

Japan Equity Strategist Flash

Lower House dissolution, a change of administration, and Japanese equities

■ Equities

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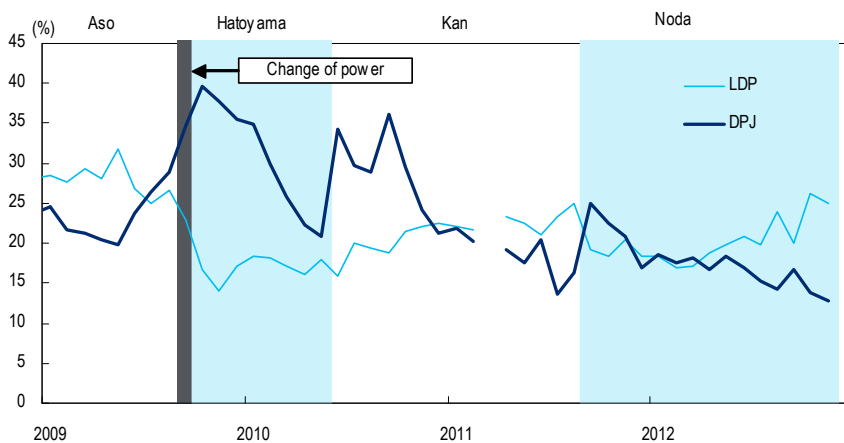
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- **Positive for Japanese equities** — Various media outlets are reporting that PM Noda is increasingly minded to dissolve the Lower House before the end of the year. There could be a Lower House election as early as December 16. We believe the election will likely result in an LDP/New Komeito coalition and that LDP leader Shinzo Abe will become the new PM. We see this as positive for Japanese equities, as there has been a considerable disappointment in the DPJ administration and there are hopes for Mr. Abe's reflationary policies.
- **Rebirth of an LDP/New Komeito administration** — According to NHK opinion polls, since the summer the LDP support rate has been on an uptrend while the DPJ support rate has been on a downtrend (Figures 1 and 2). In the November poll, the support rates were as follows: 25.0% for the LDP, 12.7% for the DPJ, 3.0% for Komeito, and 1.6% for the Japan Restoration Party. We think that after the Lower House election, an LDP/New Komeito administration is likely to be reborn, with Mr. Abe becoming PM.
- **Mr. Abe's stance on monetary policy** — On the subject of monetary policy after seizing the reins of PM, Mr. Abe has commented that he will set a CPI inflation target of 2%-3% so as to escape from deflation and end excessive yen strength, get the BoJ to make a responsible commitment to this, and consider revisions to the BoJ Law.
- **Thoughts of future BoJ governor candidates on monetary policy** — We expect Toshiro Muto, former MoF vice minister, and Kazumasa Iwata, former BoJ deputy governor, who are in the spotlight as possible candidates for BoJ governor, to be more proactive on monetary easing than incumbent governor Masaaki Shirakawa. However, we get the impression that Mr. Muto is more cautious on inflation targets and revisions to the BoJ Law than Mr. Abe (Figure 3).
- **Real estate to outperform** — After the three-party agreement was secured on the integrated tax and social security reforms, including the consumption tax hike, PM Noda has been unable to deliver on core policies. Disappointment with the Noda administration has been mounting, as it has been unable to draw up a supplementary budget even as it became clear the economy was in a downturn. We expect the Lower House dissolution and the general election to be positive for Japanese equities, in part on market expectations for the reflationary policies of Mr. Abe. TOPIX rose in 2009, when the DPJ came to power, between the dissolution date and the election date (Figure 4). We expect to see the real estate, securities, insurance, and construction sectors outperform on hopes for reflationary policies.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

