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Anticipate a Repeat of the Rally Following the Koizumi Election on Postal System Reform

Investors can't wait until the election – The Nikkei Average may approach ¥20,000 after the election

The novel Yukiguni (Snow Country) by Yasunari Kawabata begins with the famous words “the train came out of the long border tunnel into snow country.” Today, we can probably say that “after the general election, 2015 will begin with abundant sunshine.” The election will probably have a very positive influence on Japan's economy and stock prices. On August 8, 2005, Prime Minister Junichiro Koizumi dissolved the lower house to hold an election on September 11 that was a referendum for a single issue: privatization of the postal system. The result was a resounding victory for the prime minister. Following this election, stock prices in Japan rose more than 40% during the remainder of 2005, a period of less than four months. This time as well, prospects are excellent for another dramatic stock market movement.

The reason is that there is almost no doubt that this election will give the Abe administration even more power. Media that have been critical of the Prime Minister Abe and other critics have all called this an election about nothing. They believe that Japan should change its economic policies because Abenomics has been a failure. Critics also think that recognizing the right of a collective self-defense is wrong and that the Abe administration's diplomatic policies for neighboring countries have failed. But if these beliefs are true, then this election is an opportunity for these critics to submit a vote of no confidence regarding Abenomics. Consequently, this is obviously not a meaningless election.

Have the policies of Prime Minister Abe really been a failure? Some people continue to say that the Bank of Japan's quantitative easing is a forbidden action that is producing nothing but side-effects. But doesn't this mean that Japan should return to the anti-growth policies two years ago of the government led by the Democratic Party of Japan? These are the policies that made stock prices in Japan the lowest in the world for four years. Stock prices have already doubled since the Abe administration took over two years ago. Market capitalization of Japan's stock markets has increased from about ¥270 trillion to ¥280 trillion to more than ¥500 trillion. Obviously, the stock holdings of the Japanese public have doubled in value, too.

During the same period, the yen has declined from ¥80 to the US dollar to about ¥120. If the yen returned to ¥80, Japanese electronic products companies like Sony, Panasonic and Sharp would probably once again be in danger of bankruptcy. Due to the delay in the correction of the yen's excessive strength, Micron Technology acquired Elpida Memory, a Japanese company that should have been highly competitive on its own. Japan is no longer part of the global DRAM market as a result. But now Micron Technology plans to spend ¥100 billion to expand Elpida's factory in Hiroshima. These events clearly demonstrate the severity of the damage caused by the yen's strength up to two years ago. We can also see the immense potential for improvements created by the yen's recent decline.

On November 24, the Asahi Shimbun, which has been consistently critical of Abenomics, printed a peculiar editorial. The newspaper said that “once monetary easing on an unprecedented scale has started, it is extremely difficult to switch to a different policy. The prime minister has created a situation in which this unprecedented monetary easing is the only option. Continuing this easing for the time being is the only choice. Will the government continue down the path of ending deflation? Or should the government adopt a more cautious stance regarding the economy based on the risks and limitations of unprecedented monetary easing? (This is the only question that can be submitted to voters.)” So is the Asahi Shimbun saying that the current policy must be continued?

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Furthermore, there is criticism of Prime Minister Abe's diplomacy involving Japan's neighbors. However, Japan's nationalization of the Senkaku Islands is the key reason for the worsening of relations with China. This action was taken by the administration of Prime Minister Noda of the Democratic Party of Japan. Prime Minister Abe met Chinese President Xi Jinping for the first time at the recent Asia-Pacific Economic Cooperation (APEC) meeting. This may be a sign that the cold relationship between Japan and China is about to improve. There was criticism of Prime Minister Abe's visits to the Yasukuni Shrine. But even more significant was the praise from the United States for the prime minister's actions during the past two years to support a collective self-defense and end deflation. Clearly, the United States wants to increase its cooperation with the Abe administration. This is a major aspect of the prime minister's diplomacy.

No other political party can come up with a trustworthy alternative for Japan's economic, national security and other policies. That means this election is solely a referendum on the Abe administration. For the most part, this is not a vote to reject the administration based on its performance during the past two years. Voters are very likely to give the prime minister their support with perhaps an even bigger victory than before. If this happens, Prime Minister Abe will probably continue implementing his policies even more vigorously.

The next initiative of the Abe administration is likely to be the third arrow of Abenomics: reforms and deregulation. After receiving the support of voters, we can expect to see the prime minister clearly state his intention of implementing reforms while pushing aside resistance from people with vested interests. As a result, Japan will probably lower the corporate income tax, enact reforms for the labor market, health care and agriculture, and take other actions. Removing various market economy barriers that have been holding back the Japanese economy will greatly increase overseas investors' expectations about Japan.

Delaying the next consumption tax rate hike demonstrates the prime minister's resolve about restoring Japan's financial soundness in the future. Raising this tax by 2% would take away about ¥5 trillion of purchasing power from the private-sector economy. However, a stock price increase of only 1% would generate asset income of ¥5 trillion because Japan's stock market capitalization is about ¥500 trillion. As a result, a negative impact of ¥5 trillion may be negligible if stock prices rise, deflation ends and consumer sentiment improves. Therefore, there are convincing arguments for trusting Prime Minister Abe's policy of postponing the consumption tax hike in order to strengthen Japan's economy. Afterward, taxes can be increased as needed. Financial markets will probably pay little attention to talk about lowering Japan's credit rating, such as Moody's remark that Japan is driving while looking in the rear view mirror.

Over the two weeks or so, Japan's stock markets will probably factor in this line of thinking. If Prime Minister Abe is victorious, we can expect to Japan's economy advance with even more energy. Opposition parties have no alternative ideas whatsoever. This is why prospects for an Abe victory will become increasingly greater as the election campaigns progress. Consequently, we are very likely to see the start of a powerful stock market rally driven by investors who can't wait until they see the election results.

In my next report, I will talk about the outlook for the Japanese economy in 2015. But I can say now that I expect a big increase in the growth rate. Major forces will include (1) the strength of the US economy and growth in Japan's exports to the US; (2) the end of the negative impact of the April 2014 consumption tax increase; (3) growth in corporate earnings because of the weaker yen; and (4) the lower price of oil.

When the election was announced, the Nikkei Average was establishing a base at the ¥17,000 level. Once Prime Minister Abe wins the election, this index will probably be at about ¥19,000 and then rise to more than ¥20,000 by the end of 2014 or early in 2015. We may see the Nikkei Average approach ¥25,000 in the middle of 2015 if there are clear signs that deflation has ended. Furthermore, we have finally reached the point where a powerful rally is possible within a few years that propels the index to ¥30,000, which is regarded as its fair value. This is why we may be on the verge of a rally on the same scale as the one that followed the 2005 Koizumi postal system reforms. But from a long-term perspective, this time the rally will boost stock prices on a much greater scale.