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**Global Markets Division**

# **Japan's Investment Environment**

**Trading on Japan's Economic Landscape:  
Insights and Opportunities**

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# Team Overview

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- 1 **Macroeconomic Environment**
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- 3 **Markets**
- 4 **How to trade the current market**
- 5 **Conclusion**
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# Macroeconomic Environment Japan



# Catching up with Japan – The third-largest Economy in the world

## Country Overview

### Japan Overview

- **Third-largest Economy by GDP**
- **Long period of deflation**
- **Lost decade** of the 90s
- **Median Age** of population **48,4 years**

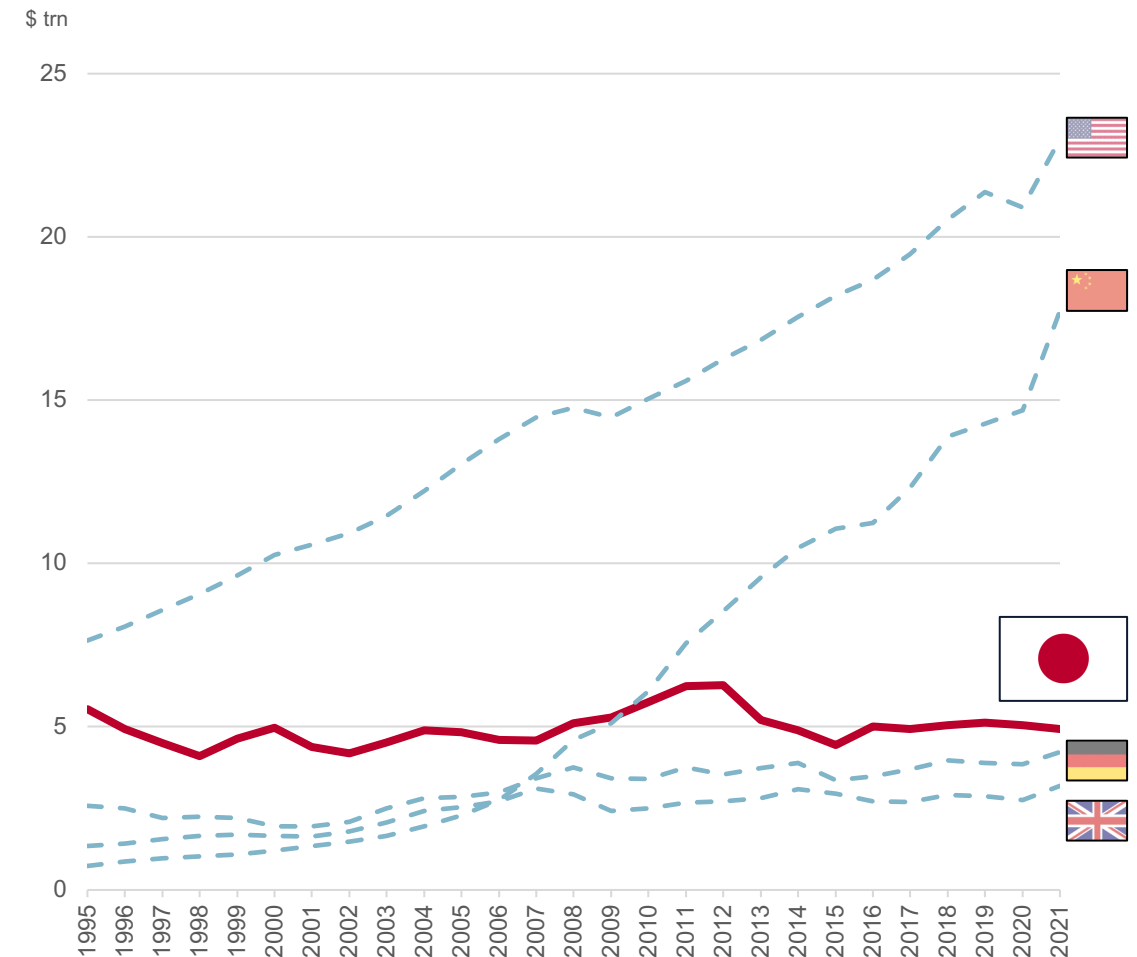


### Japanese Industry

- Strong **cooperation** between **Government and Industry**
- Networks of interlinked companies known as “**Keiretsu**”
- **Largest Industries:**
  - Automobiles
  - Consumer Electronics
  - Computers
  - Semiconductors
  - Copper, Iron and Steel



