

## Japan Research

**BofA FAQs: Japan's structural transformation – drivers and consequences**

This is a redaction from a 37-page report published on August 23, 2024.

**1. Is inflation here to stay?**

Japan's economy is on track to break out of the low inflation equilibrium of the past 25 years. The initial trigger was the COVID global inflation shock. But structural labor shortages, underpinned by demographic shifts, will be a sustained source of inflation pressures over the next decade.

**2. Will households' love of cash change?**

Japanese households hold \$15tn in financial assets (almost triple nominal GDP) around 50% of which are held in cash and cash-like deposits, far above the 13% in the US and the 36% in Europe. Assuming inflation is sustained and the stock markets remain firm, we expect a gradual but sustained shift from cash and deposits into risk assets.

**3. What are the factors behind the yen's decline?**

The yen's weakness has been driven by two main factors – 1) interest rate spreads between Japan and the rest of the world, and 2) structural outflows from Japan. While the scope for a renewed downshift may be limited in the near term, we believe JPY will move back into a downtrend by year-end, as structural outflows remain intact.

**4. Will the equity rally and corporate reform continue?**

Japanese stocks surpassed its 35 year-high and marked a new record in July, only to shed its YTD gains in early August. Though the market is already recovering, it may take some time before they set another high. Over the medium term, we think the shift towards an inflationary environment and accelerating corporate reform will lead to a sustained rally.

**5. Inbound Boom or Bust?**

Tourism in Japan is still in a recovery phase, as we are yet to see visitors from mainland China coming back to pre-pandemic levels. The exchange rate is not a major risk at current levels. Longer term, inbound trends will be influenced by how Japan handles soft infrastructure buildout and deals with concerns of over-tourism.

**6. Geopolitics: How will Japan navigate rising tensions?**

Rising geopolitical risks could provide secular tailwinds to Japan. We explore three geopolitical implications, including defense modernization, energy transition and select trade expansion.

**7. What is Japan's AI-related exposure?**

AI market expansion is expected to bring benefits to industries such as semiconductors and semiconductor production equipment (SPE), materials, electronic devices and components, infrastructure-related in the short term. In the longer term, Japan's own LLM development is also becoming more active.

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Refer to important disclosures on page 2 to 4.

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