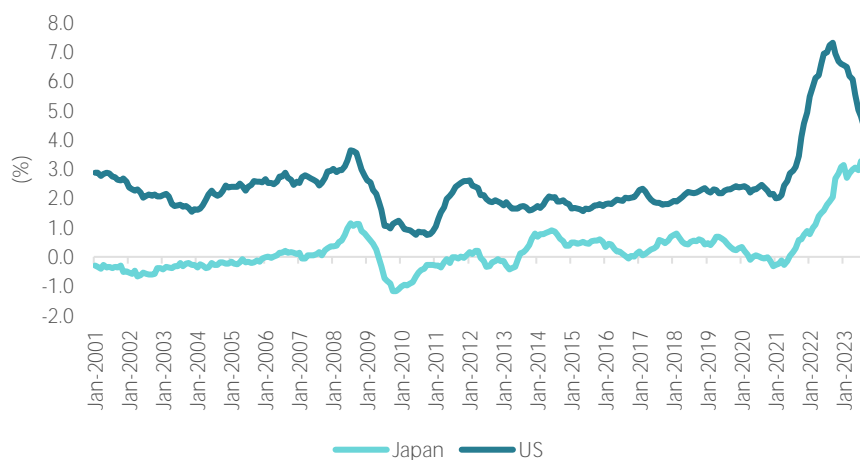
## Introduction

Japanese equities scaled impressive heights in 2023, with the TOPIX and the Nikkei Stock Average reaching their highest levels since 1990 and outperforming almost all global peers to become the envy of the developed world<sup>1</sup>. We expect 2024 to be a year of domestic consolidation and long-term reform measures, where markets are driven more by Japan-specific events than by global factors. After decades of deflation, we see Japan as finally breaking out of this cycle in 2024, as it enters a virtuous cycle of price increases and wage hikes.

## Wage increases to kick-start domestic growth

Japan is on the cusp of transitioning to an inflationary environment (Chart 1). In 2023, this inflation was largely supply-side driven, influenced by factors such as higher commodity prices, which are global in nature. However, for 2024 we anticipate an important shift from supply-side inflation to a more balanced scenario where demand-side factors, such as wage increases and consumer spending, begin to play a more significant role.

Chart 1: Trimmed-mean Consumer Price Index (CPI) year-over-year percentage change

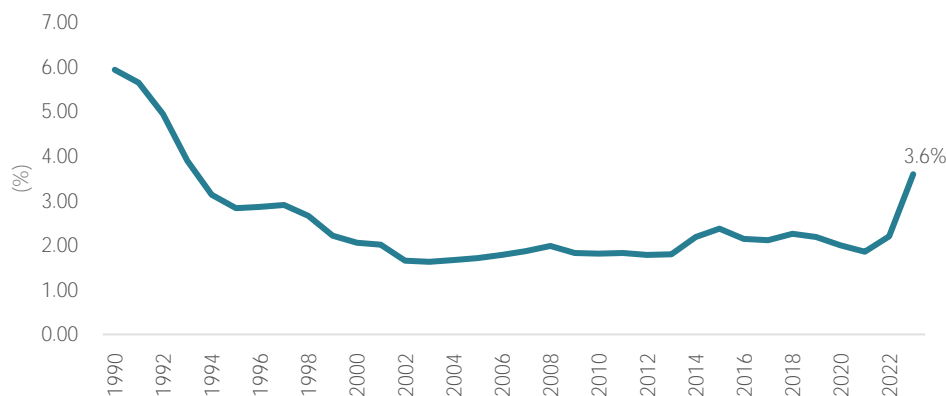


Source: Bank of Japan, Federal Reserve Bank of Cleveland as at October 2023

<sup>1</sup> Source: Bloomberg, 2023

Japanese Prime Minister Fumio Kishida is intent on ensuring wage hikes create a virtuous cycle of growth and distribution in the Japanese economy. His “new form of capitalism” agenda considers wage hikes to be critical based on the belief that higher wages would underpin consumption and allow firms to hike prices. In a November 2023 meeting with the heads of business and trade unions, Kishida requested these bodies hike wages from 2023 levels as part of 2024 “shunto” negotiations (Chart 2). Shunto translates to “spring wage offensive”, and refers to the annual wage negotiations between labour unions and company management teams ahead of the fiscal year starting in April.