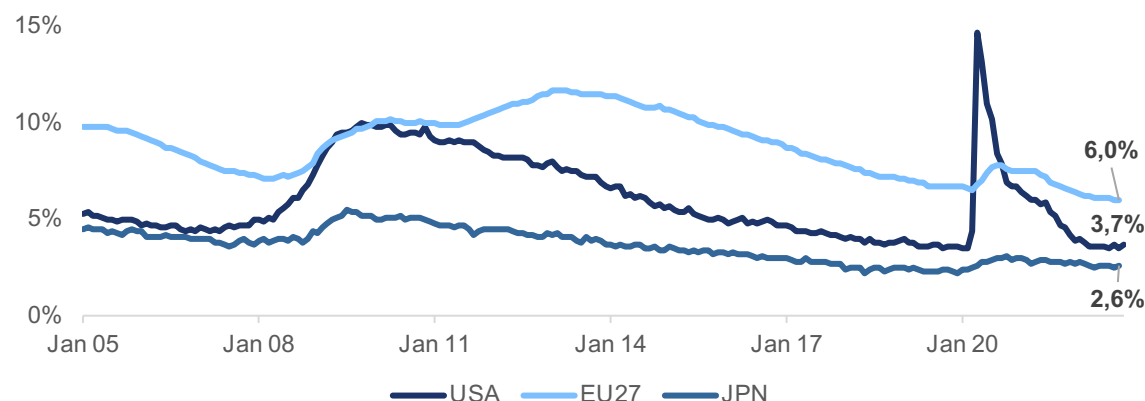
### GDP Development largest five Economies



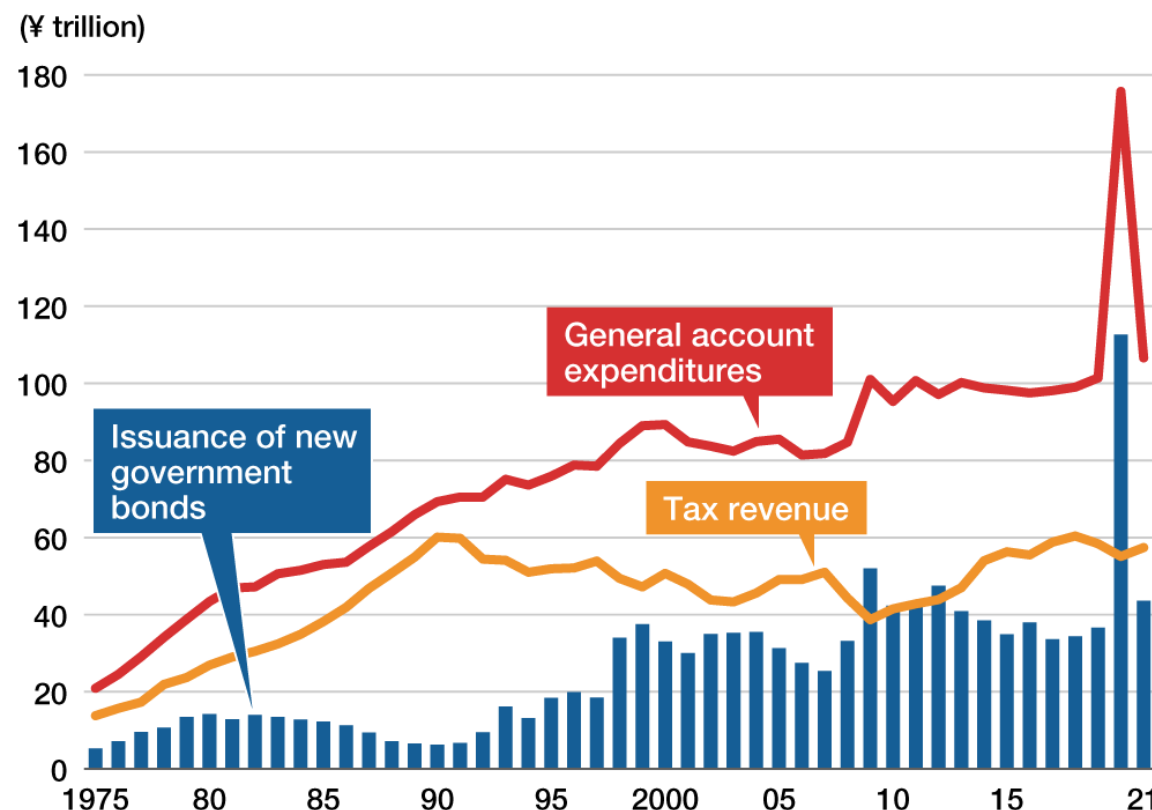
### Two main critical drivers for Japan's economic outlook

- **Highest debt of developed countries with 266% of GDP**  
Reason: "Abenomics" to tackle deflationary trends  
Consequence: High dependency on Monetary Policy
- **Second-lowest unemployment rate among OECD countries with 2.6%**  
Inflexible labour market due to labour scarcity and aging population  
Potential Interest rate hikes with severe impact on economy, society and overall competitiveness of Japan

