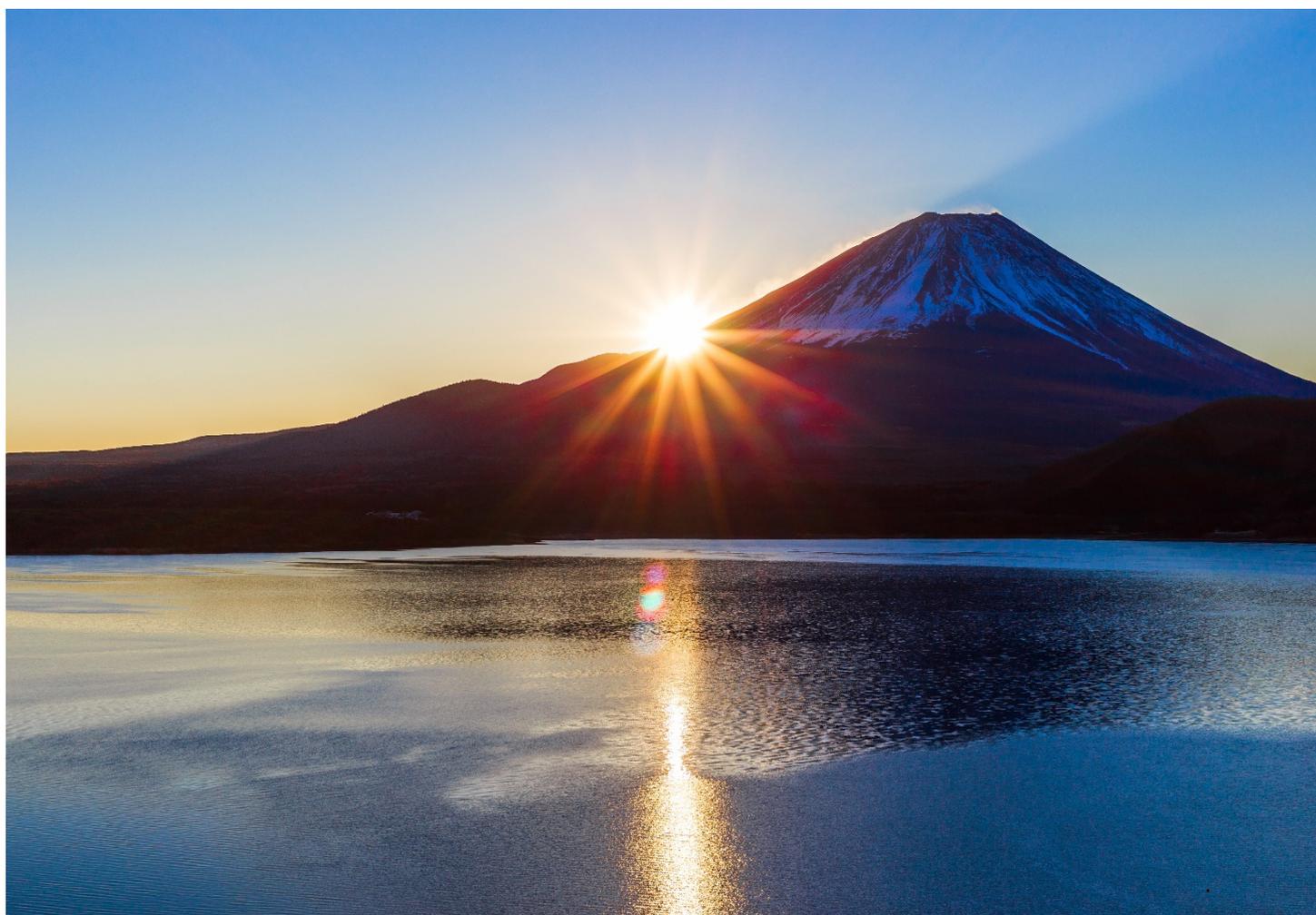


Asset Management One Co., Ltd.

# Japan Market Outlook 2022

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# Japan Economic Outlook

## Economic outlook for 2022

In 2021, the Japanese economy stagnated until the July-September quarter, weighed down by the prolonged declaration of a state of emergency (SOE) and supply side constraints, including the semiconductor shortage. The lifting of the SOE in October, following a decline in the number of new infections, and the gradual easing of restrictions on domestic activity towards the end of this year, should lead to a recovery in consumption over the next year.