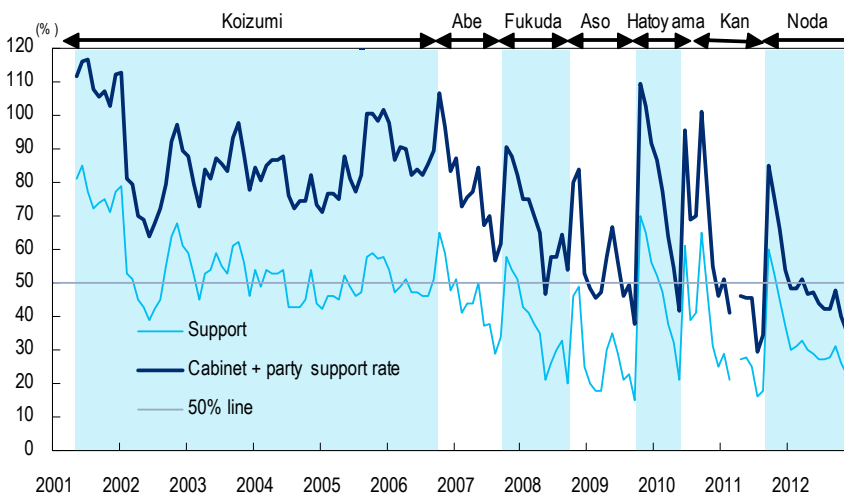
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Figure 1. DPJ and LDP support rates



Note: Excludes ad hoc polls. The March 2011 poll was called off because of the eastern Japan earthquake.
Source: NHK opinion polls, Citi Research.

Figure 2. Party and cabinet support rates



Source: NHK opinion polls, Citi Research.

Stance of the LDP and leader Mr. Abe on monetary policy

The Japan economic revival plan of the LDP says the following.

- In order to escape deflation, we will take bold monetary easing measures that exceed the established consensus.
- In order to bolster the ties between the government and the BoJ and enhance the effectiveness of monetary easing, we will take bold monetary easing measures, such as the government and the BoJ inking an agreement on a price target (about 2%) and the BoJ purchasing foreign debt, and will consider revisions to the BoJ Law.

Mr. Abe called for aggressive monetary easing in the LDP leadership election and other forums. On the subject of monetary policy after seizing the reins of PM, Mr. Abe has commented that he will set a CPI inflation target of 2%-3% so as to escape from deflation and end excessive yen strength, sign an accord with the BoJ, get the BoJ to make a responsible commitment, and consider revisions to the BoJ Law.

We think the sort of person Mr. Abe wants to see as the BoJ governor is someone who has not a shred of doubt about the possibility of escaping deflation via monetary policy, who will lift the inflation target to 2%-3% soon after appointment, will announce the sustained purchase of assets at a certain monthly pace so as to attain that target, and who will pursue additional steps should these not prove sufficient.

Is Mr. Muto more cautious on monetary easing than Mr. Abe?

One candidate for BoJ governor that has been attracting attention is Toshiro Muto, a former Administrative Vice Minister of Finance, and the media has reported on his thinking on financial policy. It appears he is more cautious about setting an inflation target and revising the BoJ Law than Mr. Abe.

Mr. Muto has said that there are still financial measures that can be taken, such as extending the maturity of JGBs subject to BoJ purchase and buying corporate bonds. However, he has also been skeptical about the ability of monetary policy to get Japan out of deflation, saying “unfortunately I do not believe monetary policy offers any extremely powerful and effective methods for ending deflation”.

Mr. Muto has said it would be more realistic to raise the inflation target to 2% after 1% has been achieved. On the other hand, Mr. Abe said regarding the BoJ’s additional easing measures on October 30 that “a little at a time is a bad idea”. This seems out of line with Mr. Muto’s idea of incremental change.

In addition, Mr. Muto has been dismissive of claims that the BoJ law must be revised, saying that he is concerned that this could damage the relationship of trust between the BoJ and the government that has been built up over the years. Here too we see a large gap between Mr. Muto and Mr. Abe, who to some extent favors BoJ law revisions.

