RBC BlueBay Asset Management

Asian takeaways
Donburi despatch

For Professional Investors Only | Marketing Communication

Maya Funaki
Asian Equity
Portfolio Manager

Published April 2024

"Beyond the excitable headlines, we found the overall mood in Tokyo to be much more muted than these suggested, with nationals responding to the market triumph with relative indifference."

Our team's latest trip to Japan coincided with the Nikkei 225 reaching an all-time high, breaking above the 40,000 line and surpassing its previous 1989 record. The country has undoubtedly had a monumental 12 months, with its market enjoying a record-breaking bull run, but, as is inevitable following periods of strong performance, investors are starting to question how much longer this can last.

Beyond the excitable headlines, we found the overall mood in Tokyo to be much more muted than these suggested, with nationals responding to the market triumph with relative indifference. Indeed, many of these individuals will have experienced the bubble crash of the early 1990s and there is a definite sense of people trying not to get ahead of themselves. Instead, locals are attributing the stellar market performance to the weakness in the yen, a dovish Bank of Japan, and redirected flows from global investors as they rotate out of Chinese funds – the momentum of which is somewhat uncertain.

In spite of this sense of caution, there are definitely signs of meaningful change that point to a sustainable market turnaround, primarily in relation to wages. During my last visit to Japan three months ago, there was a sense of scepticism amongst corporates and policymakers around whether wage hikes would be sustained. This year's shunto (Japan's spring wage offensive), however, has sent a clear message, with wage increases coming in higher than expected across companies of all sizes, and averaging an increase of 5.28% versus 3.6% in 2023, the biggest hike the country has seen in 33 years[1].

Meetings with company management indicated a broadly positive response to this from corporate Japan. Instead of raising concerns over the knock-on impact this could have on margins, management teams are aware of the necessity of these measures in order to attract skilled workers and increase employee productivity in the face of an ageing population.

1 Reuters, Japan union group announces biggest wage hikes in 33 years, presaging shift at central bank, as at 15 March 2024.

Japan in full bloom, from cherry blossom to the stock market.

Polarised consumption

Looking ahead, and following the termination of the Bank of Japan's negative interest rate policy (NIRP) on 19 March, consumption will be a key trend to watch in the face of further rate hikes.

In my last trip note (Asian takeaways - sushi special), I discussed the price of supermarket vegetables in a newly inflationary environment. While these had steadily risen over the course of the year, they remained relatively cheap when benchmarked to other global developed markets.

Price hikes such as these are now widespread, from vending machines, where drinks prices have risen from JPY150 to JPY180, to convenience store rice balls, previously retailing for around JPY120, and now selling for JPY140 as standard. With wages not increasing in real terms due to higher levels of inflation, we are seeing a trend of consumers downtrading on food and household goods. If we consider staples to define consumer sentiment, the outlook appears to be somewhat soft.

Contrastingly, discretionary spending, particularly at the higher end of the scale, is looking more robust. Tokyo departments stores such as Isetan Mitsukoshi and Takashimaya – the Japanese equivalents of Harrods or Bloomingdale's – have reported strong monthly sales since emerging from the pandemic. These were initially thought to be a reopening trade but continue to hold up even against global peers.

This resilience seems in part due to a re-focusing on high end, ultra-wealthy customers, moving away from a broader target market. Isetan, for example, has revamped its personal concierge service, gaisho, which has become a status symbol for influencers. Its top clients are spending several million a year on fashion and art, as well as on cars and condos through gaisho's recommendation service.

Visiting Isetan's personal shopping service, gaisho.

We are very much seeing a polarisation in consumption trends between the wealthier and lower income areas of society, as already wealthy individuals benefit from rising asset prices. However, we are also seeing a dispersion in trends even amongst the middle classes, with individuals choosing to save on everyday essentials in order to splurge on luxury items.

A renewed property bubble?

It appears that Tokyo is rebranding itself as a destination for the ultra-wealthy, not just in concierge-style retail services, but also when it comes to property.

On the surface, the numbers look somewhat startling, with Greater Tokyo average condo prices recently skyrocketing in a move that is somewhat reminiscent of the 1980s property bubble. Between 1985 and 1991, the average condo price in Greater Tokyo more than doubled from JPY30 million to over JPY70 million[2]. During this property bubble, condo prices reached far above fundraising capacity, but since the bubble burst in 1992, up until 2023, these have been broadly in line.

