Japan's Market: Bullish in the medium to long term, with economic growth in late 2024

Japan Outlook - Hisashi Shiraki, SMDAM Chief Global Strategist

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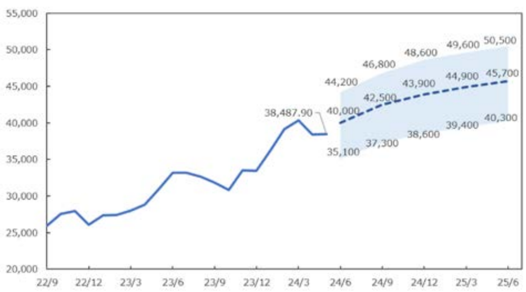
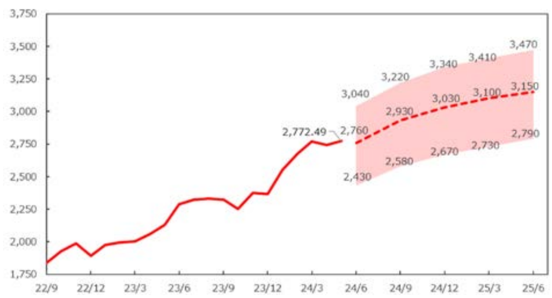
Japan Market Outlook

- We believe corporate earnings and favourable economic conditions will continue to drive the Japanese stock market higher as we go forward. The solid increase in nominal GDP and the accelerating manufacturers' business cycle could boost EPS in the mid- to long-term.
- We maintain our price target for the Nikkei 225 at 44,900 and that for TOPIX at 3,100 to the end of March 2025.
- This year's record 33-year high wage increase could boost Japanese consumer spending, which makes up more than half of the economy.
- In the short term, the market could face increasing volatility as a result of speculation over the Bank of Japan's future actions.

Nikkei 225 Forecast



TOPIX Forecast



Source: Bloomberg, forecast by SMDAM. Data after May 2024 is our forecast.

Upside and downside risks

The upside risk scenario is unchanged as optimism persists about the virtuous cycle between mild inflation and wage increases in Japan, and the Bank of Japan is set to continue adhering to its accommodative monetary policy. Addtionally, we are seeing further progress in corporate governance and shareholders' value.

Downside risks include an excessive and rapid appreciation of the yen, hasty tightening of the monetary policy by the BOJ, and political turmoil triggered by divisions in the LDP as a result of the "slush fund scandal".

Economy contracts for first time in two quarters

In the first quarter of 2024, the economy contracted for the first time in two quarters. This was partly due to a decrease in automobiles production caused by the illegal certification test scandal, the Noto Peninsula earthquake, and a reactionary decline in royalties received by pharma-ceutical companies. There was a mixed picture regarding soft data for the economy in April 2024. While the composite PMI improved, the economic watchers' survey and the consumer sentiment index were weak.

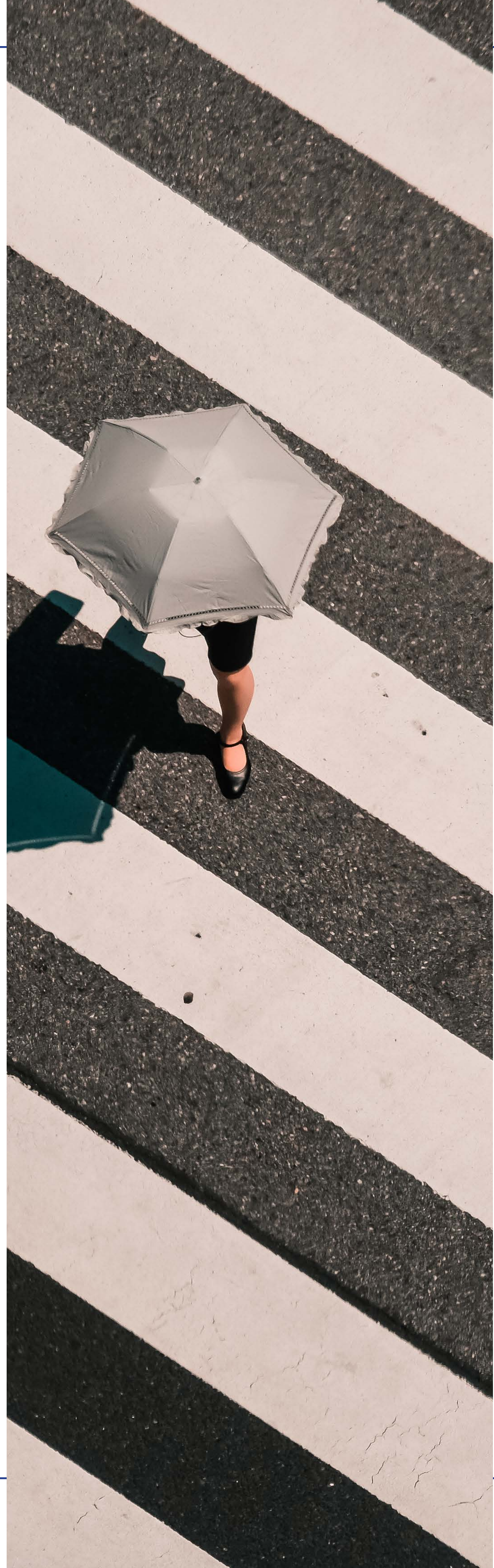
The nationwide core CPI rose +2.6% YOY in March, slowing down from +2.8% a year earlier. The Tokyo core CPI rose +1.6% YOY in April, a sharp decline from +2.4% last month. Even if we exclude the effect of effectively free tuition for high schools, there has been a slowdown in inflation in the Tokyo area.

