Japanese Equity Market Outlook

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< Market review in August and September 2012 >

In August 2012 equity markets, TOPIX dropped 0.63%, while the Nikkei Stock Average rose 1.67%. Equity prices rose until around the 20th, due to the expectation for the European Central Bank (ECB) policy response, improvements in U.S. economic indicators—such as the employment statistics, retails sales, and industrial production—and the resultant weakening of the yen. Investor sentiment was improved by German Chancellor Merkel's support for the ECB policy. Nonetheless, equity prices dropped toward the end of the month. This drop was caused by deteriorating Chinese economic indicators and falling Chinese equity prices, concerns over local government finance in Spain, the strong yen, turmoil in Japanese politics, worsening Japanese economic indicators, and the like.

September started with falling equity prices due to such factors as deterioration of economic indicators in the U.S. and China. Equity markets rapidly reversed, however, after the announcements of a new government bond purchase program by the ECB, as well as the QE3 by the FED. As a result, equity prices rose, with TOPIX rising 3.45% from the end of August, and the Nikkei 3.61% (as of September 14).

< Growing Concerns about the economic outlook >

The indices of industrial production for July—published on August 31st—showed a decrease of 1.2% from the previous month (a decrease of 1.0% according to the revised report on September 14th), which was substantially below the market expectation at 1.7% rise from the previous month. Deceleration of export in July appeared to have been reflected in production. Accordingly, the level of production index fell to the lowest level since May 2011 when effects of the Great East Japan Earthquake still largely remained. On the other hand, the inventory index saw a substantial rise of 2.9% from the previous month (revised figure) as a decrease of 3.1% in shipments from the previous month (revised figure) was larger than that of production. In addition, the level of inventory index was marginally higher than the peak level at the time of the Lehman Brothers collapse. Inventory adjustments appear to have become necessary for some time, which in turn is likely to put downward pressures on production. In July, exports decelerated in many regions in addition to Japan. We are seeing increasing uncertainties about the economic outlook. As for the U.S., there is a sign of economic recovery starting with the housing market. It is hoped that such positive developments in the U.S. will spread to other regions; however, there seems to be the risk that strengthening of economic decelerations in regions other than the U.S. could suspend the U.S. movements towards recovery.

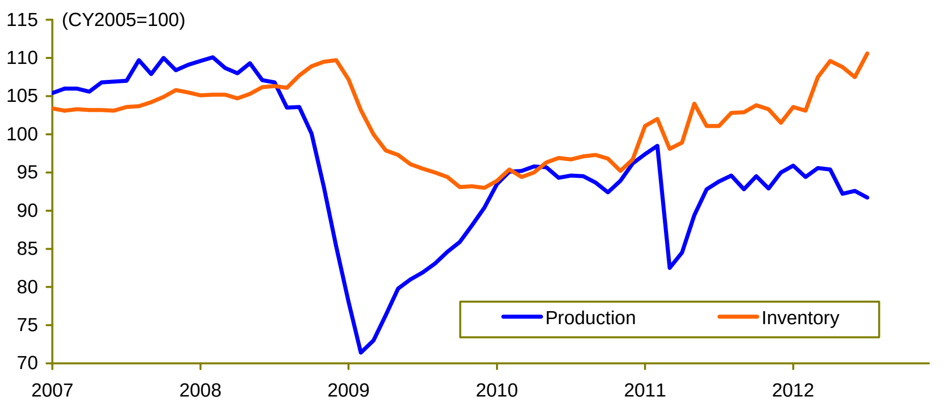
< Future outlook >

Looking at the next year or so, we expect that equity markets will continue to fluctuate within a range until around the spring of 2013, followed by moderate recovery.

Previously, it was assumed that a recovery trend would be strengthened during the October-December period, with equity prices rising as a result. We have changed our forecast, however, due to the likely continuation of the economic slowdown in regions other than the U.S., including Japan. Although we described it as a risk scenario before, we now judge such possibility is high. In Japan, with the heightened possibility of a Lower House election in November, policy response is likely to have to wait until after the election, which in turn will have negative impacts on the equity markets. From the end of 2012 to early 2013, there is concern about the fiscal cliff in the U.S. Some measures to avoid the cliff will likely be taken, but on the other hand, the cliff may not be avoided if the elections result in a divided Senate and House. Moreover, even if some measures are taken, it is highly likely that there could still be some remaining effects of the cliff. If such effects are reflected in economic indicators, concerns over the economic outlook could increase. Nevertheless, Japanese equity prices are not forecast to drop substantially due to their PBR. While the bottom range of PBR has been around 0.9 since 2011, it is close to that level at the moment.

After the spring of 2013, equity prices are expected to recover, with the global trend towards economic recovery reinforced. In the U.S., the effect of the fiscal cliff is forecast to wane gradually. In Europe, with the progress in dealing with the debt problem, financial markets are expected to be more or less stabilized, which will have positive impact on economic activities. In China, the effects of fiscal stimulus measures are likely to be felt in time. In Japan, the Governor of the Bank of Japan (BOJ) will be replaced in April. After that we expect to see some measures to contend with the strong yen and deflation, such as the purchase by the BOJ of foreign bonds.

Indices of Industrial Production



Jan 2007 ～ Jul 2012

Source: Ministry of Economy, Trade and Industry