Chart 2: Percentage wage increases following shunto spring wage offensives



Source: Minister of Health, Labour and Welfare of Japan

Kishida’s calls for sustained wage increases echo those of the Bank of Japan (BOJ), which has stressed that durable inflation must accompany sustained wage gains before it can end ultra-low interest rates and take concrete steps towards policy normalisation.

So far, these efforts appear successful. In an encouraging move, Japan’s largest national trade union Rengo will be demanding “over 5%” wage hikes (up from “around 5%” this year) and the largest industrial union UA Zensen is seeking an even higher 6% total wage increase, of which 4% will be base pay hikes, at the shunto negotiations<sup>2</sup>. And ahead of shunto, major beverage maker Suntory indicated plans to offer employees average monthly pay hikes of around 7% in 2024 for the second straight year<sup>3</sup>, aiming to retain talent in a tight labour market and offset rising inflation. The government is also pressing customers of small-to-medium-sized enterprises (SMEs) to accept price hikes, a crucial component in hiking SME employee wages, as SMEs are not as profitable as large companies and the room to hike wages is considered small.

The Japanese government has ambitions to raise the national minimum wage by 50% by mid-2030s<sup>4</sup>. It is also believed that this will have a positive effect on raising not only the low-income segment but, more importantly, the median salary for Japan. Long-term expectations of wage hikes are important for domestic consumer sentiment; people need to feel confident they will be able to afford to buy goods and services going forward. For investors, this shift represents a change in the fundamental dynamics of the Japanese economy. Sectors that benefit from increased consumer spending, such as retail, consumer goods and services, may therefore look increasingly attractive to investors.

## Consumption to remain buoyant

While wage hikes are going to be front and centre in Japan’s economic agenda, it is worth focusing on the increasing number of part-time workers in the workforce, which affects overall wage statistics. Since these workers typically earn lower wages than full-time workers, their growing presence in the labour market can make average wage growth appear slower than it actually is. This is largely due to the methodology used in calculating wage growth statistics, which is a weighted average of full-time and part-time workers.

In this instance, more part-time workers in the labour market may mean lower year-on-year wages in percentage terms, but in reality, these part-timers are paid salaries and will contribute to growing household income. Moreover, a household’s total income, which includes earnings from both full-time and part-time jobs, determines its disposable income—the amount available for spending or saving. This is consistent with the recent resilience in

<sup>2</sup> Source: Nikkei, 2023

<sup>3</sup> Source: Nikkei, 2023

<sup>4</sup> Source: Cabinet Secretariat, 2023

consumption in Japan, despite real wages (wages adjusted for inflation) being negative for the past 18 months. In the meantime, we expect wage growth to continue, just as we expect inflation to slow down in 2024. It implies that the purchasing power of households may increase, supporting stronger consumption and economic growth.

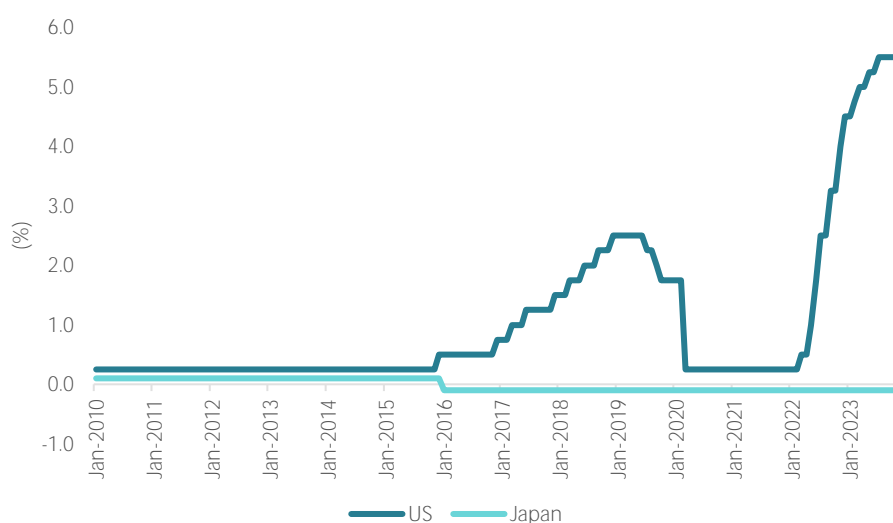
It is also worth noting that during the pandemic, Japanese households accumulated savings estimated at about 50 trillion Japanese yen due to reduced opportunities for spending<sup>5</sup>. These “forced savings” are expected to be spent in the future, further supporting consumption.

