

Path to Nikkei 225 Index of JPY 18,000

- Market expects size of economic measures supported by large-scaled supplementary budget to range from JPY 5 trillion to JPY 10 trillion.
- PM Shinzo Abe's declaration at Ise-shima Summit will be a key event, as market would react positively if delay of consumption tax hike and economic package over JPY 5 trillion were to be announced.
- Although, BOJ's three dimensional easing is difficult to function, it will positively affect stock price to rise. As such, market expectation is high on both government and BOJ's measures.

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In this report, I would like to explore through possible paths toward Nikkei 225 index to reach JPY 18,000 in future, by focusing on economic measures taken by Japanese government and BOJ's additional easing. As to economic measures, implementation of JPY 10 trillion worth of public works from April through September is planned, supported by FY2015 supplementary budget and FY2016 budget (ahead of schedule) at this moment. However, it seems that opinion supporting necessity of large-scaled supplementary budget is prevailing within the ruling parties, as public works will decrease after October this year.

Large-scaled supplementary budget will be a support to economic measures which is likely to be announced soon. "Plan of Promoting Dynamic Engagement of All Citizens in Japan", "Basic Policies for the Economic and Fiscal Management and Reform" and "Growth Strategy" will soon be approved by cabinet. Few of the measures which can be put in place immediately will be unveiled as a framework of stimulus package at Ise-shima Summit on 26th and 27th of May, 2016. While, the economic package is expected to range from around JPY 5 trillion to JPY 10 trillion, scale of the measures will be subject to outcome of First preliminary real GDP growth rate for January to March 2016 and PM's decision of whether to delay consumption tax hike or not (Diagram 1).

"Diagram 1: Key Future Events"

Schedule		Event
May	18th	First Preliminary Jan.-Mar. 2016 real GDP growth rate
	26-27th	G7 Summit (Ise-shima Summit)
	Month end	Cabinet approval of "Plan of Promoting Dynamic Engagement of All Citizens in Japan" etc.
June	1st	The last day of Ordinary Diet Session
	14-15th	Federal Open Market Committee (FOMC)
	15-16th	BOJ's Monetary Policy Meeting (MPM)
	23rd	The UK's EU referendum (to decide whether Britain should leave or remain in the European Union)
July	Within month	Casting & counting votes of Upper House election
Summer - Autumn		Summoning of an extraordinary session of the Diet (Submission of FY2016 Supplementary Budget)

(Source) SMAM, based on publicly available information.

"Diagram 2: Summary of Benchmark Ratio"

<ul style="list-style-type: none"> • Three-tier System of BOJ's Current Account Balance: i) Basic Balance +0.1% interest rate, ii) Macro Add-on Balance zero interest rate, iii) Policy-Rate Balance -0.1% interest rate.
<ul style="list-style-type: none"> • Macro Add-on Amount is included in ii) Macro Add-on Balance.
<ul style="list-style-type: none"> • Macro Add-on Amount is calculated by multiplying certain multiplier (Benchmark Ratio) to the benchmark balance (BOJ's average current account balance of the previous year).
<ul style="list-style-type: none"> • Current Benchmark Ratio is 2.5%. Reviewed on a quarterly basis. Next review is on 9th June, 2016.
<ul style="list-style-type: none"> • With increase of Benchmark Ratio, ii) Macro Add-on Balance adopting zero interest rate will increase which will eventually reduce iii) Policy-Rate Balance adopting -0.1% interest rate.

(Source) SMAM, based on BOJ's data.

PM Shinzo Abe's declaration at Ise-shima Summit will be a key event, as market would react positively if delay of consumption tax hike and economic measures over JPY 5 trillion were to be announced.

If consumption tax hike is postponed, size of the economic measures will likely be not as large as is expected. Market is already focusing on length of postponement. Some expectation emerges as; PM Shinzo Abe would (i) put off the tax hike for 3 years until April 2020, (ii) dissolve the lower house before summer of 2018, (iii) extend his office term as president of the ruling party (LDP) for 2 years from September 2018 and (iv) hold upper house election in summer of 2019. Japanese stock market will react positively to delay of consumption tax hike for 3 years and economic measures based on over JPY 5 trillion.

The economic measures are expected to include (i) public investment such as infrastructure improvement, (ii) support of labor conditions mainly to improve environment surrounding child rearing and care nursing, and (iii) stimulation of consumption by issuance of premium shopping vouchers. Not only the scale of economic measures but also number of policies included, which can impel sustainable economic growth is a key. A focal event will be to what extent PM Abe's declaration can send message in accord with other member nations, despite that agreement on collaborative fiscal stimulus seems difficult to be achieved at the Ise-shima Summit.

Although, BOJ's three dimensional easing is difficult to function, it will positively affect stock price to rise. As such, market expectation is high on both government and BOJ's measures.

If BOJ's three dimensional easing (expansion of quantitative and qualitative monetary easing with a negative interest rate) will come during its Monetary Policy Meeting on 15th and 16th June 2016, market will likely respond with stock price hike. However, it is not easy for the BOJ to go with further easing, as JGB is already in shortage for quantitative easing and liquidity in short-term money market has lowered by negative interest rate. Therefore, if (i) JGB is additionally issued to fund the economic measures and (ii) Macro Add-on Balance (zero interest rate is adopted) is to increase by dramatic rise of Benchmark Ratio on 9th June 2016, they are expected to lead to improvement of supply and demand balance of JGB and reduction of burden of negative interest rate to financial institutions (Diagram 2).

It is possible to assume Nikkei 225 index to rise towards milestone of JPY 18,000, if (i) consumption tax were to be delayed for 3 years, (ii) the economic package of over JPY 5 trillion were put in place and (iii) BOJ were to implement three dimensional easing. Please note that this is

not my outlook but just an example of scenario which can be written. However, there is a fear of global financial market instability due to concern over the UK's EU referendum (to decide whether Britain should leave or remain in the European Union) on 23rd June 2016. Market expectation on Japanese government and BOJ's actions is getting higher these days in order to mitigate this concern.

*** Please note that this report is a translation of Japanese report written on 17th May, 2016.**

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