

Japanese Equity Market Outlook

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< Market review from September to October >

In September 2012, equity markets rose, with TOPIX rising 0.79%, and the Nikkei Stock Average 0.34%. The month started with declining equity prices, due to deterioration in overseas economic indicators and the like. Equity prices reversed to rise, however, in response to the ECB decision on a new government bond purchase program. Subsequently, they continued to rise, influenced by such events as the favorable decision by the Germany's constitutional court on the constitutionality of the ESM, the victory of the Dutch ruling party in lower house elections, and the adoption by the FRB of a third round of quantitative easing. Toward the end of the month, equity prices dropped again due to concerns over the slowdown of the Chinese economy, worries about the Spanish debt problem, and the further strengthening of the yen.

The declining trend in equity prices continued upon entering into October. Some factors pushed down equity prices; for example, the deteriorating outlook of global economic activities, the poor earnings results for the July-September period in the U.S., and the downward revisions of corporate earnings by Japanese companies. TOPIX and the Nikkei Stock Average dropped 1.96% and 3.29%, respectively, from the levels at the end of September (as of October 15).

< Risk of prolonged deterioration of Japan-China relationship >

The months of August and September witnessed heightened anti-Japan demonstrations in China, caused by conflicting territorial claims over the Senkaku islands. The situation calmed down after the Chinese government moved to restrain demonstrations on September 19, but it seems that the adverse impacts remain on the sale of Japanese cars and the like. While some see anti-Japan demonstrations this time as voluntary actions by Chinese people, others point out the possible repercussions from the confusion at the time of Chinese leadership change; or regard it as an attempt to divert Chinese people's frustrations over domestic policies to a foreign country. Either way, it is expected that moves will be strengthened gradually towards improvement of relations between Japan and China going forward. There are some risks, however. On September 26, in the election for president of the Liberal Democratic Party, former Prime Minister Abe was again elected as president. At the news conference of the election, he expressed his deep regret that he had not visited and paid his respects at Yasukuni shrine during his premiership. Yasukuni enshrines not only soldiers who died during the wars but also some of the politicians and military officers who were executed as war leaders after World War II. Therefore, China and some other countries are strongly critical of Japanese politicians visiting and paying their respects at Yasukuni shrine, for whatever their reasons are. If Mr. Abe becomes prime minister after lower house elections—many regard this as highly probable—it is very likely that Mr. Abe will visit and pay his respects at the time of shrine rituals in April. Such a visit would risk further deteriorating the Japan-China relationship, as well as prolonging such a worsened situation.

< Outlook >

For the next year or so, equity markets are expected to continue their unstable movements within a range until around the spring of 2013; and then, they are expected to recover substantially in the April – June period. Japanese economic activities and performance have further deteriorated due to the slowdown of overseas economies. Real GDP growth in the July – September period is forecast to be negative compared to the previous period. In addition, some people are starting to predict the possibility of corporate earnings turning into negatives in the current fiscal year. The recent poor performance of Japanese equities can be attributed to such deterioration of economic activities and performance. Until the January – March period in 2013, we expect equity prices to continue moving in a range at the level of the July-September period, because there remain many uncertain factors such as Japanese economic activities and business performance, political situation in Japan, the fiscal cliff in the U.S., developments in Spain and Greece, and developments in the Chinese economy. In March and April 2013, Governor and two Deputy Governors of the Bank of Japan will be replaced. Appointment of BOJ Policy Board members, including Governor and Deputy Governors, is subject to Diet approval. In April 2012, Diet did not give its approval to a candidate for Policy Board member because he was regarded as reluctant to further monetary easing. In the following July, two Policy Board members—both of whom had been economists at securities firms and seen as in favor of monetary easing—were appointed with Diet approval. Given such developments, the next Governor and Deputy Governors are likely to be chosen among those who are positive about monetary easing. The new Governor, therefore, is expected to come up with new monetary easing measures, including the purchase of foreign bonds. It is possible that in equity markets expectations for getting out of deflation will be heightened, which in turn expected to push up equity prices substantially.

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