*Any reference to a particular security is purely for illustrative purpose only and does not constitute a recommendation to buy, sell or hold any security. Nor should it be relied upon as financial advice in any way.*

### BOJ monetary policy normalisation to continue

In 2023, the BOJ made significant strides in phasing out its yield curve control (YCC) policy. As we look ahead to 2024, the next anticipated step in this gradual process of policy normalisation is the exiting of the negative interest rate policy, with the BOJ policy rate currently standing at minus 0.10% <sup>6</sup>(Chart 3). This is expected to be a focal point of the BOJ’s actions early in 2024.

Chart 3: Policy rates of Japan and the US



Source: Bloomberg as at end-November 2023

The BOJ’s moves towards policy normalisation are likely to be closely aligned with the stance of the government. This alignment can be traced back to the policy accord established between the government and the BOJ in 2013, which emphasises a cooperative approach to managing the country’s economic policies. This approach is continuing to bear fruit. Importantly, any policy adjustments made by the BOJ will likely be executed in a measured and gradual manner. This cautious approach is designed to prevent any abrupt disruptions in the financial markets. Therefore, we believe that there is no immediate cause for concern regarding a rapid “tightening” of monetary policy. Instead, in our view the BOJ’s actions should be viewed as a shift from an “accommodative” stance towards a “less accommodative” one, signifying a gradual transition towards a more normalised economic environment.

### Tokyo Stock Exchange gets tougher in addressing capital efficiency

The Tokyo Stock Exchange (TSE) has taken a proactive stance to enhance capital efficiency within the Japanese stock market, and we expect this initiative to gain momentum in 2024. In March 2023, the TSE urged companies to improve management practices with a focus on cost of capital and stock prices by applying a three-phase approach (analysis of the current situation, planning and disclosure, and the implementation of initiatives).

From January 2024, the TSE will be taking a tougher approach to monitoring and incentivising corporate compliance with these three factors. This will include publishing a list of companies complying or not complying with the initiatives. We expect this transparent reporting to help investors and stakeholders to track the progress of individual companies.

<sup>5</sup> Source: Nikko AM estimate, 2023

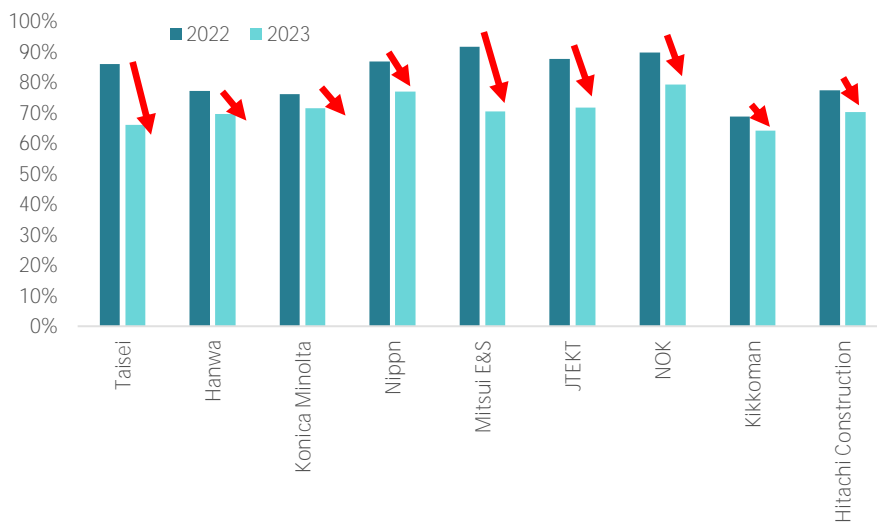
<sup>6</sup> Source: Bloomberg as at end-November 2023

The TSE has also committed to knowledge-sharing and best practice guidelines which it hopes will share valuable insights for companies looking to improve their management practices. In our view, the TSE’s initiatives will help to promote transparency and accountability, and will help to align corporate interests with those of their investors, making Japanese equity markets more attractive to a global investor base.

