Japan's Market: What lessons have been learnt from August volatility?

Japan Outlook - Hisashi Shiraki, SMDAM Chief Global Strategist

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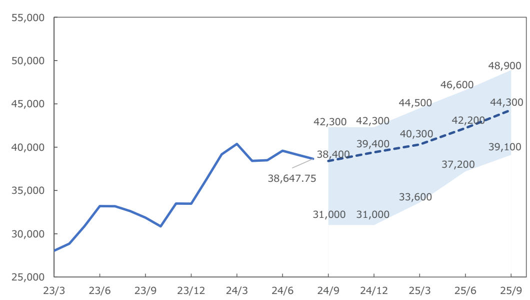
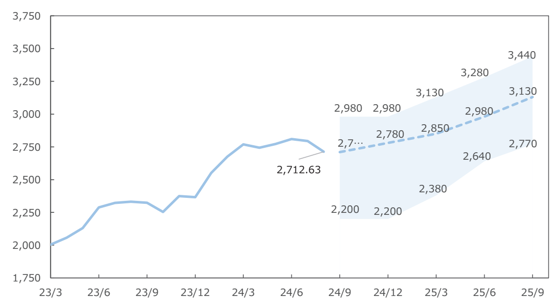
Japan Market Outlook

- We expect the Japanese equity market to resume its bullish trend after temporary correction caused by uncertainty in the US economy and concern over the hawkish stance of the Bank of Japan.
- We believe the US economy will avoid a "hard landing" thanks to the rate cut by the Federal Reserve, and the Bank of Japan (BOJ) will tone down its hawkish stance due to the recent sharp retreat of the USD/JPY rate.
- We have lowered our price target for the Nikkei 225 for FY 2024 to 40,300 from 43,000 and that for TOPIX to 2,850 from 3,050, due to a change in estimate P/E ratio after the recent spike in market volatility.

Nikkei 225 Forecast



TOPIX Forecast



Source: Bloomberg, forecast by SMDAM. Data after August 2024 is our forecast.
The figures refer to past and forecasted performance.
Past performance and forecasts are not a reliable indicator of future performance and may not be repeated.
Data shown in JPY terms

Upside and downside risks

The upside risk scenario includes the waning of excessive concern over the US economy, alongside continuing improvements in corporate governance and shareholders' value led by the Tokyo Stock Exchange.

On the other hand, 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 BOJ form the downside scenario.

Signs of economic recovery and inflation picking up

In the second quarter of 2024, real GDP grew for the first time in two quarters. In particular, consumer spending recovered, growing for the first time in 5 quarters, due to the normalisation of auto production and an improvement in wages.

As for soft data, the Economy Watchers Survey and Consumer Confidence Index for July have been adversely affected by higher inflation, while the PMI recovered in July. Despite concerns about a slowdown in the U.S. economy and the impact of sudden changes in financial markets, there were no significant changes observed in the Reuters Tankan in August.

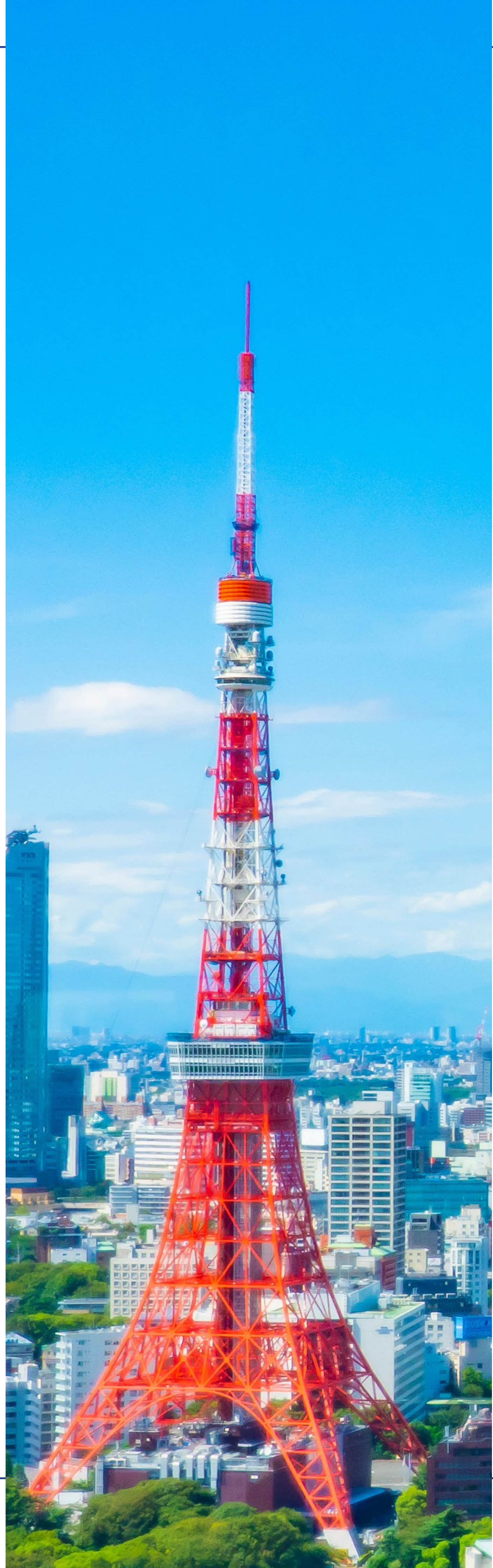
Nationwide core CPI rose +2.6% YOY in June, rebounding from +2.5% in May. Tokyo Metropolitan Area Core CPI rose +2.2% YOY in July, re-accelerating from +2.1% last month. Inflation was pushed up by energy prices as the policy factor of reduced levies for electricity and gas bills had a large