### Unemployment Rate in %, 2005 - 2022



### Government Revenue, Expenditures, and Debt

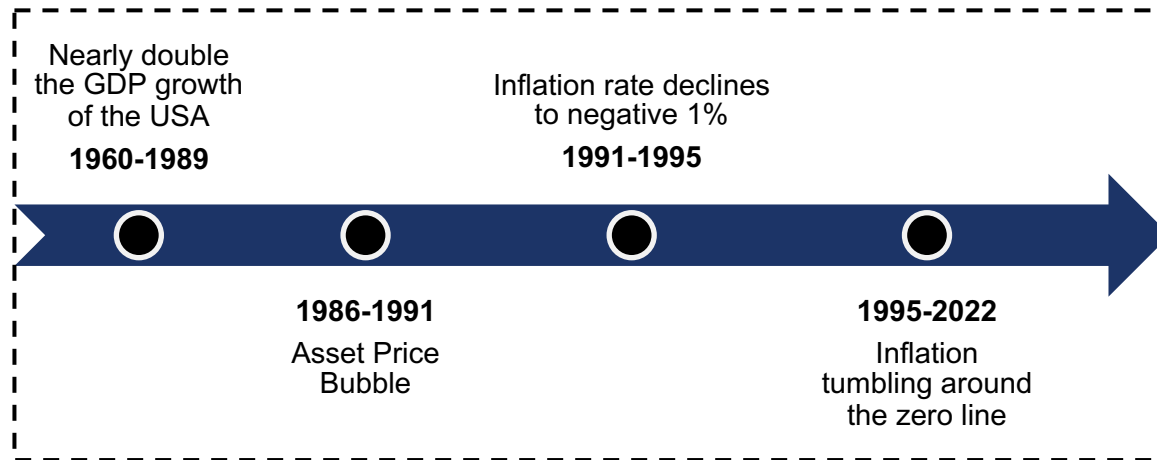


Created by *Nippon.com* based on data from the Ministry of Finance. Budgets up to fiscal 2019 are final budgets, the budget for fiscal 2020 is the revised budget, and the budget for fiscal 2021 is the initial draft budget.

# Wish: Sustainable Inflation. Reality: Rocketing Energy Costs and weak Yen.

## Inflationary Pressure

### Briefing: Japan's Inflation History



### Current Situation



- COVID aftermath and rocketing energy prices **inflate CPI**
- As of December '22: **+4.0%**
- Governor of BoJ Kuroda: Price gains are only temporarily **propelled by energy and other costs**
- Rapidly **decreasing Yen** put on additional pressure
- Recovery against USD likely