> **"The numbers look somewhat startling, with Greater Tokyo average condo prices recently skyrocketing in a move that is somewhat reminiscent of the 1980s property bubble."**

Interestingly, fundraising capacities steadily increased in this time, even in the face of a slowing economy, perhaps in part due to female participation in the workforce with levels moving from around 55% in 1985 to over 75% more recently[3]. Indeed, whilst individual income growth may have been sluggish, household incomes will have risen on the back of labour shortages and a shift from part- to full-time employment.

[2] Real Estate Economic Institute, Ministry of Affairs and Communications, Ministry of Land, Infrastructure, Transport and Tourism, Japan Housing Finance Agency, SMBC Nikko.
[3] Organization for Economic Co-operation and Development, FRED Economic, as at November 2023.

More recently, prices have soared above fundraising capacity, but looking more closely at the numbers, this jump can be broadly attributed to a single development: Mita Garden Hills. This is a luxury condominium project spread over 2.5 hectares, offering over 1,000 units, jointly developed by Mitsui Fudosan and Mitsubishi Real Estate. The project boasts on-site concierge services, as well as a gym, golf range, workspaces, and bars and restaurants, with the average price of a single 100m^2 unit coming in at JPY410 million (USD2.7 million).

The weak yen and relaxed regulations mean foreign buyers are snapping up luxury properties such as these, with one Hong Kong-based individual buying nine of Mita Garden Hills' units alone. Tokyo appears to be a new destination for the global ultra-rich, alongside Singapore, Shanghai and Hong Kong.

"The weak yen and relaxed regulations mean foreign buyers are snapping up luxury properties."

For domestic buyers, this could potentially prove to be problematic, and whilst average condo prices are unlikely to remain at the levels seen towards the end of 2023, driven by one-off developments, prices are likely to remain elevated by foreign buyers. The question now will be whether domestic wage growth can keep pace with these hikes.

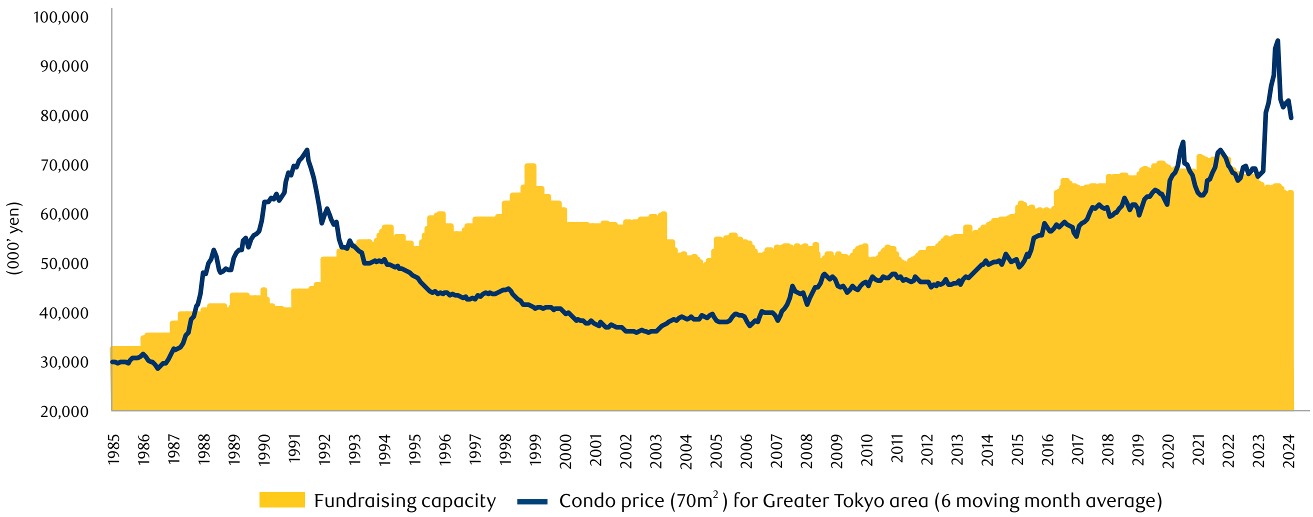
Leveraging intellectual property (IP) to transform manufacturers to platforms

Elsewhere, corporate Japan is waking up to the need to monetise and market its products, turning against the long-held Japanese business saying that 'a great product sells itself'.

