EQUITY

Why Abe's Victory Could Help Lift Japanese Stocks

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Shinzo Abe's coalition victory in the October 22 snap election helps pave the way for his fourth term as Japanese prime minister. Here, Templeton Global Equity Group's Cindy Sweeting and Alan Chua give their take on what Abe's pro-growth policies could mean for Japan's investment landscape.

Japanese Prime Minister Shinzo Abe's decision to dissolve the country's lower house for a snap election on October 22 appears to have paid off.

His Liberal Democratic Party and its coalition partner Komeito retained the two-thirds majority in the lower house that secures them power. The victory helps pave the way for Abe's fourth term as prime minister.

Abe called an election, nearly a year before his previous term of office had expired, in a bid to capitalize on an uptick in his approval rating after he took a more hawkish stance against North Korea and the precarious state of his opposition. His traditional opposition, the Democratic Party of Japan, is in disarray. Also, Tokyo Governor Yuriko Koike–widely considered to be Abe's main challenger–decided not to run for parliament.

In our view, it was difficult for Abe's challengers to claim he has failed on the economic front. Japan's unemployment rate is at record low levels, and gross domestic product (GDP) has expanded for six straight quarters—the longest sustained bout of growth since before the 2007–2009 Global Financial Crisis.

What's more, Japanese corporate profits recently have been rising faster than GDP, assisted by an undervalued yen. With the corporate sector generating positive cash flow, we think companies have room to boost capital spending and dividend payouts.

At the same time, Japan's labor market has been tightening. We believe tighter labor conditions could help boost income and lead to increased consumption.

For these reasons, we think Japanese equities have the potential to continue to do reasonably well and the domestic economy should continue to improve. Against this backdrop, we see select investment opportunities across a wide variety of Japanese sectors, including automobiles, electronics, factory automation, industrials, materials, oil and gas exploration, real estate and telecom.

In our view, Abe's victory could lead to four more years of pro-growth policies and the possibility of a second term for the ultra-dovish Bank of Japan (BOJ) Governor Haruhiko Kuroda. We believe the near-term effect of more fiscal stimulus should be more positive for the economy.

That being said, Japan has relied heavily on massive monetary easing, central-bank balance sheet and asset buying, and an overarching policy of asset price inflation. The BOJ now owns two-fifths of the country's sovereign debt and two-thirds of its domestic ETF market.

Although these purchases have been a pillar of support for Japanese equities and have kept the currency rate quite favorable, we believe this creates long-term challenges. In our view, it raises the risk of reduced liquidity and increased volatility at some point down the road.

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