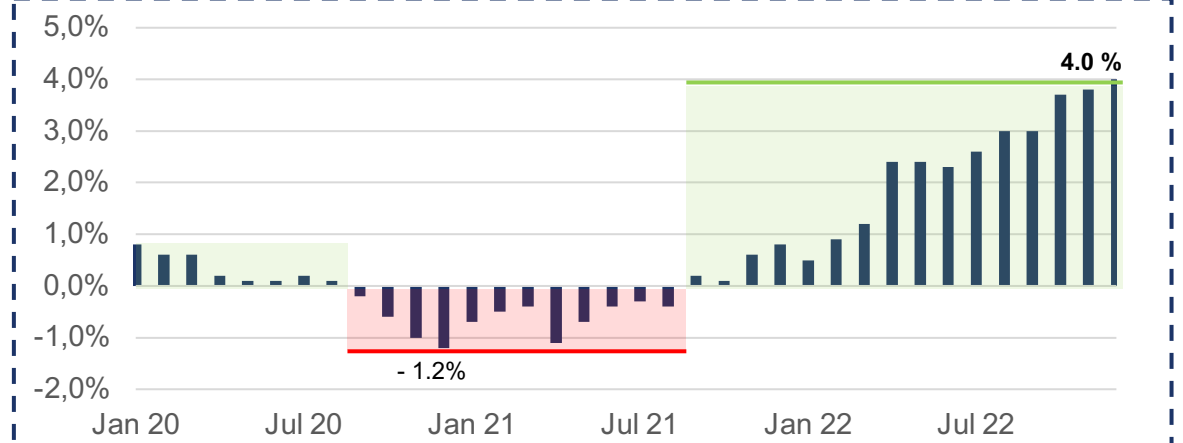
### CPI Rate Changes YoY

Good

YoY change in %

Food	+ 7.0%
Fuel and Utilities	+ 15.0%
Electricity	+ 27.0%
Energy	+ 16.9%

### Inflation development Japan

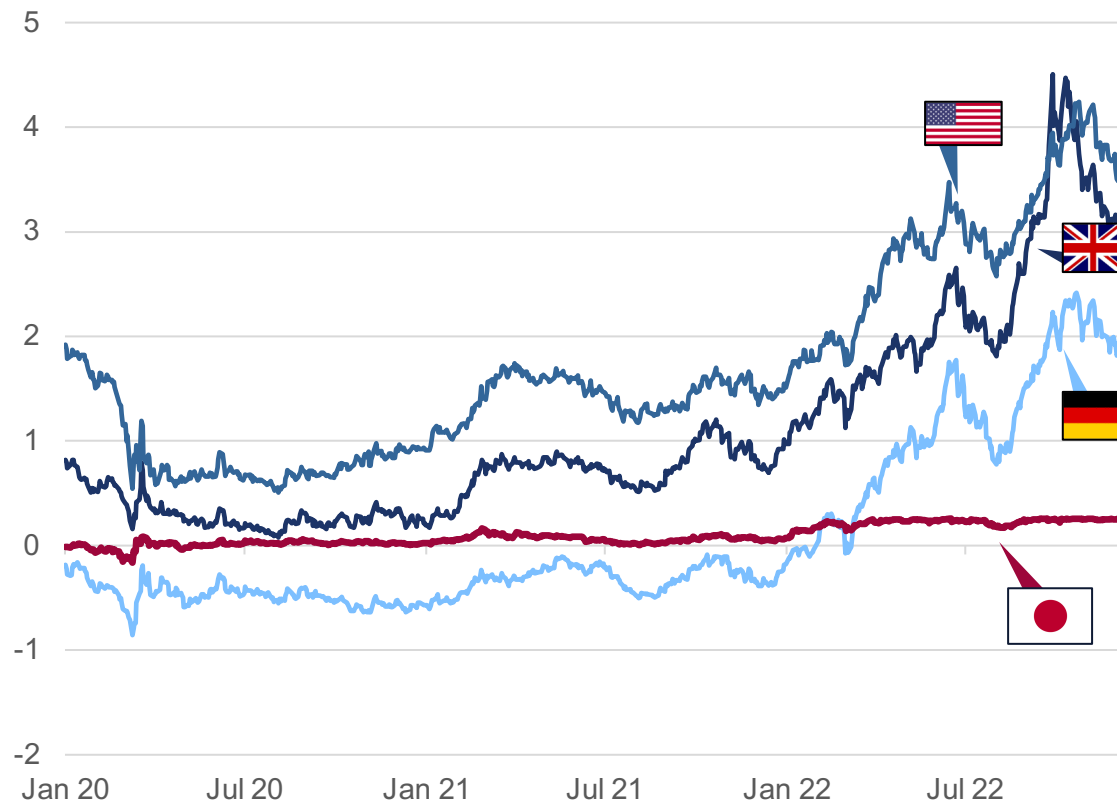


# The end of the low interest rate era?

## Monetary Policy

### Yield Curve Control Policy

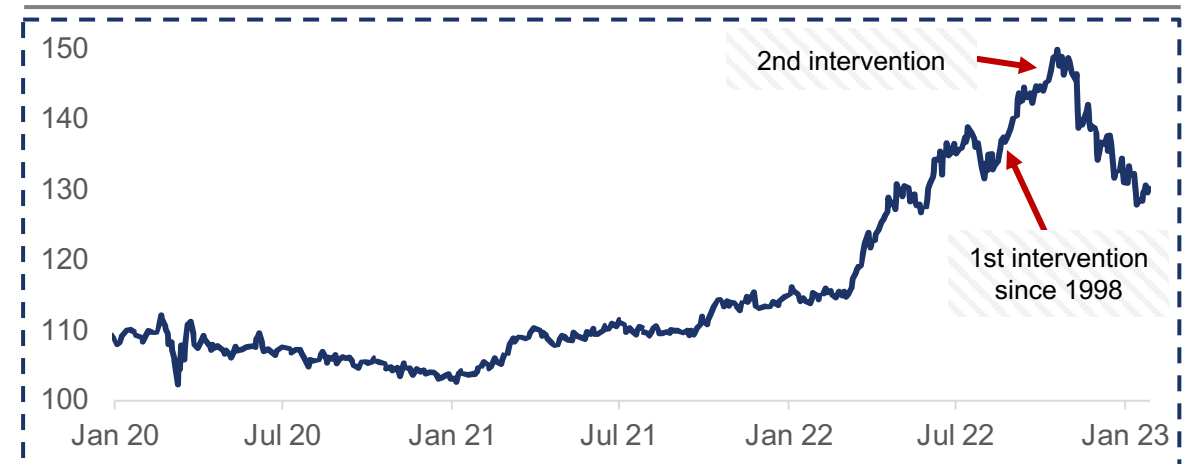
- **BoJ owns 73% of debt** due in 7 to 10 years
  - creates troubles for liquidity (e.g. the **benchmark 10-year government bond** was **untraded for four straight sessions** in October)
  - strengthen bets for a shift in the current YCC policy



### Current situation

- **\$200bn** stimulus package
- Japanese retail **foreign currency deposits** at domestic banks **rose 8.3% in 2022**
  - Unusual, because normally Japanese investors tend to buy foreign currency when the Yen is strong and sell when it is weak
  - Huge buildup of non-yen deposits could potentially lift the yen in a more favorable domestic interest rate environment
- **BoJ** might see itself obligated to **change their current policy** path, if:
  - inflation is permanent and domestically driven
  - the Yen keeps weakening despite currency interventions
  - bonds trade with yields materially higher than the cap

