

BRIEF | Japan | Intelligent Investment

Faster-than-expected interest rate hikes may lead to higher cap rates

August 2024

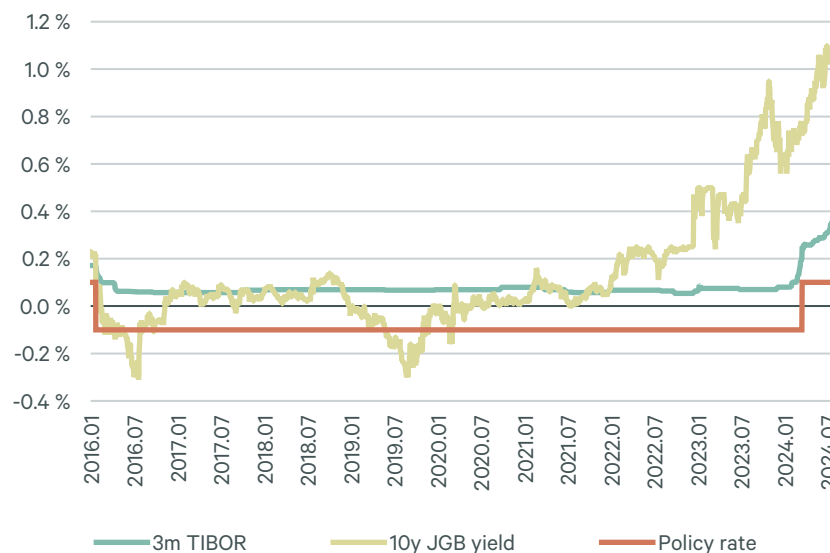
Bank of Japan implements additional interest rate hike; policy rate rises to 0.25%

Overnight Call Rate Target

0.25%

At its July 30-31 2024 policy meeting, the Bank of Japan (BoJ) decided to implement its second interest rate hike for the year. The central bank raised the target for the policy interest rate (uncollateralized overnight call rate) from the range of 0-0.1% to 0.25%. In response to this decision, the yield on 10-year government bonds dropped slightly, while the three-month Tokyo Interbank Offered Rate (TIBOR), which had been gradually rising since the first policy rate hike in March, surged by 8 bps to 0.45% on August 1, 2024.

Figure 1: 10-year government bond yield and three-month TIBOR



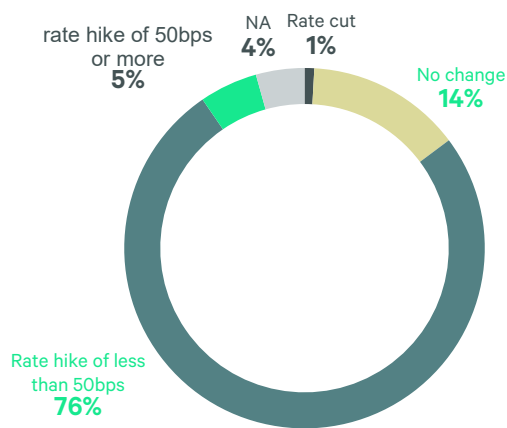
Source: Macrobond, CBRE Research, August 2024

Many market participants were anticipating an additional interest rate hike to be implemented within the year. However, due to the timing being earlier than the September rate hike expected by most observers, there is now a stronger belief that a third rate hike may be announced before the end of the year. BoJ Governor Ueda commented at the press conference after the policy meeting that he does not see 0.5% as a “significant barrier”, leading to a growing possibility of further interest rate hikes next year, though that would depend on the market environment such as stock prices, foreign exchange rates and the US economy.

Possibility of interest rate hikes surpassing investor and lender expectations

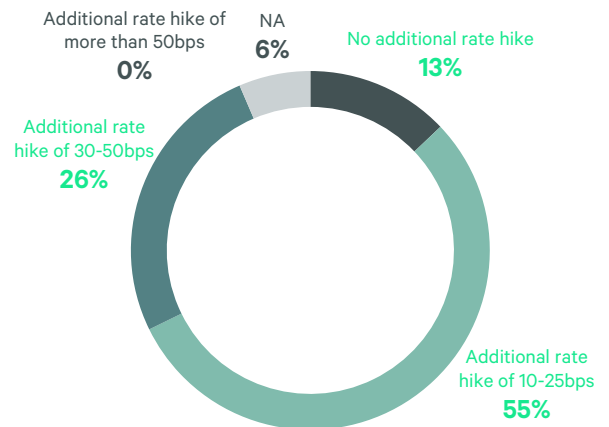
CBRE’s 2024 Japan Investor Intentions Survey, which was conducted in November 2023 when the policy rate was still in negative territory, found that 90% of respondents expected the policy rate to remain unchanged or increase by less than 50 bps by the end of December 2024, indicating that there were expectations of around two interest rate hikes to occur in 2024. Furthermore, the CBRE Lender Survey targeting lenders of real estate non-recourse loans conducted in May this year, after the lifting of the negative interest rate policy, revealed that over 90% of respondents anticipated additional interest rate hikes of up to 50 bps by the end of fiscal year 2024 (ending March 2025). Therefore, should one more interest rate hike be implemented by December 2024 and another by the end of March 2025, the policy interest rate would reach 0.75%, surpassing the consensus held by real estate investment market participants.

