Japanese Equity Market Outlook

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< Market review from December 2012 to January 2013>

In December 2012, equity markets rose, with TOPIX up by 10.02% and the Nikkei Stock Average 10.05%. During the first half of the month, equity prices rose, due mainly to the expectations for the change of government after the lower house election and additional monetary easing by the Bank of Japan (BOJ) as well as further weakening of the yen. In addition, equity prices were also favorably influenced by such events as the improvement of overseas economic indicators and a sharp rebound of Chinese equities. In the latter half of the month, equity prices rose further because of the heightened expectation for a bold monetary easing and large-scale fiscal measures after a landslide victory of the Liberal Democratic Party in the lower house election on December 16. The continued weak yen also contributed to the rise in equity prices. Towards the end of the month, although at some points there were worries about such issues as the overheated short-term market sentiment and difficulties in negotiations for averting the “fiscal cliff” in the U.S., active purchases by overseas investors of the Japanese equities pushed up the prices.

Entering into January 2013, equity prices continued rising. Equity prices were up owing to such factors as the continued weak yen, a rise in overseas equities, the formulation of a large-scale economic stimulus package with a hefty supplementary budget. From the end of December, TOPIX and the Nikkei Stock Average rose 3.29%, and 1.97%, respectively (as of January 16).

<Will BOJ introduce an inflation target?>

As for the BOJ Monetary Policy Meeting scheduled on January 21-22, more people are now thinking that the BOJ will introduce an inflation target of 2% in coordination with the government. In February 2012, the BOJ had already introduced the price stability goal in the medium to long term, which was in a positive range of 2% or lower in terms of the year-on-year rate of change in the consumer price index (CPI), and decided to strongly promote monetary easing towards the goal of 1% for the time being. In October, moreover, the BOJ announced, jointly with the government, the “Measures Aimed at Overcoming Deflation.” However, the responsibility of the BOJ to achieve the goal was not clear. In addition, although the “goal” was a translation of the Japanese word “*medo*,” the original Japanese word gave a somewhat weaker impression than the translation. If the BOJ introduces an inflation target this time in coordination with the government, the responsibility of the BOJ to achieve the target will be clearly stated. On the other hand, BOJ will accept the inflation target of 2% with the government’s promise to promote economic structural reform and to comply with fiscal discipline. Nevertheless, even if the BOJ introduces an inflation target at the coming Monetary Policy Meeting, its measures for monetary easing during the term of Governor Shirakawa (until April 8) will be centered on the existing one; i.e., the gradual expansion of the fund for asset purchases, and the like.

< Outlook >

Looking ahead for the coming year or so, we foresee that equity markets will rise until July-September 2013; and afterwards drop temporarily at some point.

For the January-March period, a gradual rise is expected. With the overheated sentiment for technical reasons, equity prices are likely to be pushed up by the expectations for hitting the bottom of economic activity in Japan as well as monetary and fiscal policies. During April-June, a backlash to the substantial rise until the January-March period is likely to materialize. Market participants may well have the sense of heightened vigilance as the world has seen adjustments of equity prices during April-June in the past three years. Nonetheless, in the July-September period, major stock price indexes will rise again and record new highs. Economic recovery in Japan is expected to begin in earnest, supported by policy measures and the improvement of overseas economic activities. If the economy is in good shape, there is a possibility that the ruling parties might win in the July upper house election, paving the way for the first long-term government in quite a while—which equity markets will also regard as good news. Afterwards, during October-December, or January-March, 2014, equity prices are likely to see a temporary but somewhat considerable drop at a certain point. It is because equity markets are supposed to take into consideration beforehand the expected economic slowdown following the rise in consumption tax rate (from 5% to 8%) scheduled in April 2014.

We consider that the weak yen and the expansion of fiscal expenditures could become both upward and downward risks for equity prices. Economic activity in Japan could show a higher-than-expected recovery and equity prices could increase further, if the weak yen and the expansion of fiscal expenditures are combined well with the improvement of overseas economic activities. However, market participants could begin to have doubts about the fiscal sustainability in Japan and sell all of JGBs, Japanese equities and the yen, if due to the slowdown of overseas economic activities, among others—the Japanese economy does not fully recover despite the weak yen and expansion of fiscal expenditures.