### The benefits of M&A, shareholder activism and hostile acquisitions

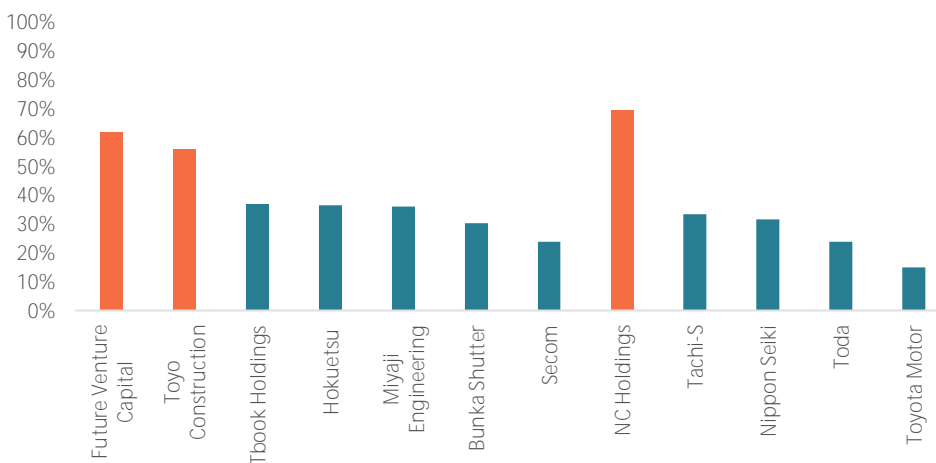
As highlighted previously, Japan’s push for corporate reforms, and the cultural imperative driving them, are forcing companies to change their behaviour. At the same time, the increasing prevalence of activist investors has been pushing companies to re-evaluate their operations and strategies, and to potentially unlock hidden value. Chart 4 shows management proposals losing support from institutional shareholders, who are becoming more vocal, after failing to sufficiently address issues such as low capital efficiency and lack of diversity. Chart 5 displays the percentage of shareholder-proposed agendas approved by other shareholders, with the orange bars indicating cases in which shareholders approved proposed agendas with majority votes. To further fuel this trend and revitalise the mergers and acquisitions (M&A) market, the Ministry of Economy, Trade, and Industry (METI) has introduced new M&A guidelines. These guidelines are designed to create a more conducive environment for M&A activities, potentially increasing deal volumes and unlocking additional value within the market.

Chart 4: Agendas proposed by management: percentage of votes for



Source: Nikkei

Chart 5: Agendas proposed by shareholders: percentage of votes for



Source: Nikkei

*Any reference to a particular security is purely for illustrative purpose only and does not constitute a recommendation to buy, sell or hold any security. Nor should it be relied upon as financial advice in any way.*

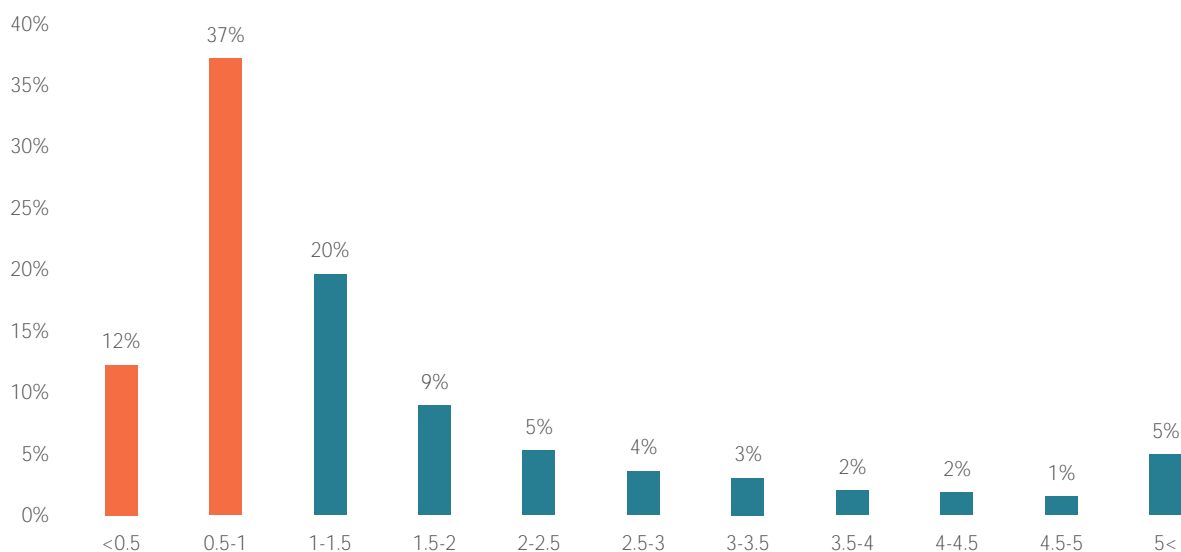
In addition, by promoting transparency, fairness and efficiency in M&A processes, the Ministry of Economy, Trade and Industry (METI) aims to encourage both domestic and international investors to actively participate in the Japanese M&A market. This could lead to increased competition for target companies, potentially driving up valuations and incentivising companies to explore strategic alternatives.

