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Amundi ASSET MANAGEMENT

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INVESTMENT TALKS

Japan’s Prime Minister Abe call for snap elections: a view from the market

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Japanese economy is running above its potential growth rate.

Japan’s Prime Minister Abe has recently announced that he will dissolve the House of Representatives and call for snap elections in October. What is your view on this move?

Alessia Berardi: Abe’s call for snap elections for the Lower House aims to secure an LDP majority longer than next year. At the moment the opposition is still in disarray and an LDP victory looks like a consensus call. However, the Tokyo Metropolitan Governor, Yuriko Koike can bring some risks to the picture. She has just formed a national party and, if she makes alliances with other opposition parties, this will make the prospect of an Abe victory more uncertain.

The base case of the election outcome is in favour of LDP and Abe. This would be a signal of continuity in the economic policies with limited impact on the markets. Some more volatility is expected in the risky case: policies should probably change but it’s not clear so far how they will change. A couple of announcements have been made in terms of the cancellation of next Consumption Tax hike and no restart of nuclear plants.

What is your macro economic outlook for Japan?

Alessia Berardi: Japan’s economy is running above its potential growth rate. That positive macro momentum is expected to stay for the rest of the year with some deceleration moving into 2018.

Growth looks well balanced between domestic and external contributions. Inflation is expected to pick up mildly in the short term and then return towards 0.5%, far below the Bank of Japan (BoJ) target. Notwithstanding the output gap is closed, global disinflationary factors are keeping inflation low. The BoJ is expected to remain extremely accommodative and focused on the “Yield Curve Control” mechanism. Securities purchases have been falling, but the BoJ is still committed to increase them if necessary. The Yen direction will be dictated more by the USD dynamics and geopolitical factors.

Overall we expect a stable Yen for the rest of the year with a tilt towards appreciation, more pronounced in 2018. Eventually, the snap elections outcome is expected to favour Abe and LDP, marking some policy continuity and without derailing the JPY path from our expectations.

What is your short and medium-term investment outlook on Japanese equity markets?

Yasunori Iwanaga: The market looks attractive when compared with the US and European markets. The year-on-year corporate profit growth is expected to reach a high double-digit in 2017 as cyclical recovery continues globally. Japanese GDP should grow at a rate of 1.1% in the real terms in 2018 on the back of the contribution from demand in the private sector.

Domestically, Abe has recently called for a snap election to rebuild his political budget while the opposition parties are less prepared. The market has reacted to the outlook positively anticipating to see fiscal stimulus - the government announced that it was going to revisit the fiscal reform plan to spend more on education or human resource development while postponing its pledge to achieve a surplus in the primary balance by 2020.

Geopolitically, however, the situation in the Korean Peninsula remains a concern. Though the United Nations sanction leads to alleviating it somewhat over the mid-term, market sentiment can get worse if North Korea continues the brinkmanship with missile launches.

Style-wise, we prefer quality and “stock” value. We are, overall, a little cautious about small/mid cap stocks having seen strong rotation from large cap. Sector-wise, we have a positive view on information technology and consumer discretionary, while we are more cautious within materials.

The Japanese equity market looks attractive when compared with other DM markets, while fixed-income is expected to remain "quiet".

What is your short and medium-term investment outlook on Japan fixed income markets?

Arie Shinichiro: In the short/medium term, Japanese fixed-income markets are expected to remain somehow "quiet" as the JGB curve will be contained within a narrow range by BOJ's "Yield Curve Control" mechanism until next April.

As Japan's economy expanded at an annualized rate of 2.5 percent in April-June, foreign investors are expected to invest further into Japanese linkers which are seen as "undervalued" compared to other countries.

With credit spreads still at their lowest levels, we maintain a cautious view on yen-denominated credit markets and we consider short-term credit bonds as the most suitable investments for our portfolios.

Eventually Samurai and Euroyen issuers will remain attractive names with higher credit spreads (than domestic issuers) albeit this positive spread difference is uncorrelated to future developments in Japanese fixed-income markets.

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