Further, given that reduced automobile production, which has significantly depressed production as a whole, is expected to bottom out, we expect the economic growth rate to accelerate between December this year and next year. On the other hand, although the economic stimulus package compiled by the Kishida administration in November included JPY55.7 trillion in fiscal spending, which was larger than market expectations, more than half of this was for Covid-19 related measures, including a rehash of some previously announced economic measures.

We expect that stimulus handouts will offset some of the increased burden on households caused by the recent rise in food, gasoline and other prices, although the multiplier effect is likely to be limited due to the nature of the funds. Apart from that, while the number of new infections in Japan has been kept under control relatively well in comparison to global peers and a third round of vaccinations is due to start in December this year, the possibility of a resurgence must still be kept in mind.

In 2022, we believe the Japanese economy is likely to exceed its potential growth rate, led by a recovery in the domestic services sector, production and capital investment, provided that the pandemic remains largely under control and progress continues to be made in resolving supply constraints.

### Forecast Summary

Calendar Year	2019 (Actual)	2020 (Actual)	2021 (AMO Estimate)	2022 (AMO Forecast)
Real GDP (YoY%)	0	-4.6	1.8	3.5
Core CPI (YoY%)	0.6	-0.2	-0.1	0.3
JGB 10 Year Yield (%)	-0.01	0.02	0.05	0.10
USD/JPY (JPY)	108.6	103.3	113	115
TOPIX EPS	114.3	74.1	123.8	140
YoY%	-11.7	-35.2	67.2	13.1
TOPIX	1721	1805	2050	2200
YoY%	15.2	4.8	13.6	7.3

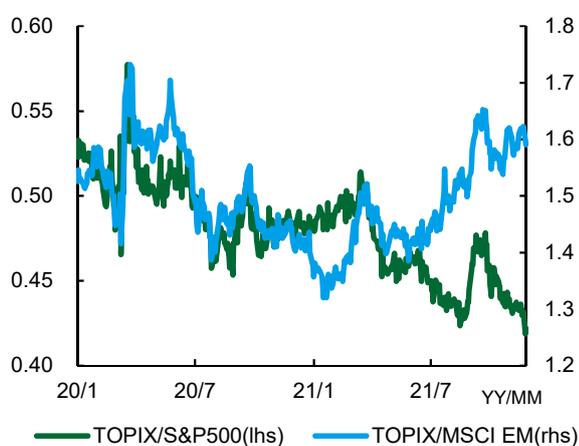
Source: Bloomberg, FactSet, AMOne

# Japan Market Outlook

## Market outlook for 2022

In 2021, Japanese equities are likely to post positive returns on a calendar year basis. However, as the chart (left) shows, the major indices have noticeably lagged behind US counterparts. In early spring, Japanese stocks, which are positioned as global cyclical stocks, rose on expectations for a resumption of global economic activity. However, by the end of August, they were in a downward trend in line with US stocks. The fall in early autumn was likely due to a combination of a lull in expectations for a resumption of global economic activity, delays in domestic vaccination progress, and political uncertainty ahead of the LDP presidential and lower house elections. In the autumn, expectations surrounding the incoming new administration saw Japanese equities rapidly close the gap with US equities, but concerns about prolonged supply constraints in the manufacturing sector later caused Japanese equities to underperform US equities again. Having said that, given that corporate earnings continued to rise through the July-September quarter despite higher raw materials prices, and a recovery in consumption is expected to drive earnings growth through next year, we expect that share prices will remain firm.

