

Japan's Market: Short-term market volatility, while growth outlook remains positive

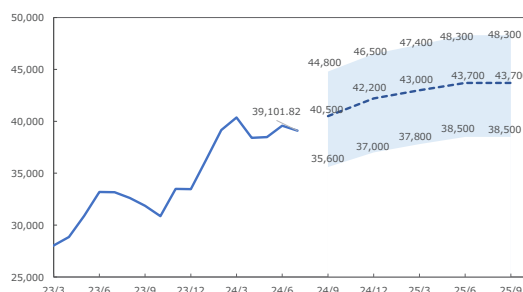
Japan Outlook - Hisashi Shiraki, SMDAM Chief Global Strategist

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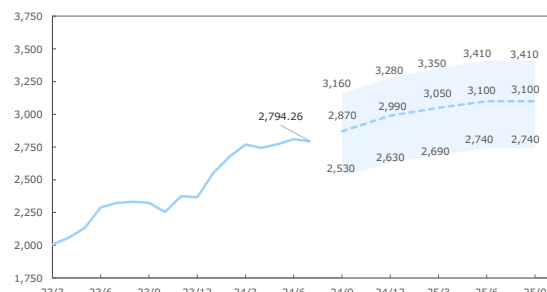
Japan Market Outlook

- We maintain our bullish perspective on the Japanese equity market due to strong corporate earnings and recovery in consumer spending.
- We expect EPS could be boosted by nominal GDP growth and the recovery of the business cycle/momentum of manufacturers' going forward.
- In the short term, the market could face increasing volatility caused by uncertainty over the global economy and monetary policy.
- Our price target for FY 2024 of the Nikkei 225 is at 43,000 and that for TOPIX is at 3,050.
- We expect to see a wage increase actualised this year and policy changes by the new administration and new leadership after the LDP presidential election in autumn.

Nikkei 225 Forecast



TOPIX Forecast



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

The scenarios presented are an estimate of future performance based on evidence from the past and/or current market conditions and are not an exact indicator. The organisations and/or financial instruments mentioned are for reference purposes only. Material content should not be construed as a recommendation for their purchase or sale.

Upside and downside risks

The upside risk scenario is unchanged as hopes for a virtuous cycle between mild inflation and wage increases, alongside further improvements in corporate governance and shareholders' value, add to an optimistic outlook.

Downside risks include the tightening of fiscal policy to achieve a surplus of primary balance, an excessive and rapid appreciation of the yen and hasty tightening of the monetary policy by the Bank of Japan (BOJ).

BOJ has raised policy rate, further rise expected this year

In the first quarter of 2024, the economy contracted for the first time in two quarters. This was due in part to a decrease in automobiles production caused by the illegal certification test scandal, the Noto Peninsula earthquake, and a reactionary decline in royalties and receipts for intellectual property rights. On the other hand, although consumer sentiment, such as "Economy Watchers Survey" and "Consumer Confidence Index", has been adversely affected by higher inflation, private consumption, CAPEX, and exports have been recovering.

The nationwide core CPI rose +2.6% YOY in June, rebounding from a +2.5% rise in May. The Tokyo core CPI rose +2.5% YOY, up from +1.9% last month. Inflation was pushed up by energy prices, largely impacted by the policy factor of reduced levies for electricity and gas bills.

