Japanese Equity Market Outlook

June 17, 2013

Daiwa Asset Management Co. Ltd.

<Market review from May to June 2013 >

In May 2013, equity markets dropped with TOPIX and the Nikkei Stock Average down by 2.52% and 0.62%, respectively. Equity prices started with a rise due to the heightened risk appetite of investors, following a remarkable improvement of the U.S. employment statistics, reduction of interest rates by the ECB, and the like. Subsequently, while there were concerns at some point about the sense of overheating in the short-run, equity prices continued rising in favorable response to the rise in U.S. equities and a weaker yen. Factors such as the real GDP growth rate higher than market expectations in the January-March period and Prime Minister Abe's announcement of the second set of the growth strategy also had a positive impact on equity markets. Equity prices dropped rapidly after May 23, however, upon the downward swing of a Chinese economic indicator. The concurrent furthering of a stronger yen caused a chain reaction of a stronger yen and lower equity prices, which in turn accelerated the drop of equity prices.

Entering into June, equity prices continued decreasing due to the strengthened risk-averse tendency globally. From the end of May, TOPIX dropped 6.98%, with the Nikkei Stock Average 7.90% (as of June 14).

<Factors for equity price decline after May 23 >

The main factors behind the drop of equity prices on May 23 and after were presumably: (1) reaction to the rapid increase of equity prices up to that point; and (2) destabilization of global financial markets caused by expectations for reduction of quantitative monetary easing in the United States.

TOPIX and the Nikkei Stock Average rose 76.64% and 80.35%, respectively, between November 14 last year—when the former Prime Minister Noda expressed his intention to dissolve the lower house—and May 22. It was the first time in 60 years, since the rising phase in 1952-1953, that Japanese equity markets recorded such a high increasing rate in such a short a period after the World War II. It is only natural that we are experiencing some reactions to it.

With strengthening expectations for the reduction of quantitative easing in the U.S., global financial markets have become unstable. As a global rise of equity prices since last year appears to owe much to unusual monetary easing in each country, if the direction of monetary policy is changed at its center, the United States, some negative impacts may be inflicted. Nonetheless, as it is the steady economic activities that are enabling the United States to proceed towards a reduction of quantitative easing, equity markets will sooner or later regard the steady economic activities as more important.

As for the reasons for drops in equity prices, some point to the disappointing growth strategy of Abe Administration as the reason. This assertion could be wrong, however. There are two main criticisms against the growth strategy. The first one is that it does not step into deregulation of immigration and restriction on job dismissal.

Another is that it is exhaustive without key items. If we immediately deregulate immigration and restriction on job dismissal, it will instead increase social unease, worsen consumer confidence, and have negative impacts on the economy. While we regard increased direct investment into Japan as important, with the accompanying increased inflow of people, policy measures for such purposes are included in the growth strategy. Quite naturally, policies are exhaustive. Can an economically-mature country easily enhance the growth potential only with a few policies? Isn’t enhancement of the growth potential only possible by addressing a number of institutional points of fatigue and bottlenecks one by one.

< Outlook >

Looking ahead for the coming one year or so, we expect equity prices to move within a wide range towards the end of 2013, and after that, to rise stably from the end of the year to the next year.
Markets are likely to continue showing unstable movements towards the end of the year. It is a process to take gradually into account that the U.S. monetary policy will turn from easing to tightening in the future. It is also the process where the driving force of rise in equity prices will shift from monetary easing to expansion of economic activities and business performance. The room for a further drop of equity prices is likely to be small, as the decrease in equity prices since May seem to have already taken into account negative impacts for a moment. Nevertheless, markets are likely to remain unstable, partly due to the effect of the taxation on capital gain and dividend returning from the reduced 10% to the original 20% in 2014 as well as concerns over the increase of the consumption tax rate (from 5% to 8%) scheduled to be implemented in April 2014. After the year end, however, when such negative effects and concerns are exhausted, we will have a stable phase of rising equity prices supported by economic activities and business performances.