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# CEO Insight: Japan's Changing Monetary Policy: Real Estate Remains a Highly Attractive Investment

***The interest rate gap between Japan and the eurozone is shrinking. However, Japanese real estate remains a lucrative investment and European real estate is becoming more attractive for the Japanese.***

The CEO Insight published in mid-July predicted an end to the yen's two-year depreciation cycle. This forecast came true shortly afterwards. By the beginning of August, the yen had appreciated by around 10% against the dollar and the euro at its peak and recently remained significantly stronger than a month ago. Although the Japanese stock market reacted more sharply than predicted to the turnaround, it has since recovered significantly.

The slump on “Black Monday”, August 5, was mainly due to the fact that many yen carry trades were unwound as a result of the appreciation of the Japanese currency. In these interest rate differential transactions, foreign investors finance high-yielding investments such as US tech stocks and emerging market bonds with a favorable yen loan. If the yen rises, these transactions are reversed.

At the same time, Japanese shares were being sold because for every 10 yen appreciation against the dollar, exporters' profits fall by an average of 8%. A second, significant factor in the exaggerated nervousness on the stock market was the low liquidity in trading due to the summer vacation period. After the more experienced traders were brought back from vacation, they bought back many Japanese shares.

Foreign real estate investors should keep a close eye on interest rates in Japan. We are seeing a slight rise in interest rates, but in a much more controlled manner than in Europe. After the increase to 0.25% at the end of July, Japan's key interest rate could still rise to 0.5% in the fall or later. But that would still be low enough for real yields of real estate investments. Investors from Europe can therefore continue to partially finance real estate purchases in Japan with debt and improve their returns through the leverage effect. At the same time, these investors can continue to expect a currency premium, as the appreciation of the yen should continue due to the narrowing interest rate gap with Europe.

These developments are also encouraging real estate investments by Japanese companies in Europe, which are also part of the Kensho Investment Group's field of activity. The key interest rate in the eurozone is likely to be cut at least once, perhaps even twice, this year. This will make real estate purchases more attractive for Japanese investors. This is because the decreasing interest rate differential and the appreciation of the yen are pushing down the yield-consuming hedging costs considerably.

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In our discussions with institutional investors in Japan, we have already noticed that these investors are reacting very positively to this ongoing development. Hedging costs have already fallen from 3.5% to below 3% and should continue to go down significantly from there. We are therefore bullish for both directions - for European investors in Japan as well as for Japanese investors in the eurozone.

We do not expect any negative changes in the future. The Japanese central bank under its governor Kazuo Ueda will continue its normalization of the ultra-loose monetary policy of his predecessor Haruhiko Kuroda. It intends to halve its monthly government bond purchases gradually until the beginning of 2026. However, the Bank of Japan will only raise the interest rate if it does not have a negative impact on the economy. This means that further interest rate hikes will require inflation close to its official target rate of 2% and further annual wage increases after the big jump this spring. We therefore do not expect Japan's key interest rate to rise much above 1%. Hence, the partial financing of real estate in yen for foreign investors will remain the standard and provide positive support for their investment yields in Japan.

The normalization of Japanese monetary policy and falling interest rates in the eurozone and the USA mean the end of the classic yen carry trades, as an appreciation of the Japanese currency is on the cards in the medium term. This new trend direction is healthy and will benefit Japan in the medium and long term. A firmer yen will make it cheaper to import energy, food and other necessary goods. Furthermore, the desired immigration of labor is encouraged because a better exchange rate raises wage levels when calculated in home currencies.

It is also good in principle that money has a price again in Japan. “An economy based on cost free money and where the central bank buys up government debt – that's not the way capitalism should work,” says German Japan strategist Jesper Koll. While recognizing the need of the BoJ’s past ultra-loose monitory policy and its success, we can only agree with his statement. The Japanese economy is ready to return to a normal monetary policy. Because this will make Japan even more attractive for foreign investors, be it shares or real estate.

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