Mizuho Market Comment

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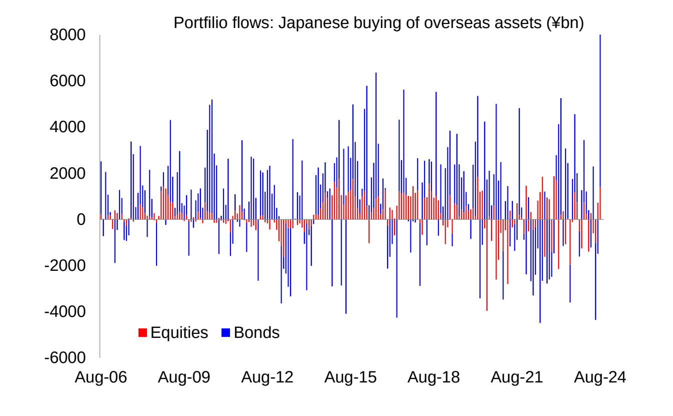
Japan Flows : JPY firms despite record portfolio outflows

- **MoF's monthly portfolio flow data for August showed record buying of overseas bonds…**
- **…as well as solid buying of overseas equites**
- **Despite the major outflows, JPY strengthened in August, help by speculative investors**
- **Looking forward, we do not expect further portfolio outflows to limit mild JPY strength**

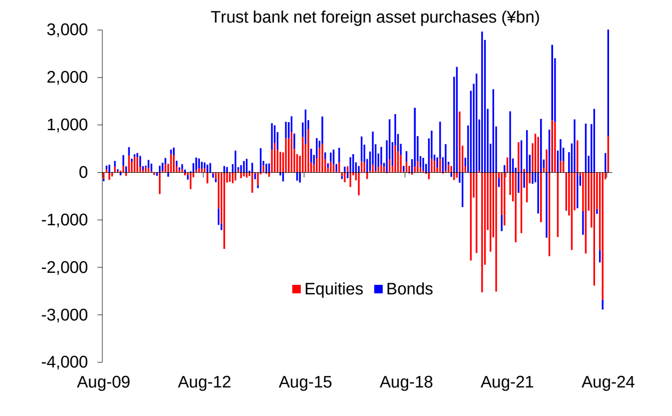
August brings record buying of overseas bonds ahead of Fed rate cuts

At the start of August, the market focus was on the unwinding of the yen carry trade and the possibility that Japanese investors would sell overseas assets and repatriate the funds given the prospects of a much stronger yen as well as higher domestic yields as the BoJ hiked multiple times. MoF's monthly portfolio flow data imply that those repatriation concerns were overblown. Indeed, as the Fed prepares to cut its policy rate for the first time since spring 2020, Japanese investors have been heavy buyers of overseas bonds. Net purchases of overseas bonds in August totalled over ¥7trn – a new monthly record. We will not get a country breakdown until next month but we assume that the bulk of the purchases were of US bonds. The buying was led by banks (¥3.99trn) and trust banks (¥2.81trn).

Portfolio outflows hit record levels…



…with no signs of a pension pullback

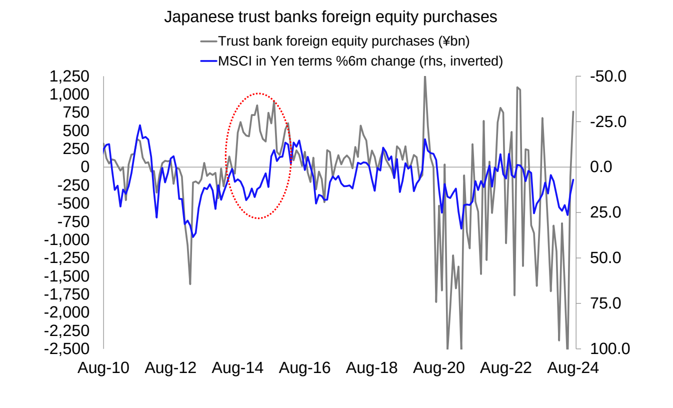


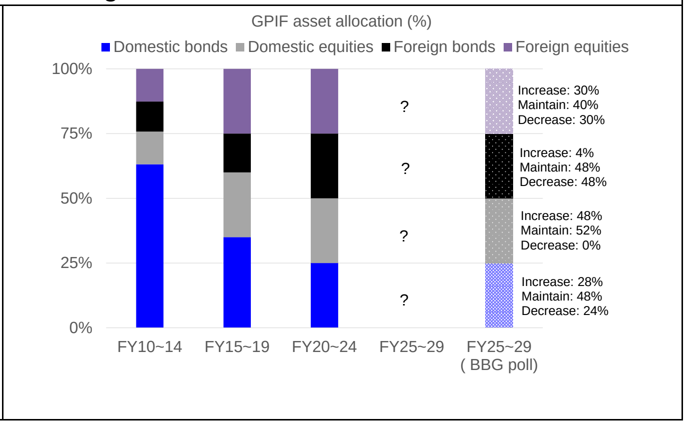
Source: MoF

Too early for signs of pensions rebalancing?