Economy expected to recover and resume growth trend

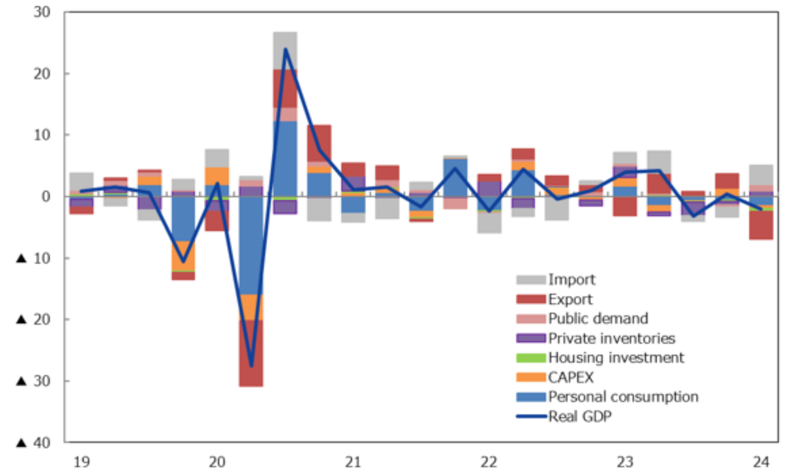
While we have slightly lowered our real GDP growth forecast for FY 2024 to +0.4% from +0.5%, we have maintained that for FY 2025 at +0.7%. The 2024 forecast was slightly lower because of the economic contraction in Q1 2024 due to the earthquake and other special factors.

We expect the economy to resume its moderate growth trend in and after Q2 2024. The economy is expected to gradually recover, avoiding a setback, due to the diminishing negative impact from the reduction in automobile production, the Noto Peninsula earthquake, and a decrease in royalties for intellectual property rights by pharmaceutical companies.

In addition, wage increases, economic stimulus, including flat-rate tax cuts, and solid overseas economic trends could support the economy going forward. While we have lowered our core CPI forecast for FY 2024 to +2.6% from +2.8% and that for FY 2025 to +2.0% from +2.1%. The main reason for the downward revision was a decline in the Tokyo Metropolitan CPI in April 2024 and a reduction in the crude oil price assumption. In the short term, the core CPI is expected to accelerate again to the upper +2% range from the previous year due to the increase in the renewable energy levy and the end of subsidies for electricity and gas tariffs.



Forecast of GDP and Core CPI



Note: Data from January 2019 to March 2024. Source: Cabinet Office & SMDAM

After that, the core CPI is likely to slow down against the background of a decline in the cost push pressure starting from import prices and a stabilising of energy prices. However, from the second half of 2025, the core CPI is expected to remain stable at around +2% YOY, supported by the rise in service prices associated with wage increases.

Continuation of accommodative fiscal policy expected

In November 2023, Prime Minister Kishida's Cabinet approved a set of comprehensive economic measures to overcome deflation. The budget, which amounts to 20.9 trillion yen on a national and local basis, included measures to counter high prices, support for growth sectors, and national infrastructure resilience. Flat rate tax cuts are expected to take effect in June 2024. In fiscal policy we should pay close attention to the risk of further expansion aimed at raising the approval ratings of the Cabinet and the ruling Liberal Democratic Party, which have declined significantly as a result of the so-called "slush fund scandal".

Expected semiannual interest rate hikes from autumn

We expect the Bank of Japan will raise its policy rate from the current range of between 0 and 0.15%, to 0.25% in October 2024, to 0.5% in April 2025, and to 0.75% in October 2025. The Bank of Japan Governor Ueda indicated that the results of the spring wage increase could be reflected in price developments this summer and fall, leading to a decision of further rate hikes going forward. The central bank is expected to raise interest rates again in October 2024, after assessing the impact of wages on prices. The BOJ is then expected to raise the benchmark interest rate once every six months while closely monitoring the impact of the monetary tightening. The risk in our scenario could be an earlier rate hike due to concerns over a weaker yen and its impact on inflation.

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