**Relative Index Changes**

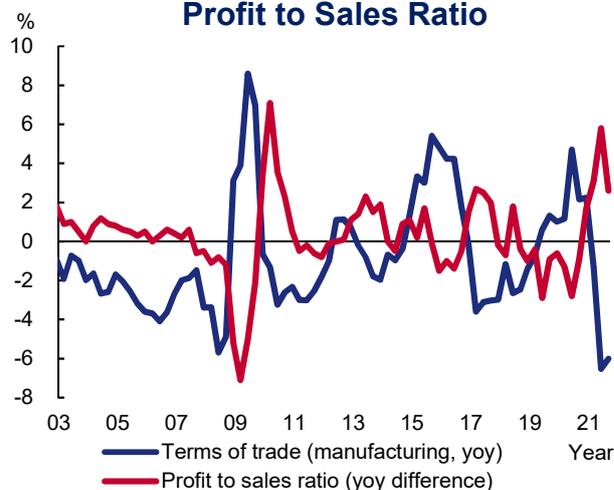


Period: From 6 Jan. 2020 to 30 Nov. 2021  
 Source: Bloomberg, AMOne

As for the impact of raw materials inflation on earnings, the chart (right) shows that in Japan's manufacturing sector, the ratio of recurring profit to sales has tended to improve rather than deteriorate during past periods of decline in terms of trade. (Import prices rise relative to export prices and demand is also strong, so it is generally thought that profit margins will improve, as volumes may increase rather than decrease.)

In 2022, inflation and a shift to tighter monetary policy by the US and other central banks are likely to be major themes for markets, particularly in the first half of the year. However, the rise in US long-term interest rates as the Fed becomes more hawkish has historically been positively correlated with Japanese equities, and foreign investors may focus on Japan as a market that is more resilient to rising US interest rates. As shown in the chart (left), EM equities underperformed Japanese equities in 2021, partly because of concerns about the Chinese economy, but also because of concerns about the hawkishness of the Fed and a shift to a monetary tightening regime by emerging market central banks against the backdrop of weakening emerging market currencies as the dollar strengthened.

**Terms of Trade and Profit to Sales Ratio**



Period: From Jan.-Mar. 2003 to Jul.-Sep. 2021 (Quarterly)  
 Source: Bloomberg, AMOne

# Japan Market Outlook

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## Foreign Exchange

The Bank of Japan (BoJ) is expected to maintain its current monetary policy stance in 2022, as the national CPI (excl. fresh food), which the Bank focuses on in its monetary policy operations, is likely to rise to only around 1% YoY momentarily in 2022, unlike the situation in the US and Europe. With domestic investors continuing to sell the yen and buy foreign currency denominated assets in search of yield, the yen is expected to weaken in the foreign exchange market. The BoJ is likely to maintain a wait-and-see stance on the depreciating yen, viewing it as benign and attributed to disparity between US and Japanese monetary policy.. Whether the yen will weaken even further will depend on the movements of the US dollar and US interest rates.

## Key themes for the Japanese stock market

### i. **Structural change and the normalisation of economic activity in the wake of the Covid-19 outbreak**

The prolonged and global scale pandemic has revealed a number of weaknesses, and services and businesses which effectively respond to the post-Covid environment are expected to continue to grow. In response to the semiconductor shortage that became apparent as a result of the pandemic, the Japanese government has announced its intention to increase domestic production of semiconductors, and capital investment is expected to progress in related industries. It is also highly likely that the resumption of economic activity will progress, and that a full recovery in the domestic service sector, which has been delayed, will proceed.

### ii. **Inflationary forces (mainly overseas)**

Although inflation is unlikely to spread downstream in Japan, investors are likely to favor assets such as financial stocks and REITs, which are considered to be highly inflation-resistant.

### iii. **Decarbonisation and ESG investment**

With the target of reducing greenhouse gas emissions set by the Suga administration at 46% of FY2013 levels by 2030 in order to achieve carbon neutrality by 2050, the Kishida administration has little choice but to make rapid progress in greening the economy. In addition, ESG investments pertaining to themes other than climate change are likely to become more active.

## Japan Market Outlook

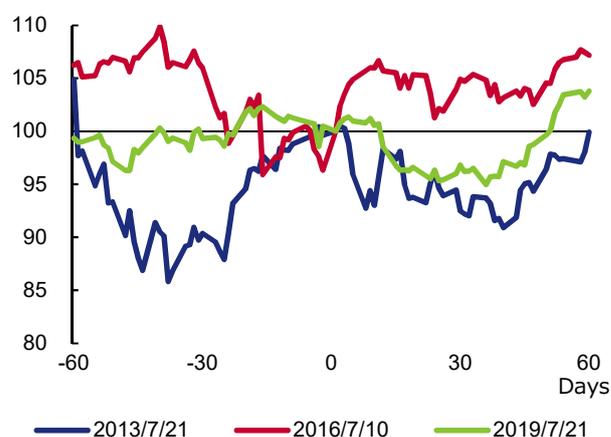
### iv. Digital Transformation (DX)

In line with the establishment of the Digital Agency in September 2021, and the Kishida administration's policy of promoting digitalization as part of its growth strategy, the government is expected to pursue efficiency improvement of IT systems within government agencies.

