The historic fall and rise of the Nikkei average stock price: What is happening now, and what might happen in the future ?

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Overview

- On August 5th, the Nikkei average experienced a historic drop, surpassing even that of Black Monday. However, it is expected to see a significant rise on August 6th.
- The decline in the Nikkei average was likely driven by futures trading, where the unwinding of arbitrage positions led to spot selling, resulting in a panicked market on the 5th.
- If this drop was driven by speculation, a similar rebound could occur. Therefore, excessive pessimism is unnecessary, given the long-term upward trend in stock prices and the current financial and domestic environment

Sudden drop in Nikkei Average on August 5th, surpassing the historic drop on Black Monday, but also a historic surge on the August 6th.

On August 5, the Nikkei Stock Average plummeted, closing at 31,458.42 yen, a drop of 4,451.28 yen (12.4%) from the previous weekend. This decrease was the largest on record, surpassing the 3,836.48 yen drop observed on October 20, 1987, the day after Black Monday, when the global impact of the U.S. stock market crash spread. However, the following day, the trend reversed. The Nikkei opened at 32,077.33 yen, up 618.91 yen (2.0%) from the previous day, and has since risen sharply by over 3,000 yen (as of 9:47 a.m.). It closed at 34,675.46 yen, up 3,217.04 yen (10.2%) from the previous day.

In this report, we will explore the reasons behind this sudden fall and rise and consider future developments. The historic drop is attributed to “concerns about the future of the U.S. economy,” which led to “a continued decline in U.S. tech stocks” and “a weakening of the dollar alongside a strengthening of the yen.” It is speculated that these three factors contributed to the Nikkei’s sharp decline. We will now examine why the drop was so significant.

The Nikkei average's fall was driven by futures, with panic in the market on the 5th due to spot selling induced by arbitrage buying transactions being liquidated.

A notable characteristic of the Japanese stock market is the significant share of overseas investors in the total trading value. Throughout 2023, overseas investors accounted for about 60% of spot trading on the Tokyo and Nagoya Stock Exchanges, with a trading volume of approximately 1,199 trillion yen. In futures trading—including Nikkei 225 futures, Nikkei 225 mini futures, Nikkei 225 micro futures, TOPIX futures, and mini TOPIX futures—the share has risen to around 75%, with a total volume of 2,887 trillion yen.

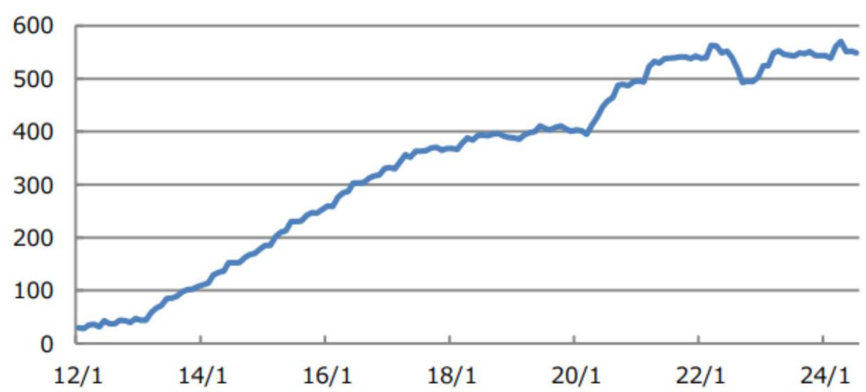
Given these figures, it is highly likely that overseas investors (such as speculators) sold a substantial amount of futures contracts, contributing to the sharp drop in the Nikkei average. This selling likely triggered spot selling due to the liquidation of arbitrage positions and the unwinding of individual investors' margin positions (which had reached their highest level in about 18 years by late July). This sequence of events created a "panic market" on August 5, where the selling pressure led to further declines and an accelerated drop in the index.

Long-term upward trend in the Nikkei average stock price

(Note) Data is from January-March 2012 to July-September 2024. Candlestick chart is quarterly, JulySeptember 2024 is up to August 5. The upper resistance line is the line connecting the high of May 2013 and the high of January 2018. The lower support line is the line connecting the low of October 2012 and the low of June 2016.

(Source) Prepared by Sumitomo Mitsui DS Asset Management based on data from Bloomberg. Theorganisations and/or financial instruments mentioned are for reference purposes only. Material content should not be construed as a recommendation for their purchase or sale.

Trends in current account balances at the Bank of Japan



(Note) Data is from January 2012 to July 2024.

(Source) Prepared by Sumitomo Mitsui DS Asset Management based on data from Bloomberg

If the decline was driven by speculation, a similar rebound could be expected. Considering the long-term trend of rising stock prices and the current financial and domestic environment, there is no need for excessive pessimism.

If the drop in the Nikkei average was driven by speculators selling futures, we would expect a relatively short-term buyback as they lock in profits. Since many investors have already sold their stocks, there is likely to be limited additional selling, and any rebound could occur rapidly.

Looking ahead, despite the sharp fall in the Nikkei average on August 5, it has merely returned to a long-term upward trend that has persisted for over 10 years (see Chart 1). We maintain the view that there is no need for excessive pessimism. Additionally, a significant amount of capital remains in the Bank of Japan's current account, and abundant liquidity continues to support stock prices (see Chart 2). Given that the current stock price decline is largely attributed to concerns about the U.S. economy, if future U.S. economic indicators and comments from U.S. financial authorities alleviate these concerns, the market is expected to stabilize.

In Japan, there are signs of improvement in wages and prices, and corporate attitudes are shifting, such as through enhanced capital efficiency. With stock prices having fallen significantly, there is ample opportunity to consider investing in Japanese stocks.

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