Outside Mita Garden Hills, which is responsible for Greater Tokyo's surging condo prices.

In terms of popular media franchise rankings on a global scale, Japanese brands are already ranking highly, with franchises like Pokémon and Hello Kitty already well-known and well-loved. The appetite for Japanese characters is evident, and companies such as Sanrio and Nintendo are making concerted efforts to capitalise on this.

Figure 1: Average condo prices in Greater Tokyo



Source: Real Estate Economic Institute, Ministry of Affairs and Communications, Ministry of Land, Infrastructure, Transport and Tourism, Japan Housing Finance Agency, SMBC Nikko, as at 31 January 2024. Note: Fundraising capacity = borrowing capacity + own funds.

Sanrio's 35-year-old CEO has made significant changes since his appointment three years ago, improving operating margins and the company's inbound sales ratio. His latest vision is to heighten the value of core IPs among the company's 450 characters, utilising omnichannels such as Netflix, YouTube and gaming platforms to do so.

Nintendo, which has already had significant success with Pokémon, is now seeing its character, Super Mario, follow suit. *The Super Mario Bros. Movie* was a box office hit in 2023, and it demonstrated the ability for an already well-established firm to transform from a 'hard' console manufacturer to a 'soft' IP platform. With a Zelda movie now in the works, Nintendo has ample opportunity to solidify its name in this space.

The prospects for Japanese brands offline are equally compelling, with recent announcements including one from Saudi Arabia, which is starting construction of a Dragon Ball theme park. This is a franchise owned by Toei Animation, and indicates the widespread and versatile opportunities that IPs can offer.

What's next for market reform?

Japan has had a blockbuster 12 months, with the market going from strength to strength, but the overall consensus from my visit is that there is still significant upside potential. More and more investors are starting to ride the wave, with significant interest from foreign asset allocators. However, we're also seeing more traction from domestic investors, who were previously cautious on the realities of inflation expectations and governance reforms.

It is encouraging to see that the measures implemented by the Tokyo Stock Exchange ("TSE") to improve corporate governance are being taken seriously, with the exchange recently publishing a list of companies that have disclosed information regarding 'Action to Implement Management that is Conscious of Cost of Capital and Stock Price'.

The name-and-shame approach seems to be paying dividends (quite literally) and the dramatic reduction in the cross shareholdings to market cap ratio, down to 8% from 50% in 1989[4], is indicative of the efforts that have been made here. Future points of focus include a relaxation of unsolicited takeover-bid regulations, which should help to further promote healthy market competition.

Looking ahead, it feels as though there are plenty of reasons to be optimistic, and now is the time for investors to really play their part. TSE has set the stage for corporate Japan, but policymakers are handing the baton over to the market, recently speaking to an audience of over 90, mostly foreign, investors on this approach.

Hello Kitty demonstrating her versatility as a popcorn machine at Sanrio's offices.

The stock exchange is passing the baton over to investors, paving the way for market-driven reform.

Our meeting with the BoJ indicated similar goals, albeit through different means, with governance reform specifically being the domain of the TSE. The central bank disclosed a long-term plan to stop purchasing ETFs, currently playing the part of one of the largest silent investors in the market, in order to make way for market driven reform.

Significant ground has been covered, but it is now up to us to work alongside companies to drive further change. We think this is an approach that can sustain over the long term, particularly with foreign investors increasingly bullish on the region. Indeed, our own BlueBay CIO, Mark Dowding, recently shared his views on his latest visit to the country (Make Japan Great Again (MGJA)), offering a constructive outlook on economic growth and inflation, and pondering whether the recent market rally is just the start.

4 Nomura Institute of Capital Markets Research, Nikkei.

Author

Maya Funaki

Portfolio Manager

Maya is a portfolio manager on the Asian Equity team at RBC GAM. She is the lead manager for the team's Japan strategy and is also the team's industrials specialist. Prior to joining the organization in 2015, Maya had worked as an analyst at a multinational investment bank in the investment banking division. She started her career in the investment industry in 2011.

Published April 2024

RE/0077/04/24

RBC BlueBay
Asset Management