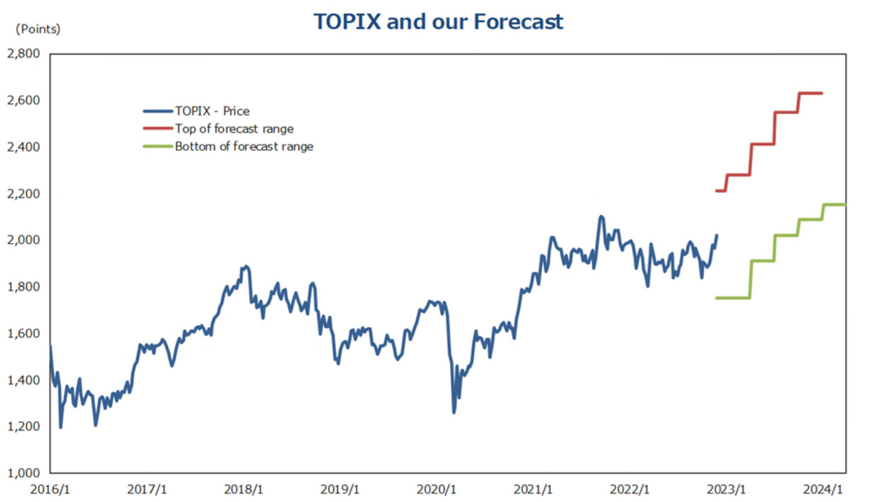
Sumitomo Mitsui DS Asset Management

Japan Market & Economic Outlook

November 2022

Outlook on the Japanese equity market

- SMD-AM expect the Japanese stock market will shortly resume its bullish trend after range trading.
- We raised our TOPIX target from 2,190 to 2,390 and that of Nikkei 225 from 31,100 to 34,100 as of the end of year 2023 due to upward revision of the EPS forecast for FY 2023 and FY 2024.
- The market will start rising after confirming the timing of the peak of the US monetary tightening and the bottoming out of the global economic cycle.



Note: TOPIX data is from Jan. 1st 2016 to Nov. 25th 2022
(Source) TOPIX: Tokyo Stock Exchange, forecast by SMDAM

Upside and downside risks

We are optimistic about the FED pivot and the strong recovery in Chinese economy. On the other hand, concern is rising over fiscal austerity and the impact of the financial crisis caused by global monetary tightening and Yen's appreciation has a negative impact on corporate earnings.

Recovery of domestic economy and inflation on upward trend

The domestic economy is recovering while consumer sentiment has been subdued on the back of higher inflation. Business sentiment has improved, particularly for face-to-face services, as the seventh wave of the COVID-19 pandemic has subsided. CAPEX has been boosted thanks to pent-up demand after the pandemic, the requirement for carbon neutrality, and digital transformation. Exports have also picked up after the lockdown slump in Shanghai. Inflation is on an upward trend. CPI is accelerating in Tokyo and nationwide. The cost-push caused by rising import prices and the loss of the impact of last year's mobile phone rate cut have contributed to the acceleration of inflation.

Outlook on the Japanese economy

We have lowered our real GDP growth forecast for FY 2022 from +2.0% to +1.7%, whilst we have raised our forecast for FY 2023 from +0.7% to +1.0%. The downward revision for FY 2022 was mainly owing to the slowing economy in the third quarter. The upward revision for FY 2023 was due to the Comprehensive Economic Package. While the eighth wave of the COVID-19 pandemic is highly likely, the negative impact on the economy could be limited as people are getting used to the new lifestyle with COVID. The economic recovery seems to continue in FY 2022, supported by CAPEX and economic stimulus. On the other hand, the economy could slow down in the first half of FY 2023 amid the pronounced impact of the deterioration in overseas economies. After that, we expect gradual growth in the domestic economy as well as a recovery in overseas economies.

We have maintained the Core CPI forecast for FY 2022 at +2.7%, but we have raised our estimate for FY 2023 from +1.3% to +2.3%. The main reason for the upward revision of FY 2023 was energy prices. Electricity companies will raise their rate of services in response to the regulated electricity rate discount in the economic stimulus package. In addition, a rise in food prices and a backlash against nationwide travel support also boost inflation. Core CPI could accelerate to the upper 3% range in late FY 2022.

PM Kishida seems to maintain his accommodative economic policy. The comprehensive economic package approved by the Cabinet turned out to be massive, totalling 37.6 trillion yen on an expenditure basis. The decision could be affected by the falling approval rate of the cabinet and mounting pressure from the ruling LDP. The impact on real GDP growth is expected to be + 0.1% in FY 2022 and +0.4% in FY 2023. The Kishida administration continues its pro-business stance for the time being, but over the medium term, it may emphasize fiscal consolidation.

The Bank of Japan to maintain its accommodative monetary policy, even after the end of Governor Kuroda's term in April 2023 due to weak wage increases and the negative impact of the slowing global economy. The BOJ regards wage increases and continued monetary easing are the keys to consistently achieving their price target. While core CPI is likely to remain above 2% in the foreseeable future. The BOJ's assessment that cost-push inflation is temporary is likely to remain unchanged. Though PM Kishida's administration is expected to appoint new BOJ board members with the flexibility to review current monetary policy, it is unlikely to change monetary policy through 2023. BOJ may change its "Yield Curve Control" by relaxing the range of fluctuation of 10-year government bond yield from ±25 bps to ±50 bps on or after FY 2024 if foreign economies will stabilize.

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Risk warning: On 1 January 2021 the UK left the EU transitional arrangements and no longer benefits from passporting rights into EEA countries.