Daiwa's View

Will households' foreign currency investments change?

- Significant yen selling potential from change in households' attitude toward investing
- However, households headed by someone 60 or older hold 63.5% of all household financial assets in Japan; tend to value stability
- Outward investment in securities much higher than Y3.0tn per year could suggest change in household investment behavior

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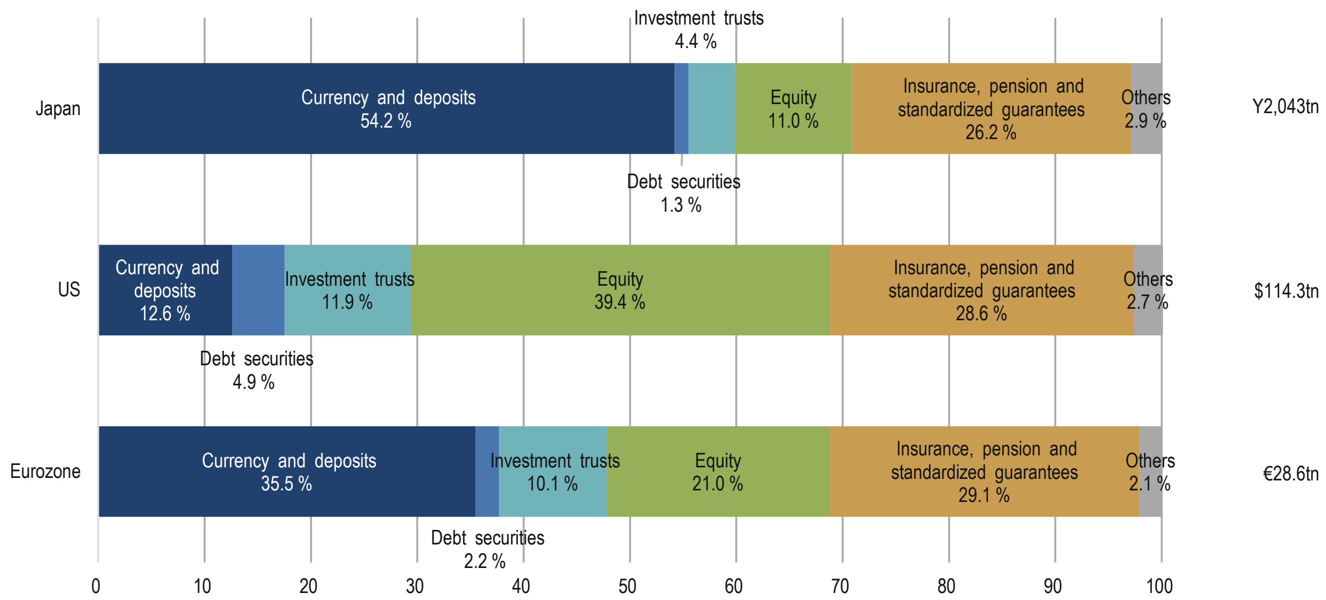
Japan's government is trying convert the country into an asset management powerhouse. One such initiative is the new NISA (Nippon Individual Savings Account), which will launch in 2024 with the aim of encouraging households to invest more. Unlike Western countries, cash and deposits account for more than half of the household financial assets in Japan (Chart 1). The government's objective is to realize a "virtuous cycle of growth and distribution," where cash and deposits go toward investments and the benefits of increased corporate value are returned to households, leading to further investment and consumption.

There are some concerns about the impact on the yen exchange rate if these government initiatives result in more aggressive investing by households. The impact of the new NISA itself is not expected to be necessarily significant over the short term, but there is the possibility that the government initiatives will help to change households' attitudes toward investing. In this report, we examine how changing attitudes toward investing among households could impact the yen exchange rate.

Chart 1: Household Financial Asset Compositions in Japan, US, and Europe (as of end-Mar 2023)



Source: BOJ; compiled by Daiwa.

Current household financial assets come to roughly Y2,000tn, of which yen-denominated cash and deposits account for more than half of that total at Y1,100tn (Chart 2). Cash and deposits now account for more than half of household financial assets and this situation has not changed for more than 20 years. This situation also underscores a strong bias among households towards cash and deposits (Chart 3). It is this cash and deposits portion that is expected to change as households become more active with their investing.