One notable example is the successful acquisition by Nidec Corp—the world’s premium maker of electric motors—of Takisawa Machine Tool Co in November 2023. Such acquisitions can lead to significant shifts in ownership and strategy within the Japanese corporate landscape. In essence, the confluence of activism, hostile acquisitions and METI’s new M&A guidelines helps to create a dynamic environment in which companies are under much greater scrutiny to deliver value to their shareholders. As a result, Japanese companies are increasingly motivated to maximise their worth.

### More value to be unlocked in 2024

Despite the rally in the broader market, Japanese value stocks—characterised by their favourable fundamentals and attractive price metrics—continue to be undervalued when compared to book value (Chart 6). This trend holds true across all market capitalisation segments, but particularly in the small- and mid-cap space where many companies are still trading at significant discounts and have room to move much higher in 2024. By focusing on these undervalued small and mid-cap value stocks, investors stand to benefit from substantial price appreciation as these stocks move closer to and above their intrinsic book values.

Chart 6: Distribution of companies with respect to price-to-book



Source: Bloomberg as at 30 November 2023

### Summary

**In our view, Japan’s success in recent years should continue and consolidate in 2024. In 2024, the government will be waiting for the right moment to officially announce victory over deflation, although the exact timing of this will largely be a function of political dynamics. Even so, it appears Japan’s policymakers and politicians are aligned, and the exit from deflation and the normalisation of monetary policy should therefore be well orchestrated. We expect this positive backdrop to augur well for Japanese companies, many of which are achieving more commercial success and benefitting from better corporate governance than ever before. As a consequence, Japan is likely to remain a promising destination for global investors who should still be able to find some attractively valued opportunities relative to the rest of the world.**

*Any reference to a particular security is purely for illustrative purpose only and does not constitute a recommendation to buy, sell or hold any security. Nor should it be relied upon as financial advice in any way.*

Important information: This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (Nikko AM) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute personal investment advice or a personal recommendation and it does not consider in any way the objectives, financial situation or needs of any recipients. All recipients are recommended to consult with their independent tax, financial and legal advisers prior to any investment.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this document will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual securities, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

**Japan:** The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association.

**United Kingdom:** This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority (the FCA) (FRN 122084). This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the FCA in the United Kingdom, and is directed at professional clients as defined in the FCA Handbook of Rules and Guidance.

**Luxembourg and Germany:** This document is communicated by Nikko Asset Management Luxembourg S.A., which is authorised and regulated in the Grand Duchy of Luxembourg by the Commission de Surveillance du Secteur Financier (the CSSF) as a management company authorised under Chapter 15 of the Law of 17 December 2010 (No S00000717) and as an alternative investment fund manager according to the Law of 12 July 2013 (No. A00002630).

**United States:** This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

**Singapore:** Nikko Asset Management Asia Limited (Co. Reg. No. 198202562H) is regulated by the Monetary Authority of Singapore.

**Hong Kong:** This document is for information to professional investors as defined in the Securities and Futures Ordinance, and intermediaries only. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

**New Zealand:** This document is issued in New Zealand by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562). It is for the use of wholesale clients, researchers, licensed financial advisers and their authorised representatives only.

**Kingdom of Bahrain:** The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

**Kuwait:** This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

**Kingdom of Saudi Arabia:** This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant

confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Holdings group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

**Oman:** The information contained in this document neither constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree 80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

**Qatar (excluding QFC):** The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

**United Arab Emirates (excluding DIFC):** This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.

**Republic of Korea:** This document is being provided for general information purposes only, and shall not, and under no circumstances is, to be construed as, an offering of financial investment products or services. Nikko AM is not making any representation with respect to the eligibility of any person to acquire any financial investment product or service. The offering and sale of any financial investment product is subject to the applicable regulations of the Republic of Korea. Any interests in a fund or collective investment scheme shall be sold after such fund is registered under the private placement registration regime in accordance with the applicable regulations of the Republic of Korea, and the offering of such registered fund shall be conducted only through a locally licensed distributor.