Japanese Equity Market Outlook

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< Market review from November to December>

In November 2012, equity markets rose, with TOPIX rising 5.27% and the Nikkei Stock Average 5.80%. During the first half of the month, equity prices dropped. This drop was caused by such factors as recognition of the difficulties in negotiating solutions to avoid the “fiscal cliff,” with the results of the U.S. Presidential and Congressional elections, heightened uncertainties over the future of the Greek debt problem, and substantial negative GDP growth in Japan for the July-September period. In the latter half of the month, however, equity prices rebounded considerably. Upon the declaration by Prime Minister Noda on November 14 to dissolve the House of Representatives (the lower house), expectations for a bold monetary easing advocated by Liberal Democratic Party (LDP) president Abe were heightened, which led to a weaker yen in foreign exchange markets. Equity markets rose in a favorable response to the weaker yen, and the fact that the European Finance Ministers’ meeting reached an agreement to resume additional assistance to Greece also had a favorable impact to the market.

Equity prices continued to rise in early December. The factors that contributed to the rise in equity prices were announcements of positive U.S. economic indicators and the rebound of sluggish Chinese stocks, in addition to the continued trend of the weak yen in foreign exchange markets. From the end of November, TOPIX and the Nikkei Stock Average rose 3.38% and 4.05%, respectively (as of December 17).

<LDP landslide victory in a lower house election>

In the lower house election held on December 16, the LDP won a landslide victory, getting 294 seats out of 480 in total. In equity and foreign exchange markets, more and more people are forecasting that the Bank of Japan (BOJ) will take a further positive monetary easing going forward, in response to the intentions of LDP president Abe, the would-be prime minister. Nonetheless, as this view has become quite commonplace in the market, we should be aware of the possibility that it has already been reflected in equity prices to a considerable extent. It should be noted that, as a result of the New Komeito—which had been the coalition partner of LDP until 2009—gaining 31 seats as well, the combined number of seats for the LDP and New Komeito has surpassed two-thirds of the total. In Japan’s parliamentary system, the Constitution stipulates that even if the House of Councilors (the upper house) has voted down a bill the lower house passed, the bill can be enacted by a second vote of the lower house with a two-thirds majority or more. The LDP and New Komeito have thus acquired a strong power to enforce their policies, with their more than two-thirds of the total seats in the lower house, although they do not have the majority in the upper house. In reality, however, it will be difficult to enact laws frequently by the second vote in the lower house. This is because they are likely to refrain from steering parliamentary proceedings in a way which could be criticized as self-righteous ahead of the upper house election (for half of the seats every three years) scheduled in July.

< Outlook >

Looking ahead into the next year or so, equity markets are expected to rise in April-June 2013, but possibly to drop in the October-December period.

During the January-March period, we expect the market to be range bound. The rise in November appears to have reflected the expectations for a new government in equity prices, to a considerable extent. Market participants are likely to try to judge the abilities of the new government to get their policies implemented. Entering the April-June period, following the recovery of overseas economic activities, expectations for economic recovery in Japan are likely to be heightened, which in turn will push up equity prices. Depending on who will replace the BOJ Governor and Deputy Governors in March and April, the yen may be weakened again and the rise in equity prices accelerated. Nevertheless, as the year-end nears, people will become increasingly alarmed by the negative impact on the economy of the scheduled rise in the consumption tax rate (from 5% to 8%) in April 2014, and there is potential for a correction of equity prices.

The short-term risk factor is that investor sentiment is strongly tilted to be bullish. The medium-term risk factor is that the relationship with China could deteriorate further, depending on the new government's foreign policy.