### Summer Upper House Elections

In the summer of 2022, the key to the election of the upper house of the Diet will be public opinion following the receipt of benefits from economic stimulus measures, the pandemic situation, and progress in the resumption of economic activity. The last three LDP administrations have seen mixed reactions to the elections, but the summer months, when uncertainty over the full-year earnings outlook is high, are usually associated with weakness in Japanese equities.

**TOPIX Performance around the Last Three Upper House Election Days**



Source: Bloomberg, AMOne

NOTE: TOPIX price on the upper house election day (0) is normalised to 100.

## Topic: Kishida's long-term economic measures

### **Kishida's long-term, systematic approach has the potential to create a virtuous economic cycle**

Prime Minister Fumio Kishida has drawn up his first economic stimulus measures in which he incorporated the launch of a so-called "New Form of Capitalism". The package, which has been approved by his cabinet, sets out a long-term systematic approach, which if followed we believe shows potential to instigate change in society and activate a virtuous cycle of economic growth and distribution of wealth. The economic stimulus package is significantly large, at a size of JPY55.7 trillion (10.4% of nominal GDP) in fiscal expenditure and JPY78.9 trillion (14.7% of nominal GDP) in total. However, so far it has failed to generate much positive publicity locally. We believe this is largely attributable to three reasons.

Firstly, bundling initiatives of different nature and time horizon in the supplementary budget, which is designed to finance a single year of fiscal spending, has watered down their impact and resulted in a muted response from the general public. The coronavirus response measures and support measures to revive economic activity are essential in the short-term while the launch of a New Form of Capitalism is an ideological transformation of society which requires a long-term systematic approach in order to change the mind-set of a variety of different stakeholders. Secondly, the growth strategy laid out in the package includes the realisation of a science and technology nation, launch of a "vision of a Digital Garden City Nation" to revitalise rural areas and connect them to the world, and economic security, which were perceived as minor modifications to existing policies and lacked novelty. Thirdly, a one-off cash distribution to children under 18 years old, which was adopted as a compromise to the LDP's coalition partner Komeito, proved to be unpopular among the general public.

### **Can a long-term, systematic approach lead to a virtuous circle this time?**

Both the growth strategy and the distribution strategy to support and broaden the middle class need to be implemented systematically from a long-term perspective. The "launch" of the new form of capitalism included in the economic stimulus package is just the beginning. Although it has not received much attention in the media, we note that the Kishida Vision, which was presented at the LDP presidential election, displays the Prime Minister's awareness of issues from a long-term perspective. Including for both the private sector, as it "urges large corporations to manage their businesses with a long-term perspective", as well as for the public sector, where the vision states that "alongside correcting the negative effects of the single-year policy governing the allocation of public finances and requiring companies to take a long-term perspective, the government should systematically address national issues such as the promotion of science and technology and economic security".

## Topic: Kishida’s long-term economic measures

With the Kishida government in power, several new bodies congruent with the vision have been established, including a “Council for the Realisation of a New Form of Capitalism”. The formation of two new committees is also significant, the newly established “Public Price Evaluation Committee” aims to create an environment to achieve public sector pay rises, while the aim of the New Economic and Industrial Policy Subcommittee is to actively support the government’s long-term and systematic efforts to solve diverse medium- and long-term social and economic problems.

The ruling LDP won an outright majority of seats in the House of Representatives election in October, in the first general election since Prime Minister Kishida took office, and if the ruling party wins the House of Councillors election, scheduled for around July 2022, it will be able to manage proceedings within the Diet in a smooth and stable manner thereafter. The difference between the policies of previous administrations and those of the Kishida administration is the attitude of the nation towards the challenges it faces, and the long-term, deliberate perspective needed to create an environment for a virtuous cycle of growth and distribution. We expect that this time the government will be able to pursue its policies, leading to a virtuous circle.

