

## Strategist View

### Japanese Equity Market Outlook: Suga Makes Way for a New Prime Minister

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#### PM Suga's Resignation Raises Expectations for Japan Equity Market

On September 3, the Nikkei Stock Average rallied sharply following an announcement in the morning that Prime Minister Yoshihide Suga would not seek reelection as president of the Liberal Democratic Party. In response to this news, the Nikkei 225 climbed to 29,916 yen, the highest price since April, while the TOPIX Index, which tracks the broad Japanese equity market, climbed to 2,063 points and recorded its highest level for more than 30 years. Prime Minister Suga's decision to step aside in the leadership race significantly reduced the risk of political disruption that could result from a significant loss of seats for the ruling parties in the upcoming House of Representatives (Lower House) election this autumn.

Several candidates are expected to run in the election for LDP president, including former Foreign Minister and LDP Policy Chief Fumio Kishida, who has already announced his candidacy, Minister for Regulatory Reform Taro Kono, and Sanae Takaichi, a female candidate with the backing of former Prime Minister Shizo Abe. If we look at the changes in approval ratings of past cabinets (Fig. 1.), we can see that the approval ratings of incoming administrations tend to rise significantly with the establishment of a new cabinet. While it is unclear at this point which candidate will win the LDP presidential poll, if a new government with a high approval rating enters the Lower House election, it is likely to be advantageous for the ruling parties. Moreover, expectations of new economic stimulus and other policy measures are likely to attract investor interest in Japanese stocks.

Figure 1. Change in the Approval Rating of Japan Cabinet

	Previous Cabinet	Final Approval Rate		New Cabinet	Initial Approval Rate	Change in Approval Rate (%pt)
2007	Abe	34%	→	Fukuda	58%	+24%
2008	Fukuda	20%	→	Aso	48%	+28%
2009	Aso	15%	→	Hatoyama (DPJ)	72%	+57%
2010	Hatoyama (DPJ)	21%	→	Kan (DPJ)	61%	+40%
2011	Kan (DPJ)	18%	→	Noda (DPJ)	60%	+42%
2012	Noda (DPJ)	20%	→	Abe	64%	+44%
2020	Abe	34%	→	Suga	62%	+28%
2021	Suga	29% *	→	?	?	?

Note: The Democratic Party of Japan (DPJ) is current the Constituional Democratic Party of Japan.

Period: From 2007 to the latest.

Source: Nomura Asset Management based on NHK public opinion survey.

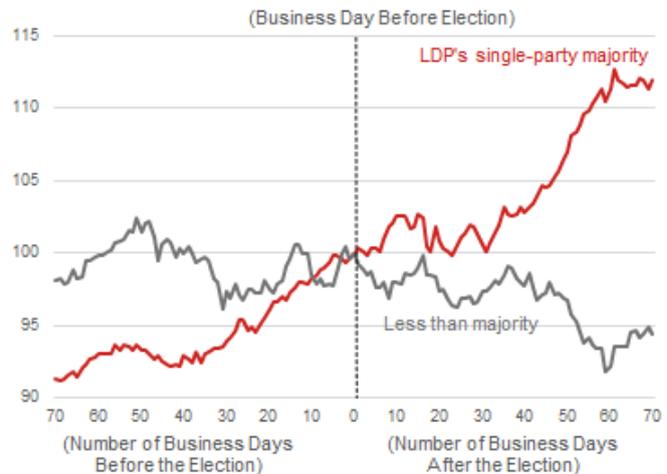
Figure with \* mark is as of August 2021.

The shaded area indicates when the ruling party changed.

## LDP Lower House Majority Usually Positive for the Japanese Equity Market

Looking at stock price trends (Fig. 2.) before and after the last 10 Lower House elections since 1990 (following the collapse of the bubble economy), we can see that when the LDP secured a single-party majority, stock prices rose ahead of expectations even before the Lower House election. Stock prices continued to rise after the election due to expectations for the new government. With Prime Minister Suga's decision to relinquish the party leadership, the risk of a major setback for the ruling coalition parties in the House of Representatives election has receded. Concerns over the political risk to the Japanese stock market have also eased.