Chart 2: Household Financial Assets (as of end-Sep 2023)

	Amount (Y tn)	% of total
Total assets	2,121.2	100.0
Foreign currency denominated	73.8	3.5
Foreign currency deposits	6.7	0.3
Outward investment in securities	25.9	1.2
Investment trusts	41.2	1.9
Yen denominated	2,047.4	96.5
Cash and deposits (excl. foreign currency deposits)	1,106.3	52.2
JGBs, etc.	28.0	1.3
Equities / capital	272.9	12.9
Investment trusts (excl. foreign currency portion)	60.0	2.8
Insurance / pension funds	539.1	25.4
Deposits, etc.	41.2	1.9

Source: BOJ; compiled by Daiwa.
Note: Foreign currency portion of investment trusts is calculated based on the share of outward investment in securities in the securities investment trust sector of the Flow of Funds statistics.

Chart 3: Household Financial Assets (as of end-Dec 1999)

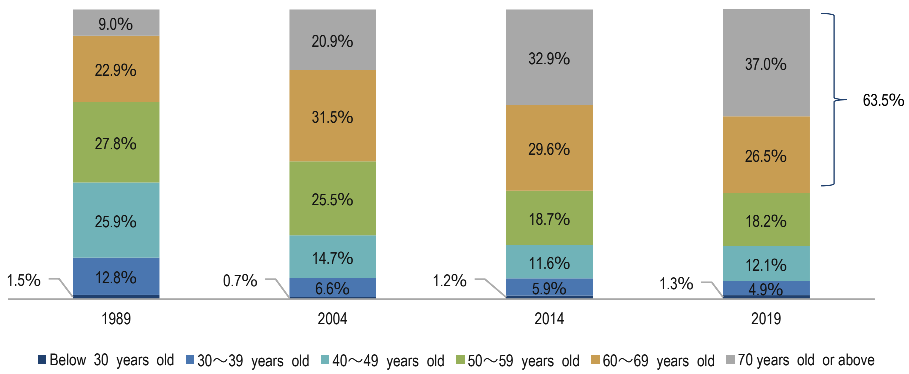
	Amount (Y tn)	% of total
Total assets	1,401.6	100.0
Foreign currency denominated	12.4	0.9
Foreign currency deposits	2.9	0.2
Outward investment in securities	4.7	0.3
Investment trusts	4.8	0.3
Yen denominated	1,389.2	99.1
Cash and deposits (excl. foreign currency deposits)	748.1	53.4
JGBs, etc.	51.6	3.7
Equities / capital	138.1	9.9
Investment trusts (excl. foreign currency portion)	24.6	1.8
Insurance / pension funds	365.5	26.1
Deposits, etc.	61.4	4.4

Source: BOJ; compiled by Daiwa.
Note: Foreign currency portion of investment trusts is calculated based on the share of outward investment in securities in the securities investment trust sector of the Flow of Funds statistics.

The main points of interest in terms of any potential impact on the yen exchange rate are (1) How much of the approximately Y1,100tn in yen cash and deposits will be invested and (2) How much of it will be allocated to foreign currency-denominated assets. In terms of foreign currency-denominated assets, there has been little change in the share of foreign currency deposits, while there has been an increase in the share of outward investment in securities and investment trusts (foreign currency portion). If cash deposits were to move more toward investments with further foreign-currency investment, the increase would probably be in the outward investment in securities and the investment trust portions.

We looked at how household financial assets are distributed by householder age bracket. As of 2019, households headed by someone 60 or older held 63.5% of all household financial assets in Japan (Chart 4). As this age group retires and starts to live off their pensions (= reduced income), the objective of their asset management will shift more toward stable interest and dividend income rather than asset price appreciation. As such, we believe that their home-country bias will be stronger compared to the younger generations.

Chart 4: Distribution Conditions of Household Financial Assets by Generation

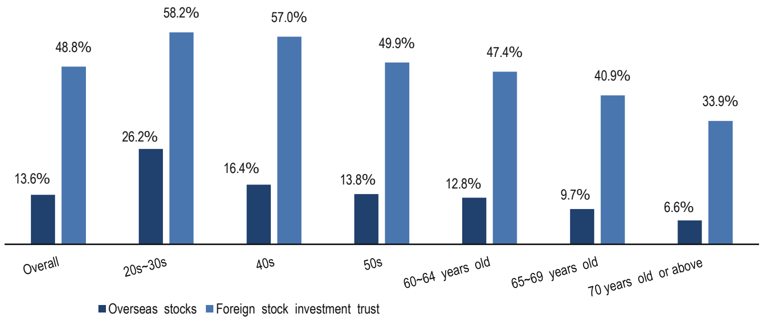


Source: Cabinet Office; compiled by Daiwa.

Actually, among stock and investment trust holders, those in their 20s and 30s hold the largest share of foreign-related financial assets, while the older the generation, the smaller this share becomes (Chart 5). For investment trusts with a large ratio of overseas assets, the share drops significantly from those age 50 and above, falling below the overall average for those in their 60s and above. At the very least, the potential for financial assets to be invested in new foreign currency assets from now on is not particularly large.

