July 16, 2024

CEO Insight: A significant yen correction is only a matter of time

Anyone wishing to realize a currency premium when investing in Japanese real estate should no longer think too long when selecting a property. Apart from that, Japanese real estate remains highly attractive as an investment.

Last Friday (July 12), the Japanese Ministry of Finance would neither confirm nor deny that the Bank of Japan had intervened in the foreign exchange market to strengthen the yen against the dollar. In New York the night before, one dollar was suddenly worth four yen less in a matter of minutes. Nor did Finance Minister Shunichi Suzuki comment on a press report that the Bank of Japan had undertaken a "rate check" of the euro-yen pair, a typical harbinger of an actual intervention. But the Japanese currency also appreciated against the euro, from 175.08 yen the previous day to 172.10 yen for one euro.

In any case, the presumed intervention was well timed, as shortly before the upward jump in the exchange rate, data was published showing that the US inflation rate had fallen month-on-month for the first time since the coronavirus pandemic, and surprisingly sharply at that. In June, consumer prices rose by just 3.0% year-on-year. As a result, yields on US government bonds fell.

The overall picture of US inflation thus finally turned positive in the second quarter of 2024, after the first quarter was characterized by setbacks in the fight against inflation. The falling inflation rate triggered speculation that the Federal Open Market Committee could cut interest rates in the US as early as September and twice this year. So far, only a one rate cut was expected.

This prospect should herald the end of more than two years of downward movement in the yen. This is because the main reason for the weakness of the Japanese currency is the yield differential between Japanese and US or euro government bonds. If the US Federal Reserve does indeed cut its key interest rate twice this year and the Bank of Japan raises its overnight interest rate slightly once more, as expected, this difference will shrink significantly, which should give the yen a boost.

This means that for German and European investors who want to invest in Japanese real estate, the time is finally running out to pocket not only the still positive real return from the property but also a probably considerable currency premium, because the yen is likely to strengthen during the term of their investment. In my opinion, the yen is by no means a soft currency and is currently heavily undervalued. The time for a countermovement now seems to have come.

>>>

It is not possible to predict exactly how big the upward correction will be. But in the past, the yen has appreciated very quickly and strongly on several occasions. From August 2008 to January 2009, for example, the euro fell from 162 yen to 120 yen, i.e. by around a quarter in less than half a year. This time, too, there is a lot to be said for such a rather sharp movement. One reason is the many forward transactions on a falling yen, the other is the widespread carry trades, in which investors borrow yen at low Japanese interest rates and invest the capital in dollar assets with higher yields. When the trend changes, these investors reverse their trades and thus accelerate the upward movement.

Former Vice Finance Minister Hiroshi Watanabe, now President of the Institute of International Monetary Affairs in Tokyo, believes that only half of the fall in value since the beginning of 2022 is due to the high yield spread. "The other half is due to the fact that the (previous) overvaluation of the yen (due to the currency's role as a safe haven in times of crisis) has been reduced," Watanabe told the financial newspaper Nikkei. "Even if the interest rate differential shrinks, the yen is unlikely to return to its previous level of 115 (per dollar) anytime soon." Even if he is right, there is still upside potential of at least 20 percent.

A firmer yen will certainly not reduce the attractiveness of Japanese assets. The Nikkei 225 fell just 3% on Friday and remained above the 34-year record set in March. For a while, there was an impression that foreign investors were holding back on buying Japanese stocks because of uncertainty over the exchange rate. But in the second week of July, the broad-based Topix, the benchmark for most investors in Japan, hit a new high since the end of 1989. Most analysts expect a stronger yen to weigh on share prices only temporarily.

Japanese real estate will also remain in the focus of foreign investors if the yen appreciates against the euro. This is because yields in the office, residential, tourism and logistics sectors remain above the inflation rate. And raising debt funding in Japan remains favorable. This situation will not change if the Bank of Japan raises its key interest rate to 0.3% this year as expected; even a second step to 0.5% will not make loans excessively more expensive. Only the currency premium for euro investors is now likely to shrink. All those who value this bonus should therefore hurry up now.

Leonard Meyer zu Brickwedde

Dr. Leonard Meyer zu Brickwedde
President and CEO

Kensho Investment Corporation
Sanno Park Tower 3F
2-11-1 Nagata-cho,
Chiyoda-ku, Tokyo 100-6162

Tel: +81(0)3-6205-3039
contact@ken-sho-investment.com