### USD/JPY FX interventions





# The effects on Japan's international trade

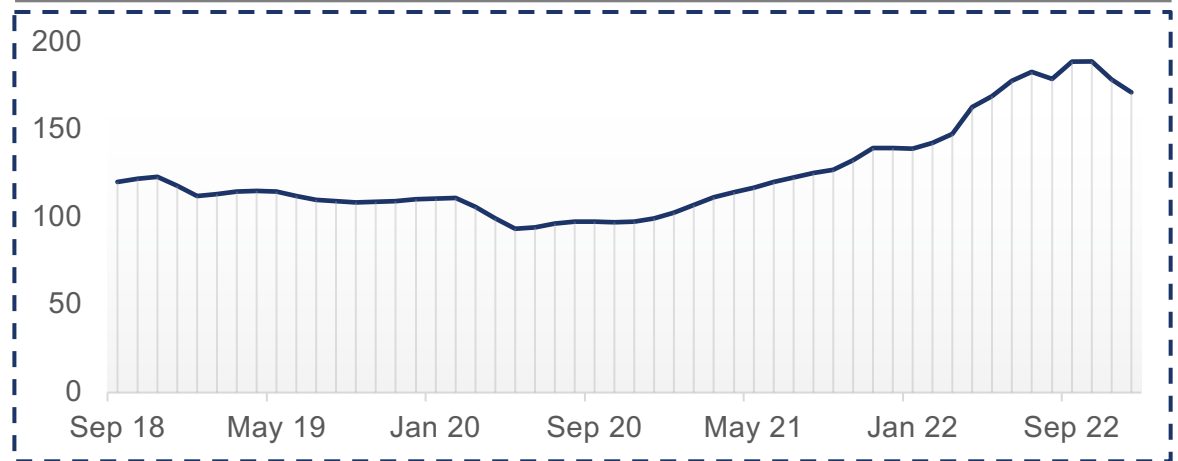
## International Trade

### Overview

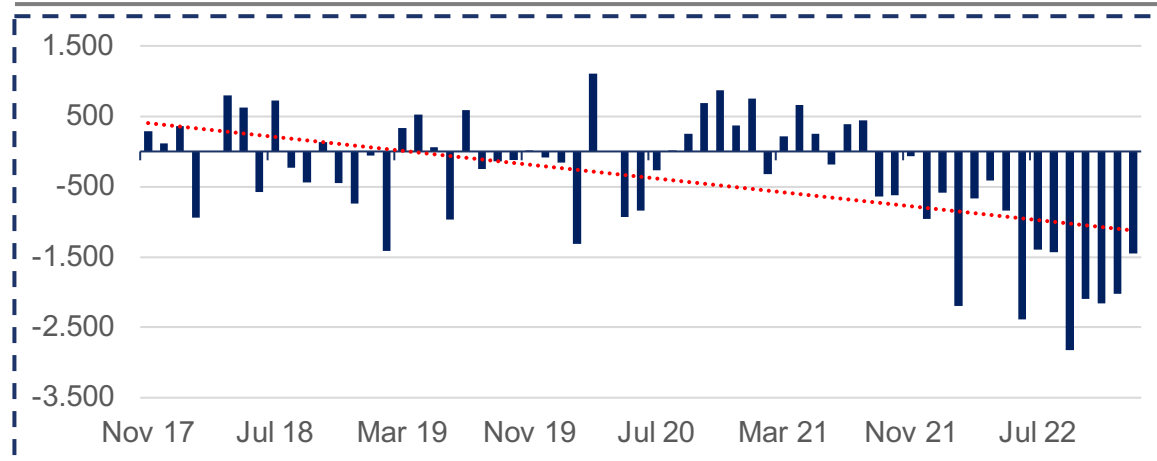


- **Negative Trade Balance** for 17 months in a row
  - Turned negative shortly after Inflation in Energy Prices
- **Import Prices increased** more than Export Prices
  - Biggest cause for the negative Trade Balance
- **Imports:** Energy (Oil, Gas & Coal) & Electronics
  - Most Imports from China (also USA & Australia)
- **Exports:** processed Items (like cars, electronic circuits,...)
  - Most Exports to China and USA