### Key Points of Economic Measures

<p><b>Prevention of the spread of novel coronavirus</b> JPY22.1 trillion</p>	<ul style="list-style-type: none"> <li>• Ensure stability of medical care system and promote vaccination rollout</li> <li>• Support for businesses</li> <li>• Stimulus payment of JPY100,000 in cash for each household exempt from resident taxes</li> <li>• Response to soaring energy prices</li> </ul>
<p><b>Safe resumption of socioeconomic activities</b> JPY9.2 trillion</p>	<ul style="list-style-type: none"> <li>• Implement new measures to stimulate demand such as the Go To Campaign</li> <li>• Establish domestic development of vaccines and therapeutic drugs</li> </ul>
<p><b>Launching a “New Form of Capitalism” for future society</b> JPY19.8 trillion</p>	<p>&lt;Growth Strategy&gt;</p> <ul style="list-style-type: none"> <li>• Realization of science and technology nation</li> <li>• Vision of a digital garden city nation</li> <li>• Stimulus payment equivalent to up to JPY20,000 per person</li> <li>• Economic security</li> </ul> <hr/> <p>&lt;Distribution Strategy&gt;</p> <ul style="list-style-type: none"> <li>• Incentives for companies raising wages</li> <li>• Policy package of JPY400 billion over 3 years for strengthening investment in people</li> <li>• Raise the income of public service workers (medical care, nursing, elderly care, childcare services, etc.)</li> <li>• Stimulus payment equivalent to JPY100,000 per child</li> </ul>
<p><b>Prevention of disasters and enhancement of national resilience</b> JPY4.6 trillion</p>	<ul style="list-style-type: none"> <li>• Promotion of measures to prevent and reduce impact from disasters and to enhance national resilience</li> <li>• Accelerated recovery and reconstruction from natural disasters</li> <li>• Safety and security of the people, including by ensuring national security</li> </ul>

Source: Cabinet office, AMOne

## Topic: Service Consumptions

### **Services consumption to recover in Japan as the nation adapts to coexisting with Covid-19**

In Japan, the framework to allow normalisation of economic activity whilst effectively managing the pandemic is in place, and consumption, which has been restrained for much of 2021, will begin to recover on the back of an increase in household savings accumulated over the course of the pandemic.

#### **i. Review of consumption in 2020-2021**

Looking back at the consumption trend in Japan since 2020, a period where Covid-19 spread globally, durable goods, which had still been experiencing impact from the consumption tax rate hike in October 2019, declined significantly with the first declaration of a state of emergency during spring 2020. From autumn 2020 onwards, there was a phase in which consumption exceeded pre-pandemic 2019 levels, partly due to the effect from the one-off payment to every resident of Japan of JPY100,000 per person. On the other hand, services consumption continues to remain below 2019 levels by more than JPY10 trillion per quarter on an annualized basis. This drag from depressed services consumption is the main reason why Japan's GDP has not recovered to 2019 levels, whereas US and European peers have returned to pre-pandemic levels.

#### **ii. Normalised economic activity in coexistence with Covid-19**

In Japan, due to delays in vaccination rollout and fears over the fragility of the medical system, previous responses to each wave of the pandemic have centered around widespread restriction on economic activities and discouragement of consumption of services involving higher risk of infection. However, now policy side support is in place to allow a normalisation of economic activity whilst effectively managing the pandemic. Nearly 80% of the population have been vaccinated with two doses and economic measures formulated by the Kishida administration in November are both supportive of further vaccination - including a third dose - and look to enhance the medical provision framework, including by promoting the use of therapeutics to manage the pandemic. Therefore, even if the population does not immediately return to a pre-pandemic level normal in terms of activities and behavior, we can expect a recovery in services consumption.