Fig. 2. Nikkei Stock Average Before and After the House of Representatives Election

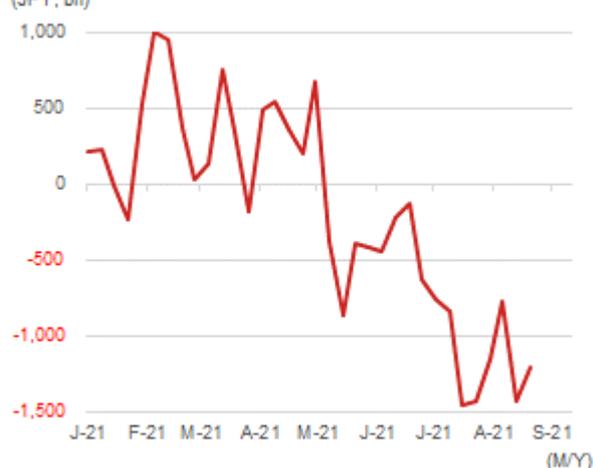


Period: 70 business days before and after the House of Representatives election  
 Source: Nomura Asset Management, Bloomberg  
 The survey covered 10 House of Representatives elections held since the bursting of the bubble in 90. The average of the Nikkei Stock Average V, which recorded 5 times a single majority and 5 times less than a single majority

## Prospects for Increased Foreign Investor Interest

In terms of supply and demand, the focus will be on whether overseas investors will take a fresh look at the Japanese stock market. Looking at the difference in total transactions of Japanese stocks by foreign investors since the beginning of this year (Fig.3.), the net selling trend has been growing since the spring against the background of further local outbreaks of Covid-19 and waning government support. Indeed, the net selling exceeded 1.2 trillion yen as of the 4th week of August. Although none of the candidates have announced clear policy programs yet, it is reasonable to expect that a new administration, will prioritize the prompt implementation of coronavirus control measures and economic support. Such measures are likely to be at the top of the agenda and therefore widely recognized by the market in the short term, so buybacks by overseas investors through adjustment in their shareholdings can be expected to boost equity market supply-demand conditions.

Figure 3. Cumulative Foreign Investors Net Transaction Volume

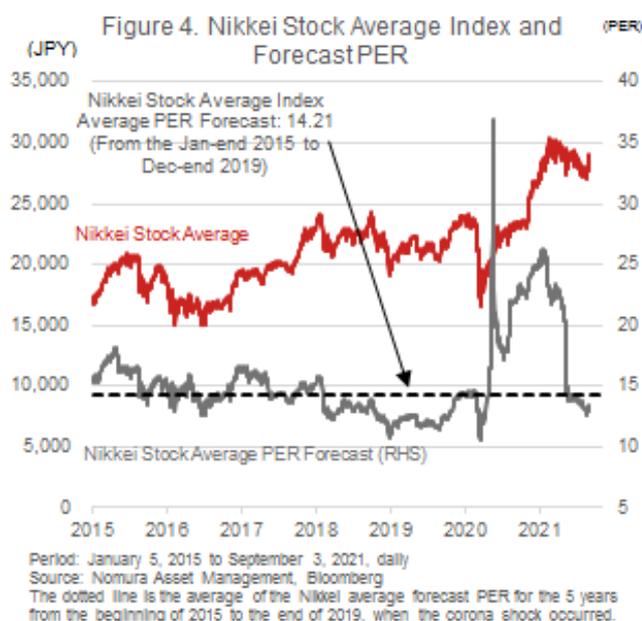


Period: Week 1, January 2021 – Week 4, August 2021, weekly  
 Source: Nomura Asset Management, Bloomberg  
 Futures are the sum of Nikkei average futures and TOPIX futures (both Large transactions)

## Market Appears Undervalued

Relatively cheap equity valuations in the Japanese stock market are another an important consideration. The Nikkei Stock Average's price-earnings ratio (PER) stood at 13.49 as of September 3, still below the 14.21 times average for the previous 5 years (Fig. 4). Also considering the business performance, we can say that Japanese stocks have the potential for an upward valuation correction. The Nikkei Stock Average could therefore hit the 30,000 yen mark toward the end of the year against the backdrop of rising earnings.

From a longer-term perspective, beyond the immediate election cycle, we believe it will be important for the new administration to carry out structural reforms and implement deregulation policies that enhance corporate strength and competitiveness. Compared with US companies, Japanese companies still have significantly lower profitability in terms of their return on equity (ROE). Therefore, if a reform minded candidate with a progressive policy agenda can win the LDP leadership race, it is quite conceivable that Japanese stocks can gain from this political shift.



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