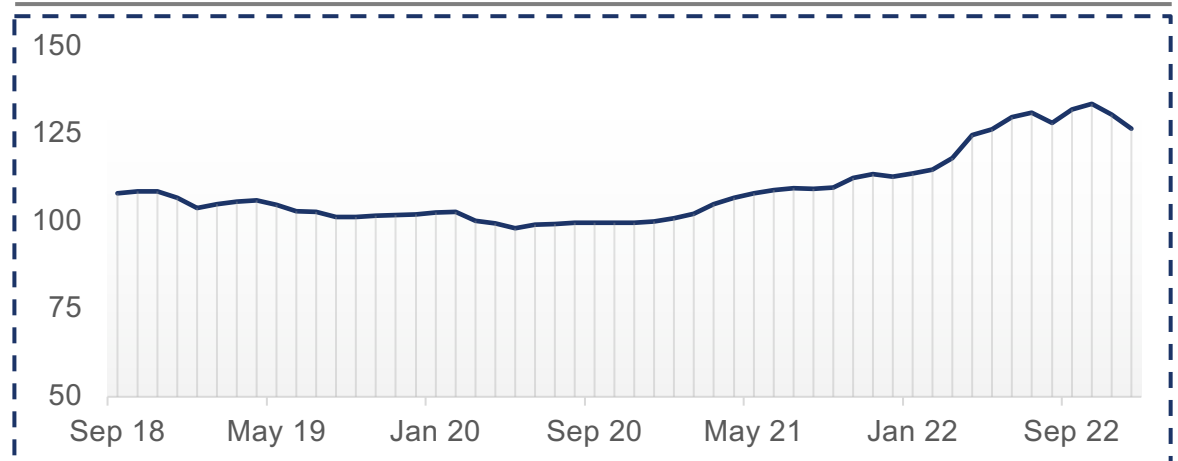
### Index of Import Prices



### Trade Balance (in JPY Billions)



### Index of Export Prices



# Japanese Equities Remain Resilient

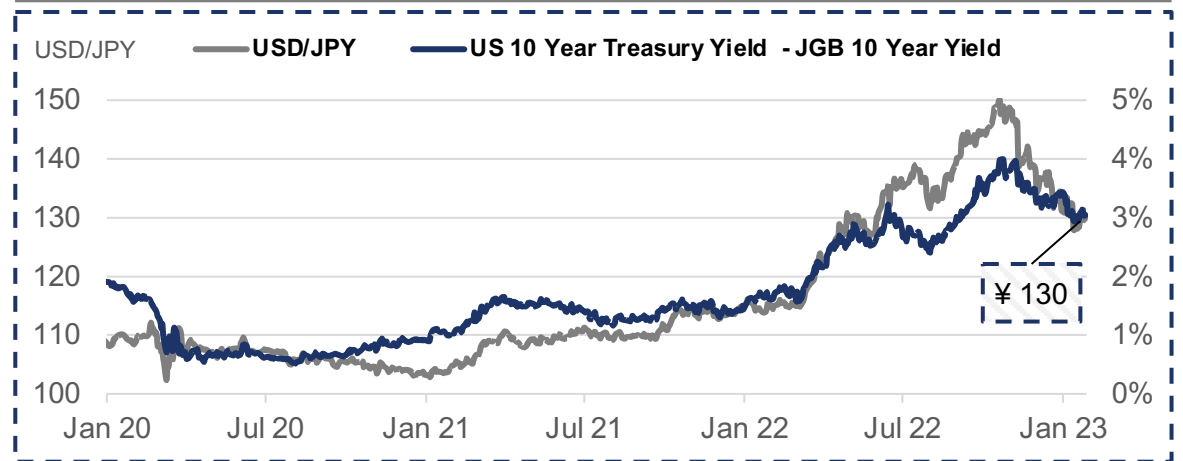
## Markets

### Main Drivers



- Japanese **Equities** are **less volatile**
- Heavily **influenced by US** monetary policy
- Upside potential offset by **concerns over fiscal tightening**
- Fed – BoJ policy divergence
- 10 Year JGBs rate fixing below 0.50% - broke out in January