#### **iii. Demand for services consumption and measures to stimulate it**

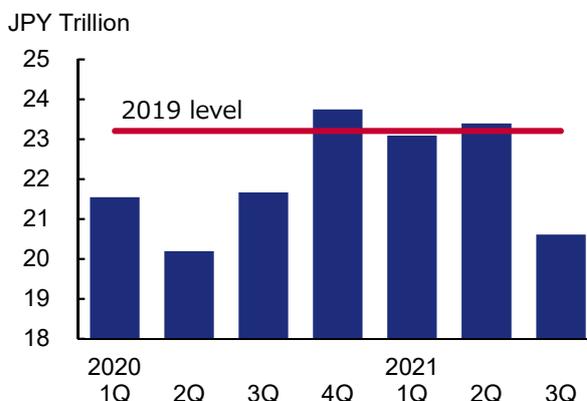
According to the White Paper on Leisure, in 2019, the number one leisure activity participated in by the Japanese population was domestic tourism, and the second was eating out. Even in 2019, when the number of foreign visitors to Japan reached a record high of 31.88 million, the travel consumption of foreign visitors to Japan was JPY4.8 trillion, while the domestic travel consumption of Japanese in 2019 was JPY21.9 trillion, four times that of foreign visitors to Japan. In addition, according to data from the Japan Food Service Association, the market size of the food service industry (excluding group meals) in 2019 was JPY22.7 trillion, on an upward trajectory since 2012.

## Topic: Service Consumptions

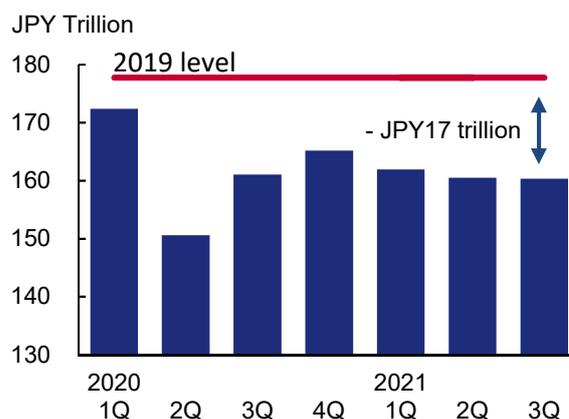
Japanese consumption of domestic travel in 2020 was JPY10 trillion, less than half of what it was in 2019; in 2021, it was about JPY5.8 trillion in the three quarters to September. Nominal services consumption in the July-September period of 2021 was about JPY17 trillion (about 3% of GDP) lower than in 2019, and pent-up demand is expected to be great.

Furthermore, household savings are now higher than in 2019 due to lower consumption and unspent economic stimulus by a cumulative total of about JPY35 trillion from the beginning of 2020 to the April-June quarter of 2021. In addition, the economic stimulus package includes GoTo Travel and GoTo Eat projects to support travel and eating out, which are expected to start around February 2022. The GoTo Travel project was also implemented during July-December 2020, and according to the Ministry of Land, Infrastructure, Transport and Tourism, the actual amount of support provided by the government was JPY539.9 billion, so taking into account the subsidy rate for the campaign (around 30%), the total amount spent on travel through this campaign was around JPY1.5 trillion. As economic activity normalises going forward it is expected that these policies coupled with excess household savings will boost services consumption.

### Nominal durable goods consumption

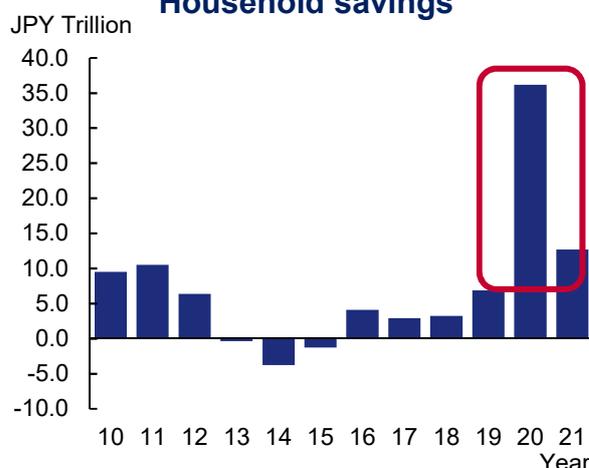


### Nominal services consumption



Period: From Jan.- Mar. 2020 to Jul. - Sep. 2021 (Quarterly)  
 Source: Cabinet Office, AMOne  
 NOTE : Annualized, seasonally adjusted

### Household savings



Period: From 2010 to 2021 (Annual amount)  
 Source: Cabinet Office, AMOne  
 NOTE : 2021 as of Apr. - Jun.

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