Mr. Muto has also expressed concern about the difficulty of getting other nations to buy into the BoJ purchasing foreign bonds, as this would likely lead to a weaker yen. This view does not match up with the LDP’s economic revitalization plan.

What is more, we believe Mr. Muto, who began at the MoF, likely thinks the consumption tax needs to be hiked even if the economy is quite weak. Mr. Abe, on the other hand, thinks that economic conditions are such that perhaps the consumption tax hike should be abandoned, saying “as things stand it would be

difficult to put the necessary conditions in place to hike the consumption tax in April 2014.”

Mr. Iwata's thinking on monetary policy

One other individual who has been attracting attention as a candidate for BoJ governor is Kazumasa Iwata. He has said that the BoJ should create a financial crisis prevention fund and purchase ¥50trn in foreign bonds. On this point he is in line with the LDP's economic revitalization plan. This is easy to understand from an economy perspective as well as it would weaken the yen, which would likely lead to inflation.

As for potential criticism from other countries, Mr. Iwata has said that Japan should express that it is taking these measures as part of efforts to ensure the stability of the global economy. However, it is hard to imagine that other nations would accept this explanation given their parlous economic state, so we note that in the end this proposal is unlikely to happen.

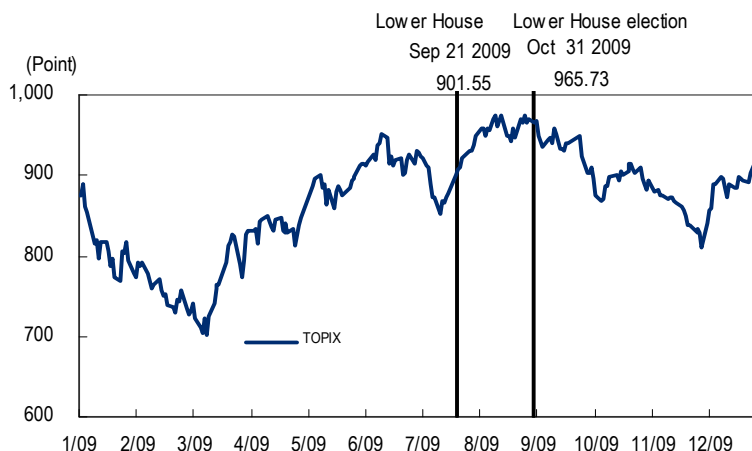
The next BoJ governor is likely to be a major theme on the market until March 2013, and we think it will have a major impact on Japanese equity performance in 2013. As such, we will continue to watch developments with interest.

Figure 3. The views on monetary policy of Mr. Abe (LDP head), Mr. Muto (former Administrative Vice Minister of Finance), and Mr. Iwata (former deputy BoJ governor)

	Mr. Abe/LDP	Mr. Muto	Mr. Iwata
Inflation target	Believe the government and BoJ should enter into an agreement on an inflation target of 2%-3%. 1% is seen as insufficient.	Says raising the target to 2% after 1% is achieved would be realistic.	Supports a flexible inflation target measure.
Purchasing foreign bonds	Have discussed of dramatic monetary easing measures like foreign bond purchases by the BoJ.	Feels that it could be difficult to get a buy-in from financial ministers of other nations at G7 meetings, etc. as they would be concerned about yen depreciation.	Believes that the BoJ should establish a financial crisis prevention fund and purchase ¥50trn in foreign bonds. To counter criticism from overseas, he feels Japan should say it is taking these measures as part of efforts to ensure stability for the global economy.
BoJ law revisions	Have discussed dramatic monetary easing measures with an eye to revising the BoJ Law.	Concerned that claims about the need to revise the BoJ law could damage the trust between the government and BoJ built up over many years.	

Source: Media reports, Citi Research.

Figure 4. TOPIX around the change of administration in 2009



Source: Astra Manager, Citi Research.

Appendix A-1

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