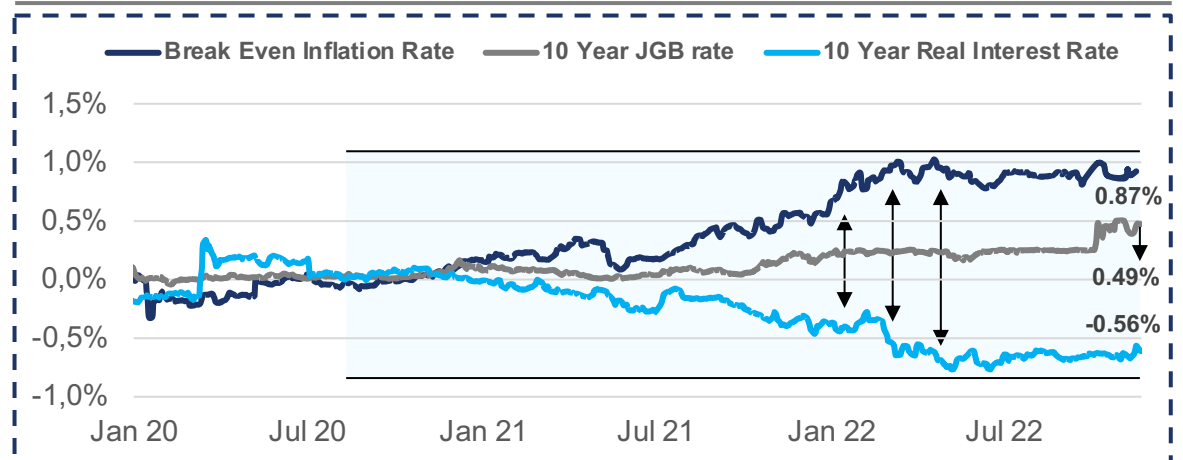
### USD/JPY and Yield Gap



### Equity Index Performance (normalized)



### BEI, 10 Year JGB and Real Interest Rate



# Challenges of Japanese Real Estate Market

## Real Estate

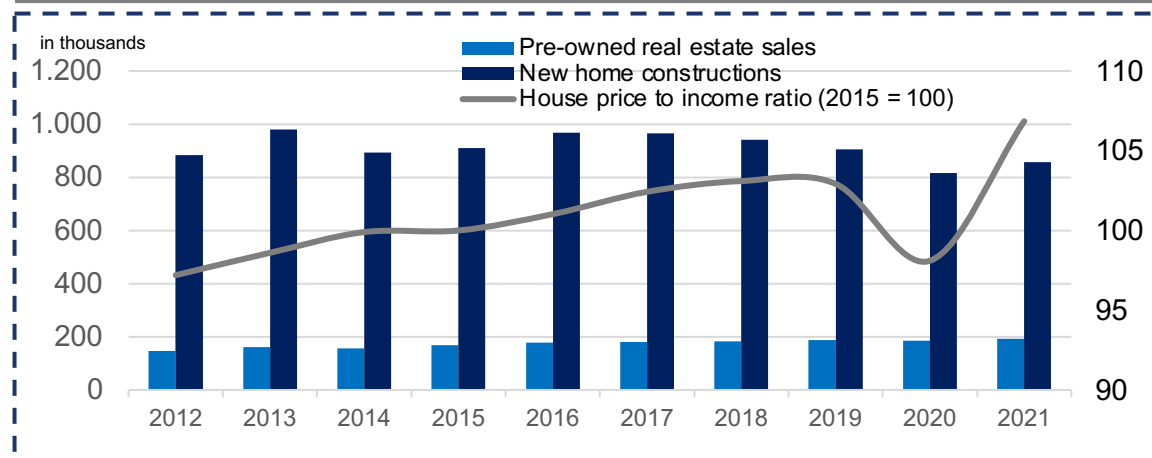
### Unique Real Estate Market Characteristics

- **High share** of new homes compared to most western countries
- Relatively **quick depreciation** of real estate in rural areas
- **14%** of residential real estate is **vacant**
- Accommodative **building code**

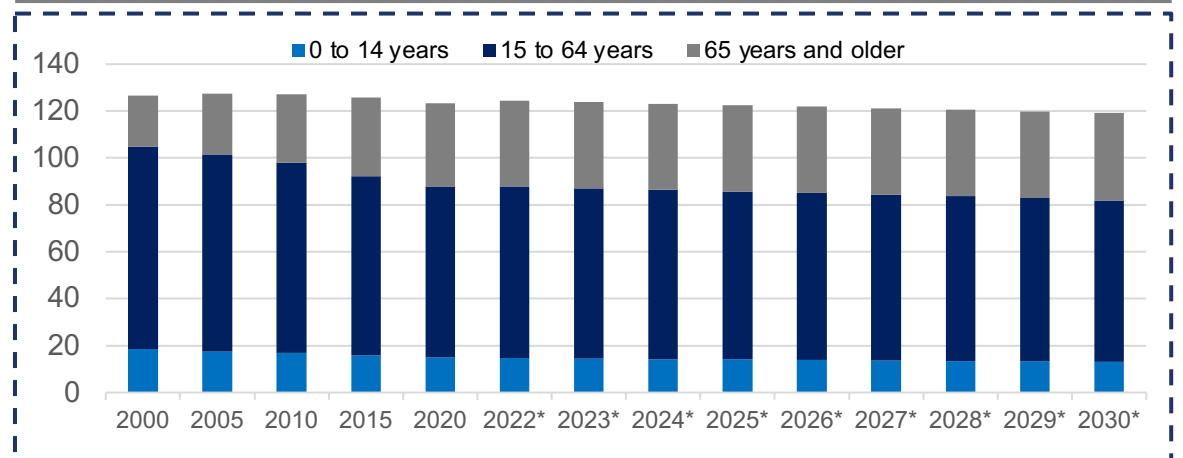
### Overview

- Ageing and decreasing **demographics**
- Increasing home **supply and prices**
- **Mortgage rates** (variable and fixed) are still low
- Largest cities still see **population rise**