Furthermore, even if the assets held by older generations are to be inherited, that does not necessarily mean that the assets will be transferred to a generation with a weaker home country bias. This is because the core generation group now inheriting assets in Japan are in their 50s and 60s. Those 60 and older hold roughly Y600~700tn of the total Y1,100tn in yen cash and deposits. For now, it is unlikely that the bulk of that amount will be newly invested in foreign currency assets. Any new investment in foreign assets would probably come from the remaining Y500tn (held by the working-age population).

Chart 5: Percentage of Foreign-related Financial Assets Held by each Generation



Source: Japan Securities Dealers Association; compiled by Daiwa.
Note: Percentages based on 100% of stock and investment trust holders, respectively.

Even if just 1% of the approximately Y500tn in cash and deposits held by the working-age population is newly invested in foreign currency assets each year, that would result in the selling of five trillion yen, which is not a small amount. The potential for long-term yen selling due to changes in household investment behavior is significant. We probably need to keep a close eye on that point from next year onward as it could impact the yen exchange rate.

However, the only easily understandable change in the investment environment for households is the launch of the new NISA in 2024. It is probably unlikely that a large percentage of households that have not utilized NISA in the past will become more active in investing as a result of the introduction of the new NISA. This is because households with a strong interest in investing are likely already using the current NISA. From this point of view, we assume that households have tremendous potential for investment, but it is difficult to see an immediate change in their investment behavior.

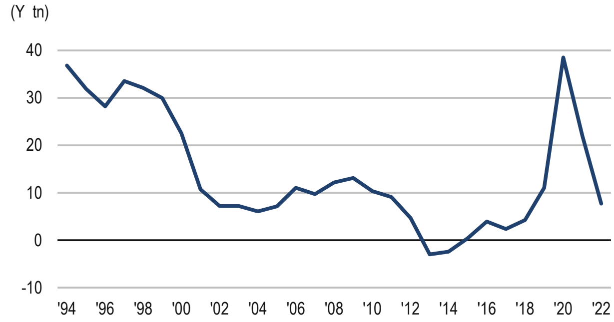
Of course, it is quite possible that government initiatives such as the new NISA will gradually take hold and households will become more active in investing. However, in that case, as well, it seems like the hurdle to investing some percentage of one's income (flow) would be lower than that for investing in assets (stock).

One-year household savings came to Y11.0tn in FY19 before the coronavirus outbreak and Y7.7tn in FY22, when conditions normalized with containment of the outbreak (Chart 6). These savings swelled to Y38.5tn and Y22.0tn in FY20 and FY21, respectively, due in large part to the coronavirus. However, looking ahead, households are likely to save roughly Y10.0tn per year, given that incomes have not increased significantly.

Of that Y10.0tn, at most 30% (about Y3.0tn) will be invested and at most another half of that amount (about Y1.5tn) will be invested in foreign currency assets. Yen selling to the tune of Y1.0tn to Y2.0tn each year is not that large. In other words, the amount of periodic investing from regular income, which is assumed to be a relatively easy investment option, is not particularly large, while the impact on the yen exchange rate is greater when cash and deposits already held by households are invested in foreign currency assets.

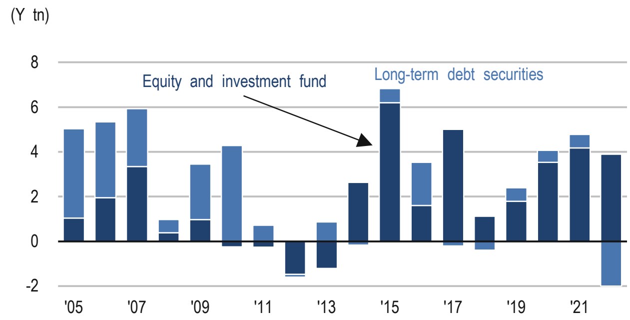
The potential for households to invest in foreign currency assets from their cash and deposits is significant and should be closely monitored. However, as noted above, such potential is not likely to be realized immediately and the impact will only be seen over the long term. Considering that most household investments in foreign currency assets have been made through investment trusts, the investment behavior of the investment trust sector should be closely watched. The average annual outward investment in securities by the investment trust sector since 2005 is Y3.0tn (Chart 7). If the pace of outward investment in securities is seen to be much higher than that average, that could signal a change in households' investment behavior.

Chart 6: Household Annual Saving Amount



Source: Cabinet Office; compiled by Daiwa.

Chart 7: Investment Trust Outward Investment in Securities



Source: MOF; compiled by Daiwa.

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