Economy expected to recover and resume growth trend

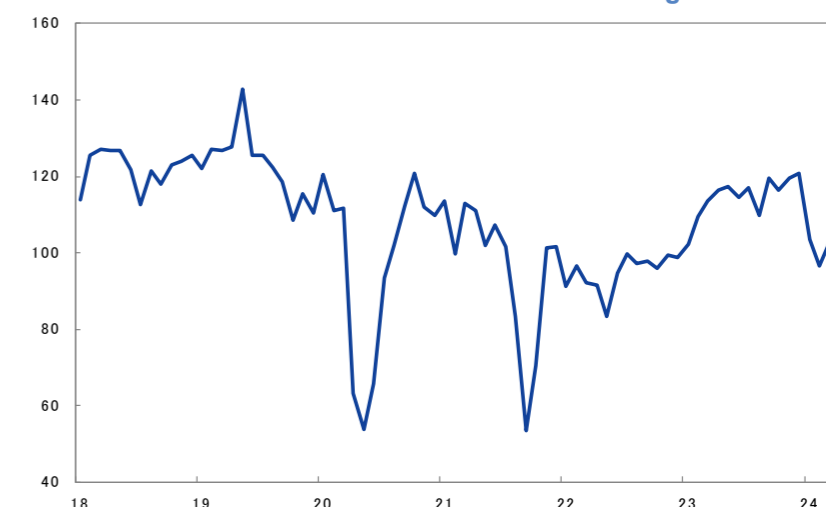
We have lowered our real GDP growth forecast for FY 2024 to +0.2% from +0.4% and that for FY 2025 to +0.6% from +0.7%. Figures for FY 2024 have been revised downward based on the revision of real GDP figures for Q1 2024, whilst the Japanese economy is expected to return to a moderate growth path from Q2 2024. The economy is expected to recover gradually and avoid recession as temporary downward pressure, caused by factors such as a reduction in automobile production, a major earthquake, and a reactionary decline in royalties on intellectual property rights, begins to ease.

In addition, wage increases, fiscal stimulus, such as tax cuts and benefits, and the resilience of overseas economies could lift the economy going forward. We have slightly lowered our growth forecast as a whole due to additional monetary tightening by the BOJ at the policy meeting in July. While we maintain our core Consumer Price Index (CPI) forecast for FY 2024 at +2.5%, we have lowered that for FY 2025 to +2.2% from 2.3%.

The revision for FY 2025 is mainly due to a change in the monetary policy and assumptions for fiscal policy against higher living prices. Regarding these measures, utility bill subsidies will be temporarily resumed between August and October 2024, while the gasoline subsidy, which we had previously forecast to be extended, will finish at the end of 2024.



Automobile Production is rebounding



Note: Automobile production (2020=100). Data is from January 2018 to May 2024.
Source: METJ, SMDAM.

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In FY 2024, the effects of these two measures will mostly offset each other, but in FY 2025, both measures will lift our inflation forecasts. The nationwide core CPI is likely to be +2% by the end of 2025, given the energy boost from the end of subsidies for utility bills and gasoline. Thereafter, core CPI is likely to decelerate again due to the receding energy factor, and core CPI is expected to remain stable at around +2% YOY from around H2 of CY 2025, supported by the rise in service prices accompanied by wage hikes.

Government plans countermeasures to combat rising prices

We expect the government to continue their accommodative fiscal policy. Prime Minister Kishida said the government will start economic measures from the autumn after implementing new countermeasures against rising prices. In addition to providing subsidies to low-income households, the government will provide local subsidies for small and medium-sized companies, school lunches, medical and nursing care, logistics and regional tourism. While his statements do not suggest large-scale measures, we will pay close attention to the risk of fiscal policy expansion.

Steady interest rates rise in line with expected inflation

The BOJ decided to raise its policy rate to 0.25% from range of 0 - 0.1% at the July policy meeting, and to gradually reduce the volume of JGB purchases from JPY 6 trillion a month to JPY 3 trillion by the end of FY2025. From hereon, we expect the BOJ to raise its policy rate by 0.25% again in December 2024, June 2025, and December 2025, with the rate reaching 1.0% by the end of 2025.

The BOJ governor Ueda repeatedly stressed at a press conference after the central bank's monetary policy meeting that the real interest rate is very low and the negative impact of a rate hike on the economy would be limited. Given this, the hurdle for further monetary tightening is not so high and we expect the BOJ will raise its policy rate again before the end of the year.

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