### Real Estate Supply and Costs



### Population by Age Group (in millions)



## Bear Call Ladder on \$FXV

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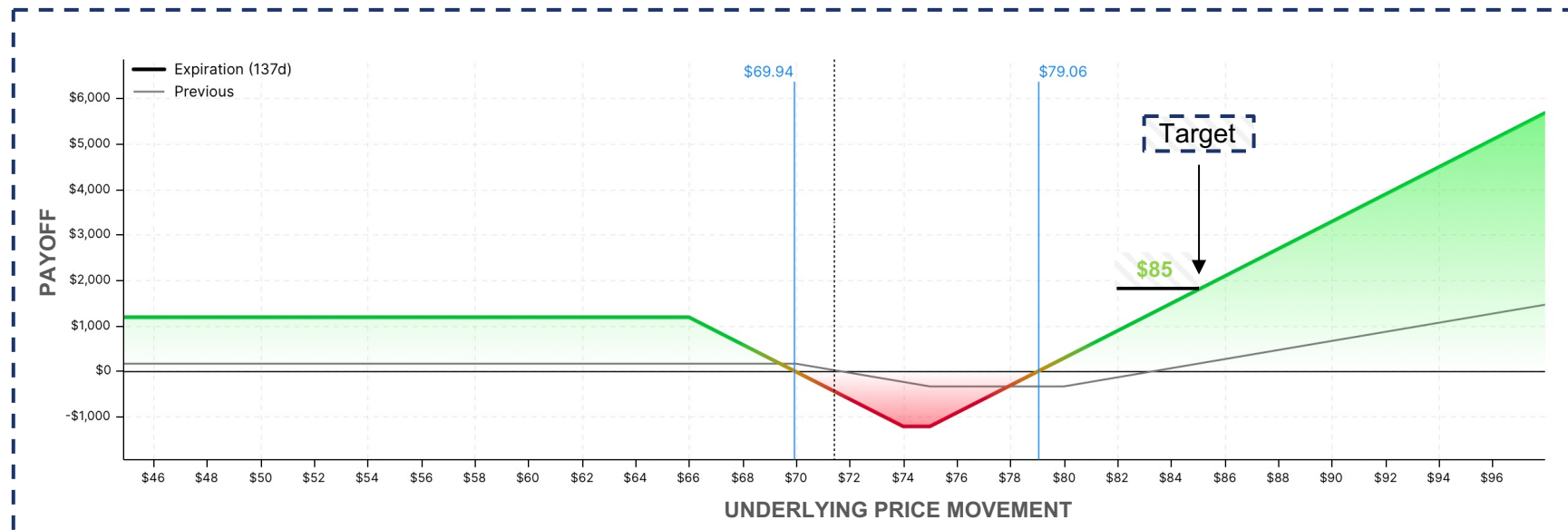


# Trade Idea

FX Option with profit on depreciating as well as appreciating Yen

## Bear Call Ladder on \$FX¥

Position	Expiration	Strike Price	Break Even Points	Net Credit	MAX Loss
<b>SELL 3x</b> <b>FX¥ 66C 6/16/23 at \$ 6.75</b>	June 16, 2023	\$ 66	\$ 69.94 and \$ 79.06	\$ 1.182	-\$ 1.218
<b>BUY 3x</b> <b>FX¥ 74C 6/16/23 at \$ 1.58</b>		\$ 74			
<b>BUY 3x</b> <b>FX¥ 75C 6/16/23 at \$ 1.23</b>		\$ 75			



## Trade Description

### Bear Call Ladder

- **Bullish Strategy**
  - Expectation: Implied Vol will be higher than realized Vol, breakout of breakeven points expected

### Scenario 1: ¥ appreciates vs. \$

- Target: **\$ 85** (+20% appreciation)
- At expiration profit at Target:
  - **\$ 1.790**

### Scenario 2: ¥ depreciates vs. \$

- Keeping received premia:
  - **\$ 1.182**
- For risk management reasons, would also close at 80% of option value

# Appendix

## Sources

Source Name	Link	Date of Retrieval	Used for
Nippon.com	<a href="https://www.nippon.com/en/japan-data/h00895/">https://www.nippon.com/en/japan-data/h00895/</a>	8 December 2022	Economic Overview
OECD	<a href="https://data.oecd.org/unemp/unemployment-rate.htm">https://data.oecd.org/unemp/unemployment-rate.htm</a>	30 November 2022	Economic Overview
Reuters	<a href="https://www.reuters.com/markets/asia/japanese-foreign-currency-deposits-rise-fastest-rate-since-2015-2022-10-11/">https://www.reuters.com/markets/asia/japanese-foreign-currency-deposits-rise-fastest-rate-since-2015-2022-10-11/</a>	30 November 2022	Monetary Policy
Satista	<a href="https://www.statista.com/topics/5167/real-estate-in-japan/#topicOverview">https://www.statista.com/topics/5167/real-estate-in-japan/#topicOverview</a>	30 January 2023	Real Estate
Bloomberg Terminal	Market data	30 January 2023	Equity
OptionStrat	<a href="https://optionstrat.com/build/bear-call-ladder/FXY/-230217C70,230217C75,230217C80">https://optionstrat.com/build/bear-call-ladder/FXY/-230217C70,230217C75,230217C80</a>	30 January 2023	FX Trade