

How frothy is the property market in Japan?

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Executive Summary

The Japanese government started a new indicator to monitor the price development in the commercial property market in Japan. According to the indicator, the commercial property market has risen by 17% since early 2013. There are some disparity among different types of properties. Prices of structured properties such as retail properties have risen robustly since 2013, while prices of lands without structures have hardly risen until quite recently.

A new indicator for the commercial property market

The Japanese government has started to publish a new indicator, Commercial Property Price Index (CPPI), to monitor the price development in the commercial property market in Japan. CPPI comprises of a total of seven sub-indices covering categories such as retail properties, warehouse properties, industrial lands and such. CPPI is currently on a provisional release phase, pending a full operation as official statistics. It is published quarterly with three months' lag. The latest publication is for the January-March 2016 quarter, published on June 29 2016.

CPPI is novel in a number of ways. Most importantly, it is based on actual transaction prices. Existing statistics on the real estate market such as Land Market Value Survey are mostly based on appraised values by experts, rather than on actual transaction values. CPPI also takes into account the value of structures, while Land Market Value Survey only measures the value of lands. For more details on CPPI, we would encourage our readers to see [relevant official documents](#) available at the Ministry of Land, Infrastructure, Transport and Tourism.

What does the data say on the current market?

In the January-March quarter, commercial property prices continued to rise at a robust pace of 4.7% year on year. Commercial property prices in Japan has been on a moderate bull market cycle, rising at a rate of 4% year on year on average.

Commercial property prices rose by 4.7% year on year in 2016Q1



Commercial property prices have risen by 17% since early 2013



In the sub-category level, we see a notable difference in the price developments of properties with structure and properties without structures. While the prices of structured properties such as retail properties and office properties have risen sharply between 2013 and 2016, prices of properties without structures have stayed stagnant until quite recently.

Prices of land properties without structures have hardly risen until recently



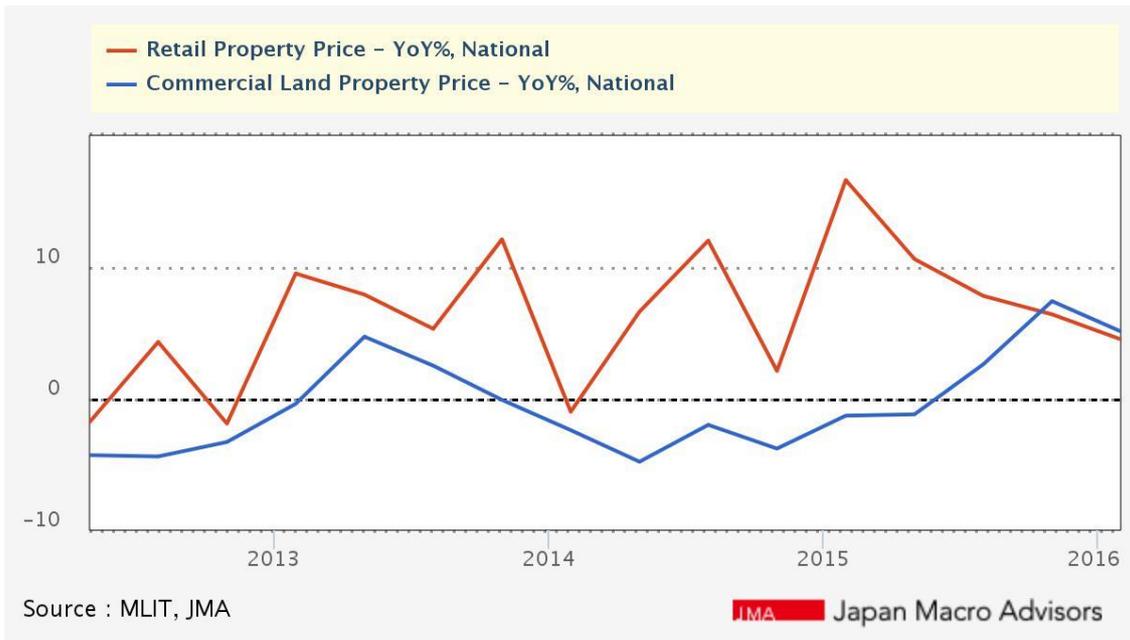
We have seen similar lagged relationship between prices of properties with structures and prices of properties without structure in the last property market boom in mid-2000s. Prices of structured properties started to rise in 2002, but it was not until 2005 when we started to see similar rises in the prices of properties without structure.