Q2 lead to upward revision of real GDP growth forecast

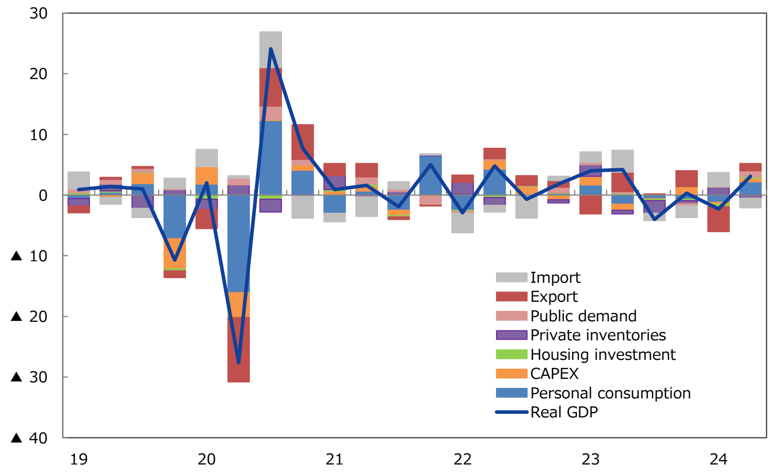
We have raised our real GDP growth forecast for FY 2024 to +0.5% from +0.2%, and that for FY 2025 to +0.7% from +0.6%. Figures for FY 2024 have been revised upward due to strong results in Q2 2024.

As for the outlook, we expect the Japanese economy to return to a moderate growth path on the back of wage increases, fiscal stimulus, such as tax cuts and benefits, firm capital investment motivation, such as labour saving, digitalisation, greening, urban development, and construction of semiconductor factories, and the resilience of overseas economies.

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.



Real GDP growth rate (YOY, %)



Data is from Q1 2019 to Q2 2024. Source: Cabinet Office, SMDAM

We have maintained our core CPI forecast for FY 2024 at +2.5% and that for FY 2025 at +2.2%. As for the outlook, the nationwide core CPI is likely to be above +2% level throughout 2025, given the energy boost from the end of utility bill subsidies and the gasoline subsidy. Thereafter, core CPI is likely to slow down due to the receding energy factor, and core CPI is expected to remain stable at around +2% YOY, supported by the rise in service prices accompanied by wage hikes.

Economic measures set soon after new prime minister

Prime Minister Kishida announced plans to implement various economic measures in autumn. In addition to providing subsidies to low-income households, the government will provide local subsidies to small and medium-sized companies, school lunches, medical and nursing care, logistics and regional tourism. Although the details of the economic measures have become less clear since Kishida announced that he will not run for leader of the Liberal Democratic Party, it is highly likely that the economic measures will be handed over to the next leader and prime minister. In view of the possibility of a dissolution of the Diet and a general

Revised forecast for policy rates

The new forecasts of policy rates are 0.50% in January 2025, 0.75% in July 2025 and 1.00% in January 2026 (previously 0.50% in December 2024, 0.75% in June 2025, and 1.00% in December 2025). The main reason for our revision is the recent turnaround of USD/JPY rate, which reduces inflation risk and allows the BOJ to take time to assess various data before an additional rate hike.

The BOJ is expected to maintain its policy stance, and will focus on downside risks to the economy for a while. If the yen weakens sharply again or downside risks to the economy subside quickly, we cannot rule out the possibility of an additional rate hike by the end of the year. However, the main scenario is that an additional rate hike will be implemented after the central bank conducts a comprehensive review of the economy in the January 2025 Outlook Report.

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