

MV Weekly Market Flash

Japanese Equities Fall...and Fall...And Fall

June 7, 2013

For most of this year Japanese equity markets have been on a roll, but the unusual run of good news for chronically underperforming Japan did a massive about-face a couple weeks ago. On May 23rd the Nikkei 225, a broad index of Japanese stocks, took a 7.3% plunge from the commanding heights it had scaled – a 47% run-up since the New Year – and the downward momentum has snowballed since. The index is now more than 18% below the 5/23 high. Clearly things are not quite right in the Land of the Rising Sun.

Cherry Blossoms and Abenomics

Japanese stocks had been on this spectacular rally largely due to Prime Minister Shinzo Abe's brash push for monetary expansion to vanquish deflation, as well as his other policies intended to kickstart the economy out of its decades-long funk. Economists have been referring to this bundle of policies as "Abenomics", and the springtime buzz has been palpable in the retail high streets of Osaka and the trading rooms of global securities firms alike. Relative to the size of Japan's economy, Abenomics is a more turbo-charged program than even the massive QE3 stimulus architected by US Fed chairman Ben Bernanke.

The Skeptics Weigh In

Like those ephemeral cherry blossoms, though, the euphoria over Abenomics may prove to be short lived. Rising Japanese government bond yields are fueling concerns: higher yields may mean rising inflation expectations which could mean that the country will have trouble paying its debt (currently more than twice the size of its economy). Rising inflation is one of Abe's primary goals, but Japanese economist Richard Koo argues that a rise in inflation before the economy truly begins to recover could do more harm than good. Mr. Koo states: "This is clearly an unfavorable rise in rates driven by concerns of inflation, as opposed to a favorable rise prompted by a recovery in the real economy and progress in achieving full employment." (Business Insider, 06/04/13)

Meanwhile, In the Real Economy...

Japan's monetary problems, serious as they may be, are not the whole story. The once dynamic economic superpower that produced Toyota, Sony and just about every trendy management fad of the 1980s has long been a subdued shell of its former self. The story in Asia these days is much more about China, a recently resurgent Korea and emerging consumer giants like Indonesia. Decisions in Japanese corporate boardrooms are neither nimble nor bold, and companies from Suntory (beverages) to Daiei (retail) to Orix (financial services) have squandered opportunities for regional market share growth as a result. The Nikkei's ongoing woes may be more than anything else about doubts among investors that this state of affairs will be changing any time soon.

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