Japanese Equity Market Outlook

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<Market review from March to April 2013 >

In March 2013, equity markets rose, with TOPIX and the Nikkei Stock Average up 6.05% and 7.25%, respectively. Equity prices rose dramatically from the start of the month due to the improvements in U.S. economic indicators, rapid weakening of yen, and the like. Expectations for a bold monetary easing were heightened through the hearings of policy stance of the candidates for Governor and Deputy Governors of the Bank of Japan (BOJ) also contributed to the rise of equity prices. Afterwards, equity prices maintained the rising trend following the announcements of favorable U.S. economic indicators. Toward the end of the month, however, equity prices turned to a gradual fall, which was due to the recognized risk of Europe—including conditions for supporting Cyprus which included sacrifices of depositors at banks as well as the continued difficulties in agreeing on a coalition government in Italy.

Entering into April, equity markets started with a drop owing to the lower-than-expected indicators for the economic sentiment in Japan, the U.S. and China; however, equity prices rose rapidly after the announcement by the BOJ of the introduction of the “quantitative and qualitative monetary easing” which would be in a different dimension from the previous policy. From the end of March, TOPIX and the Nikkei Stock Average rose by 9.59% and 7.08%, respectively (As of April 15).

<Introduction of quantitative and qualitative monetary easing >

The quantitative and qualitative monetary easing that the BOJ announced on April 4 had a huge impact on markets. The sense of overwhelming size i.e., doubling the monetary base from 138 trillion yen at the end of 2012 to 270 trillion yen at the end of 2014 must have made market participants feel that the BOJ was serious this time around. We can say that it is comparable to or exceeding the QE by the Fed and LTRO by the ECB. The objective of this monetary easing is to raise the rate of inflation to two percent year on year within two years, and overcome deflation. Nevertheless, the possibility of achieving the target is not regarded as very high. This is because many academics and economists do not acknowledge the correlation or causal relation between changes in the monetary base and movements of prices. On the other hand, not all but some express concerns that massive supply of funds and massive purchase of JGBs could result in hyper-inflation. It may not be exaggeration to say that monetary easing this time is a major experiment in economics that we have not seen before. This major experiment may have less negative impacts than expected on the Japanese economy and equity markets. If this monetary policy does not lead to a rise in prices, government could take fiscal measures by issuing JGBs as much as it needs. On the other hand, if it led to hyper-inflation, it would be proof that monetary easing is effective in raising price levels; there must be a phase of a moderate increase in price prior to hyper-inflation. Of course, it could be difficult to have a stable economy with moderate growth in both cases. This would seem, however, to be better than an unstable economy with the current low growth.

< Outlook >

Looking ahead for one year or so, we expect equity markets to rise from July to August, and then have a temporary adjustment phase from September to the year-end.

With the current sense of overheating, it is only natural that technical adjustments of TOPIX in the magnitude of around 5-8 percent could happen anytime. Nonetheless, policy expectations and the realization of their effects might keep the rising trend of equity prices. The supplementary budget approved on February 26 will contribute to enhanced economic growth in future. The quantitative and qualitative monetary easing announced on April 4 will maintain market participants' expectations for monetary policy going forward. A growth strategy is scheduled to be decided in June, and it might attract more attention in coming days. In preparation for the upper house election in July, government and the ruling parties might take various measures without pause. In addition, the host city for the Olympic Games in 2020 will be decided on September 7, If Tokyo is chosen (other candidate cities are Istanbul and Madrid), it will have a favorable impact on equity markets.

From September to the year-end, we expect adjustments, which could be triggered by a rise in interest rates in the United States. Although the U.S. economy slowed down from spring to summer in the past three years, it may not slow down this year. If that is the case, we might witness scaling-down/suspension of quantitative easing and termination of zero-interest rate policy much earlier than currently thought. As a result, U.S. interest rates could rise more-than-expected, which in turn could lead to fall in U.S. equity prices. In such a case, Japanese equities are likely to be affected as well. Moreover, some factors are likely to drive down equity prices toward the year end, e.g., a return of tax rates on capital gains and dividends from the reduced 10% to the original 20% from 2014, and concerns over expected temporary economic slowdown after the rise in consumption tax rate (from 5% to 8%) scheduled in April 2014. Equity prices, however, will return to a rising trend in 2014, by which time effects of these possible factors should be over.