Japanese Equity Market Outlook

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< Market review from January 2013 to February 2013>

In January 2013, equity markets rose, with the TOPIX and the Nikkei Stock Average up 9.36% and 7.15%, respectively. The month started with a sharp rise, in favorable response to the successful avoidance of the “fiscal cliff” in the U.S., for the time being. Afterwards, equity prices continued to rise, due to the announcements of good economic indicators in the U.S. and China as well as expectations for an emergency economic stimulus package. Entering into the latter half of January, we saw a temporary drop in equity prices at some point owing to words of precaution by senior government officials on the extremely weak yen starting to be heard and disappointment with the additional monetary easing by the Bank of Japan (BOJ). Towards the end of the month, however, equity prices rose substantially, reflecting expectations for policy measures by the Abe administration, a further weakening of the yen, and the like.

After entering into February, equity prices kept rising. The rise was caused by the continued trend of weakness in the yen and improved economic indicators in Japan, the U.S., and China. From the end of January, the TOPIX rose 2.39%, and the Nikkei Stock Average 2.42% (as of February 18).

<Policy measures by the Abe administration>

The Abe administration started in December 2012, and in the economic area, spelled out “bold monetary policy,” “flexible fiscal policy,” and “a growth strategy that encourages private sector investment.” Together, these are called the “three prongs.” As for the “bold monetary policy,” the government and the BOJ issued a joint statement at the Monetary Policy Meeting in January. In the joint statement, the BOJ expressed its intention to set the target of price stabilization at 2% of CPI year on year, and the Cabinet is scheduled to submit candidates for BOJ Governor and Deputy Governors to the Diet soon. All of them are likely to be in favor of monetary easing. Moreover, as Governor Shirakawa has brought forward his resignation date by 20 days or so, the new BOJ team will start on March 20. At the Monetary Policy Meeting on April 3-4, it is very likely that the first set of bold monetary easing will be announced. As for the “flexible fiscal policy,” an economic stimulus package of about 10 trillion yen was announced in January. The draft supplementary budget to implement the package was already passed by the Lower House, and the Upper House is expected to do so soon as well. This is expected to boost GDP growth going forward toward the April-June period. Regarding the “growth strategy,” it is scheduled to be determined in June by the Industrial Competitiveness Council, and full discussions have just begun. In particular, developments in regulatory reform need to be watched. We can say it will depend on this growth strategy as to whether the recent rise in the equity price will be sustainable in the long-term. In relation to that, it is also important as to whether the government will express its intention to participate in the TPP or not.

Some people say that Prime Minister Abe will express participation in TPP at the Japan-U.S. summit meeting on January 22. Domestically, however, farmers and related parties are adamant in their opposition to the participation. Reflecting that, the opposition appears to have a slightly greater voice than supporters within the Liberal Democratic Party. Prime Minister Abe seems to be positive about participation, but he needs to act prudently in order to maintain a stable government.

< Outlook >

Looking ahead to the next year or so, we expect equity markets to rise toward the July -September period in 2013, but to drop temporarily at some point afterward.

In March-April an increasing trend is expected to remain, albeit with larger ups and downs. Despite the sense of overheating for technical reasons, equity prices are likely to be pushed up by the recovery of the Japanese economy and expectations for monetary and fiscal policies. After that, reactions to the large gains in equity prices thus far are prone to occur. The fact that equity prices have been adjusted in April-June in the past three years will provide the reason for market participants to be more vigilant. Nevertheless, equity prices will rise in July-September, with major equity indices recording new highs. A full-fledged recovery of the Japanese economy is expected to materialize, supported by policy measures and the improvement of overseas economic activities. With good economic conditions, the chances become higher that the ruling parties will win in the Upper House election in July, and the Abe Administration will serve for a long period, after an absence of such for quite a while. This situation will also contribute to higher equity prices. Later, at some point in October-December or January-March in 2014, equity prices may experience a temporary fall. This is because equity markets are likely to take into account in advance the expected slowdown of economic activities after the rise of the consumption tax rate (from 5% to 8%), which is scheduled to be implemented in April 2014. Moreover, it will also contribute to a temporary increase in equity selling that the tax rate on capital gains and dividends are going to return from the lowered 10% to the original 20% from 2014.

We think that a weaker yen and expanded fiscal expenditures will contribute to a rise of equity prices for the time-being, but they could also bring a risk of causing a drop in equity prices. For example, if the Japanese economy does not fully recover due to a slowdown of overseas economies despite the weaker yen and expanded fiscal expenditures, market participants will start to doubt the sustainability of the Japanese government finance, and as a result, all Japanese government bonds, equities and yen could be sold.