STABLE POLITICS—DYNAMIC ECONOMY —JAPAN PREMIUM

23 Oct 2017

In the world of politics and policy making, Japan has become the envy of the world. The snap election got "Team Abe" re-elected with a strong majority and they will be controlling parliament with basically the same two-thirds super majority they had before. Stability, continuity and consistency of a strong pro-growth and pro-business agenda is poised to be rewarded with a growing "Japan Premium" in financial markets, that is, Japan's equity markets deserve a higher PE multiple, in my view.

Specifically, we see the following post-election trigger-points for rising P/E multiples in the Japanese equity market and further Yen-depreciation:

Corporate sector dynamism and accelerating CAPEX cycle

Political and policy stability is poised to add momentum to Japan's domestic business investment cycle. Already leading companies like Canon and Shiseido have announced some on-shoring, that is, building new production capacity in Japan and the up-grade cycle for small and medium sized companies is poised to accelerate further.

Here we do expect that the new opposition party, led by Tokyo Governor Koike, will put pressure on "Team Abe" to accelerate "special economic zone" programs, particularly in Japan's largest economic region. While the new Party of Hope failed to become the largest opposition party in this election, it's political future depends on holding "Team Abe" accountable for a concrete and visible structural reform agenda. In our view, the new configuration of Japanese parliament has reduced the risks of economic policy complacency. This is particularly so since the LDP may have to depend on the Party of Hope to support the constitutional reform agenda.

BoJ de-couples from the Fed cycle

Japan's monetary policy is poised to de-couple from the Fed rate hike cycle. No matter who will be appointed as the next BoJ Governor, he or she is almost certainly going to continue the current support for "Abenomics" from the central bank. If at all, the election has strengthened "Team Abe's" conviction that its economic policy is on the right track, precisely because Japan's unique collaboration between fiscal- and monetary authorities.

If at all, Abe's election promise to go ahead with the 2019 consumption tax hike suggests a growing responsibility for the BoJ to ensure against recession. Clear-speak—the Japan-US de-coupling of monetary policy cycles has become more probable, in my view.

Constitutional reform not an obstacle for economic

For the first time in history, constitutional reform was part of the ruling parties' official policy platform and there can be no doubt that "Team Abe" will use the two-thirds super majority status to now engage in concrete parliamentary proceedings to revise Japan's basic law. However, this does not mean economic policy comes to a stop. Parliament is not a zero-sum game. If at all, "Team Abe" knows full well that constitutional reform can only happened if the Japanese people support it—a national referendum has to be called within six months of parliament approval.

So it is imperative for "Team Abe" to remain focused on the creation of pro-growth, pro-business policies. Without a broader feel-good factor amongst the people, any constitutional referendum is poised to be defeated. If at all, the risks are that the pressure to deliver constitutional reform tempts "Team Abe" to become more fiscally irresponsible and puts even more pressure on the BoJ, in our view.

All said, I believe Japan's policy dynamics is poised to deliver strong upside surprises to economic growth in general, earnings growth in particular. The Japanese equity market should begin to discount this, resulting in PE multiple expansion. Position for a Japan Premium.

PS: current TOPIX PE is 16.3-times; an expansion to 20-21x would push it to the top range observed during the past decade.

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