Early this month, a Bloomberg survey of GPIF watchers suggested that the GPIF may boost its allocation to equities at the start of FY25, with a reduction in the foreign bond allocation pegged as the most likely source of funds. The GPIF reviews its asset allocation every five years. There is no set timing for the announcement of the results of the review. The announcement of the new asset allocation for FY15 was made alongside former BoJ Governor Kuroda's "Halloween Surprise" in the 31 October 2014 BoJ meeting – well ahead of the fiscal year end. In contrast, the result of the review for FY20 was announced on the last day of FY19. The GPIF has strived to take more risk over the past decade and this has paid off handsomely. The GPIF's assets under management have swelled to ¥258trn as of end June 2024. As such a rebalancing of say 5% from overseas bonds to domestic equities would represent an inflow of ~¥13trn into Japanese equities. Given that the GPIF does not currency hedge the bulk of its portfolio, it would also represent a similarly-sized inflow into the yen. The GPIF may dominate the public pension sector but it is not the only public pension fund. Where the GPIF leads, other public pensions tend to follow. In FY20, the GPIF completed well over half the change in asset allocation before the public announcement of the review on the final day of the fiscal year. We suspect that if the GPIF was indeed planning such a step, it would show up in the data ahead of the end of the fiscal year. There was no sign of such a step in the August data, with trust banks as net purchasers of both overseas equities and bonds. That said, it may be too early in the fiscal year and we may have to wait until H2 FY 24 to see if the data suggest such a move is underway.

Trust banks back on the buyside in overseas equities in August



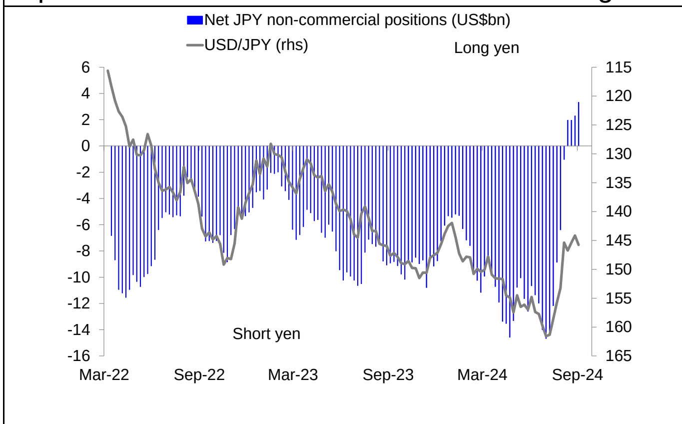


Source: MoF, Bloomberg, GPIF

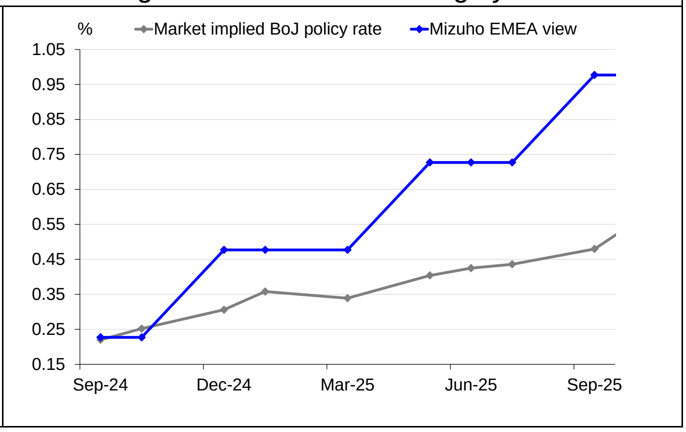
Trust banks and investment trusts drive net purchases on the equity side of the flows equation
MoF’s monthly data for August showed trust banks were also net buyers of equites, despite the fact that US equities were a little higher on the month. Generally, trust banks passive strategies mean buying into weakness and selling into strength. However, the fact that the yen firmed sharply at the end of July and into August means that US equites declined in yen terms on the month, which likely drove the inflows into overseas equities. Investment trust net purchases of overseas equites dropped below the ¥0.9trn level for the first time since the new NISA rules were introduced at the start of the calendar year, coming in at ¥0.7trn in August. NISA flows look to have remained solid on the month, with investors looking to buy the dips. Fears that Japanese investors would repatriate cash in the wake of the huge market volatility at the end of the July have been unfounded. Note that NISA flows are tax advantaged and are thus less flexible compared to other retail funds. This makes them sticker and less prone to repatriation.

Yen still cheap, further gains likely
The huge portfolio outflows on the month have had little impact on JPY, which firmed against most G10 currencies in August, especially the US dollar. One factor here is the fact that the short-term speculative investors have aggressively bought back JPY shorts in since the BoJ meeting at the end of July. Indeed, speculative investors are now net long JPY, despite the still deeply negative carry. Another factor is that fact that much bank activity is funded in repo markets and has limited fx impact. Recall banks accounted for over half of the record overseas bond purchases in August. In the short run, we can see scope for higher front-end UST yields as US rate cut expectations look a little overcooked, which in turn will lift the US dollar. However, in the medium term, we expect the yen to continue to firm modestly as the BoJ hikes more aggressively than markets currently expect. We look for USD/JPY to push down to the 135 level on a 12-month horizon.

Speculative investors slash JPY shorts in August



Further to go in BoJ’s modest hiking cycle



Source: MoF, Bloomberg