Figure 2: Expected policy rate changes by end-2024 (investors, surveyed November 2023)



Source: 2024 Asia Pacific Investor Intentions Survey, Japan, CBRE Research, February 2024

Figure 3: Expected policy rate changes in FY 2024 (lenders, surveyed May 2024)

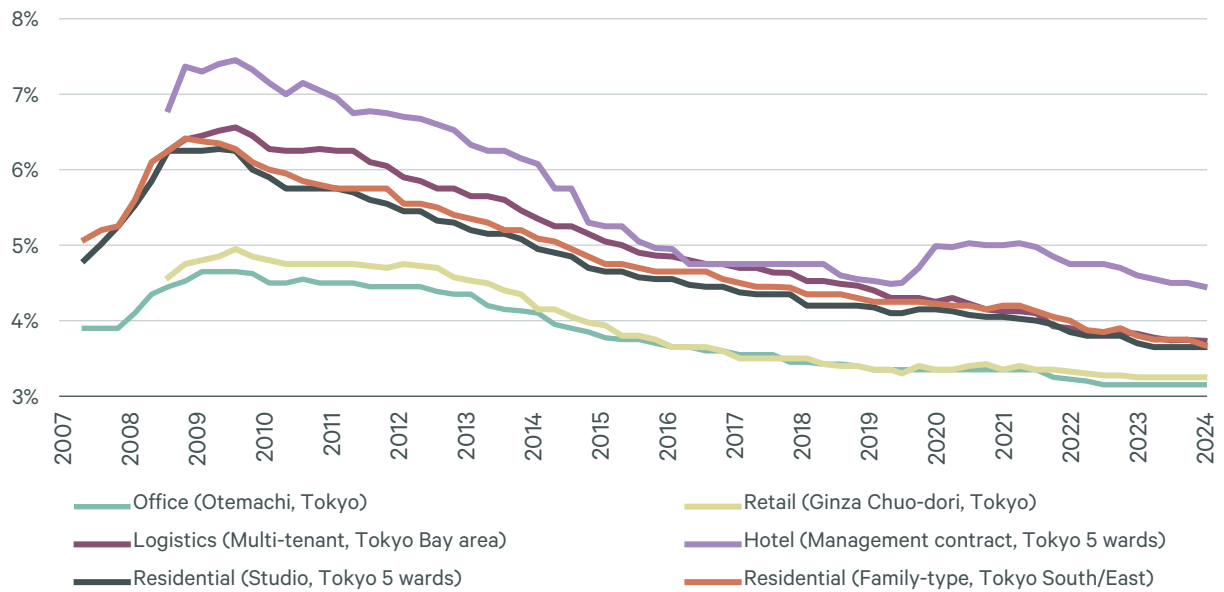


Source: Japan Lender Survey 2024, CBRE Research, June 2024

Expected cap rates may turn upward

According to CBRE’s quarterly Cap Rate Survey, investors’ expected yields have remained low across all sectors. Even in the most recent survey conducted in June 2024, there were no sectors where expected yields for prime assets had increased. It appears that the gradual rise in interest rates up to June have been absorbed by compression in yield spreads.

Figure 4: Expected NOI Yield



* Note: Average figure of the median of lowest/highest yield each.
 Source: Cap Rate Survey, CBRE Research, June 2024

As of the end of June 2024, CBRE’s estimated prime office yield spread against long-term interest rates (10-year government bond yields) was approaching levels just 10 bps or so away from the tightest level recorded in Q2 2007. Although the outlook is uncertain with the recent volatility in the stock market and the yen exchange rate, as well as the situation of the US economy, the likelihood of interest rates rising at a pace exceeding expectations has increased. Investors and lenders are therefore likely to adopt a more selective approach. CBRE believes that there is a possibility of an uptick in investors’ expected yields, potentially leading to lower real estate transaction volumes in the coming quarters.

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