In the last bull market cycle, land property prices also lagged behind



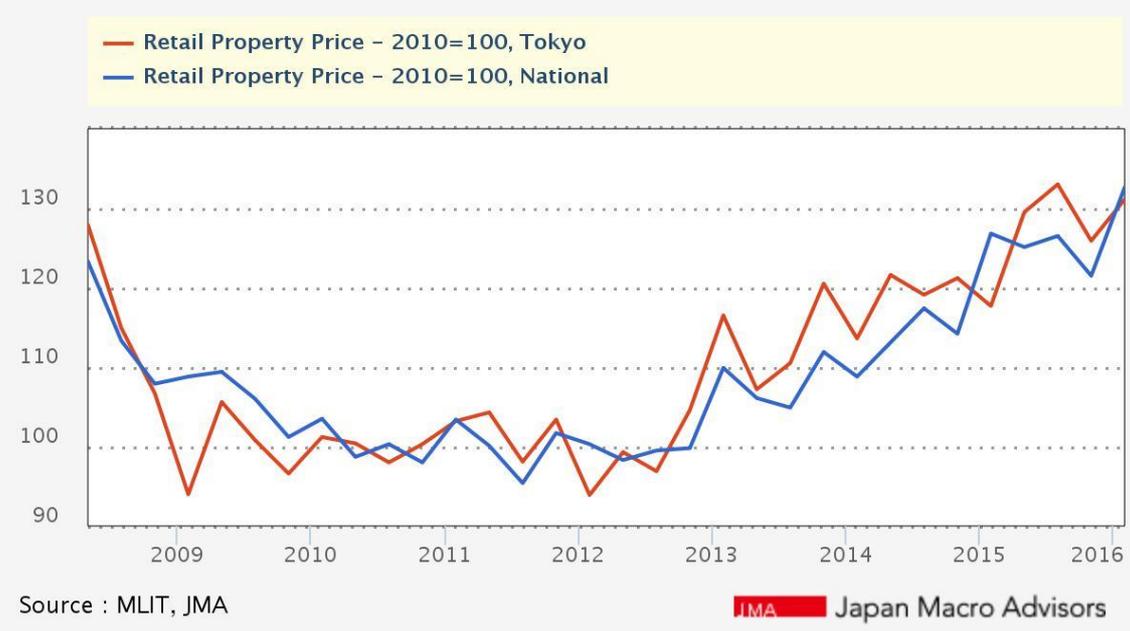
Judging from the recent quarterly data, it seems that we are entering a catch-up phase in the current cycle. The gap between the prices of structured properties and unstructured properties must have grown to such an extent that it is starting to make sense for developers to consider purchasing bare lands to turn them into structured properties.

Land property prices are starting to catch up



CPPI statistics provides regional breakdowns for some of the categories, such as retail properties and office properties. We examined to see if there is any large disparity between Tokyo area and elsewhere in the current phase. We did not see any notable difference though. The current bull market cycle seems to have affected properties nationwide.

The rise in property prices are national, rather than Tokyo only phenomenon



There is yet no alarming froth in the commercial property market

When we compare the bull phase of the property market in 2002-2007 and the current phase, we do not think the current market has become frothy enough to alarm Japanese policy makers. Policy makers in Japan are still focusing on reflating the economy. The sharp declines in long term interest rates in the last few months should in principle help the real estate market in Japan by lowering funding costs for developers. The larger concern for real estate market participants though is the general direction of the economy and where we are in the economic cycle. In our view, the commodity market bust in 2014-2015 are taking a prolonged toll on the global economy and it will not be easy for policy makers in Japan and abroad to reverse the tide. In Japan, the sharp yen appreciation so far in 2016 has all but choked off the reflationary sentiment in Japan. The negative interest rate policy by the Bank of Japan should be helpful for the Japanese real estate market, but we doubt if the stimulus is strong enough to counter the deflationary force that seems to be descending on Japan. While the commercial property market may be able to enjoy another few quarters of expansion, we are skeptical on its sustainability beyond 2016.

No froth yet in the commercial property market in Japan



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