

Abenomics gets a second chance

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Many of Shinzo Abe's fellow party members disagreed with his decision¹ when he dissolved the Diet in November. But the gamble paid off and he has won another term to become one of Japan's longest-serving Prime Ministers.

Calling a snap election may have been a shrewd political move but it also raised questions about the timing, given Japan's current economic state, "Now is not the time to dissolve the Lower House,"² said Hiroshi Shikanai, Mayor of Aomori – a city in the north of Japan's largest island, Honshu. "We're faced with issues that require co-operation between the central and local governments, such as measures to boost regional economies and fight population decline, but the election will create a vacuum," he added.

The *Land of the Rising Sun* is certainly in a situation which is a far cry from the heady days of the 1980s boom period, when the Japanese business was nicknamed *Japan Inc.* because of the close relations between the business sector³ to the government, which seemingly aided the former in exporting goods. Once the Soviet Union had collapsed, some saw the Japanese system as the only real alternative to Western free-market capitalism. They believed that the US was unable to compete with Japan's *managed trade*.⁴

In the late 1990s Japan's huge post-war economic growth came to a halt and the asset price bubble burst. Stock and house prices plunged, which had a particularly dramatic effect as banks had leant heavily using land prices as collateral.⁵ The government's reaction was to embark on public works projects to stimulate demand. These projects included massive spending on roads but only resulted in a huge increase of public sector debt and the economy continuing to stagnate.

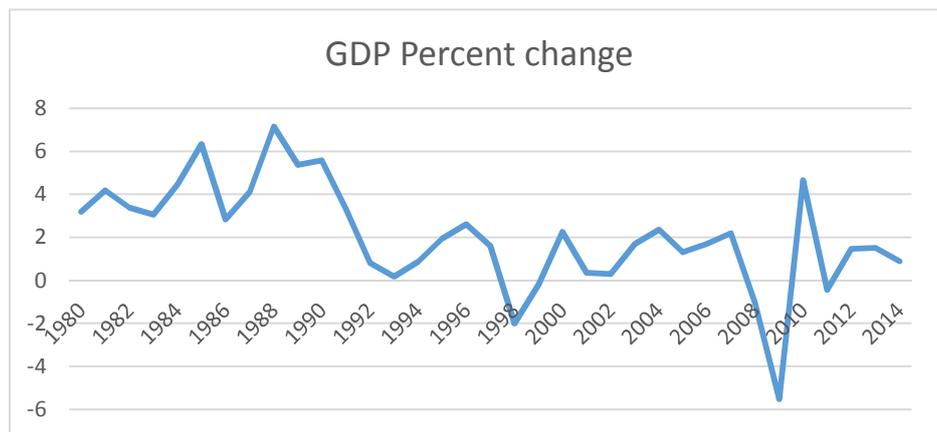
¹ <http://www.economist.com/news/21636467-shinzo-abe-wins-easily-weak-mandate-voters-romping-home>

² <http://www.japantimes.co.jp/news/2014/11/21/national/politics-diplomacy/mayors-governors-cast-doubt-on-abetes-dissolution-gambit/#.VJFGi7QcSM8>

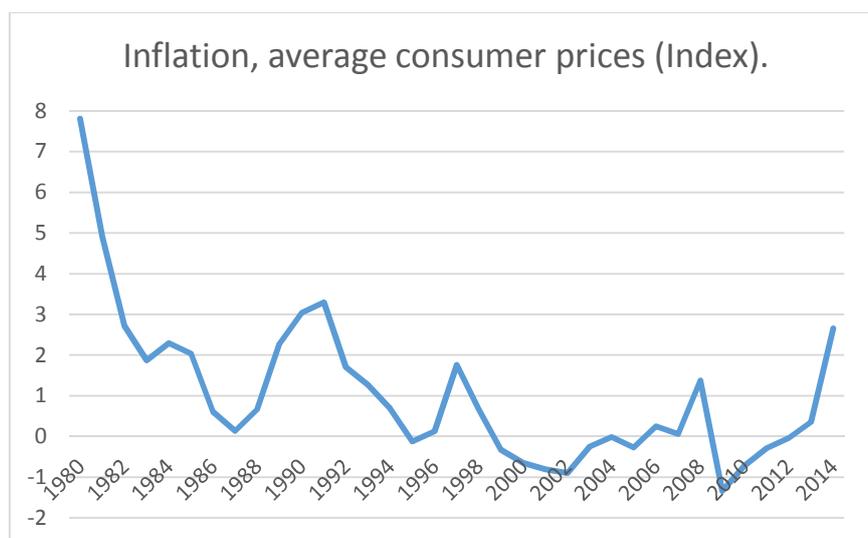
³ <http://www.investopedia.com/terms/j/japaninc.asp>

⁴ Brink Lindsey & Aaron Lukas, *Revisiting the "Revisionists": The Rise and Fall of the Japanese Economic Model*, Trade Policy Analysis No. 3

⁵ Thayer Watkins, *The Bubble Economy of Japan*, San Jose State University



The next attempt to check the slump was to implement structural reforms; but these only led to deflation. Falling prices may sound like a favourable thing, particularly when it comes to the cost of living. However, it is bad news if you have investments, it increases the real price of any debts and can counterbalance the shoots of economic recovery.



In 1998 Princeton economics professor Paul Krugman published a paper entitled *Japan's Trap*,⁶ which recommended embarking on a policy to boost inflation and thus cut long-term interest rates and promote spending.

⁶ <http://web.mit.edu/krugman/www/japtrap.html>

In the early 2000s, the Government embarked on its own version of Krugman's recommendations. The policy came to be called quantitative easing (QE) and was not about printing huge amounts of new money, but in fact increasing the money supply in the banking system by buying bonds and similar products.

The effect of this was some small improvement in demand, however deflation remained. That hasn't stopped the government though, which has continued to implement QE policies ever since. The latest raft of these – nicknamed *Abenomics* – began after Abe's previous election victory in 2012. It constitutes a three-pronged approach (the so-called *three arrows*⁷) of fiscal stimulus, more aggressive QE by the central bank and structural reforms to boost competitiveness. If you thought the Federal Reserve was dogmatic with its insistence on QE, the Bank of Japan is on a different level altogether.

As December's election took place, Abenomics was entering into its third year and yet results have been mixed. In October it was announced that public debt stood at a huge 240% of GDP, as the Bank of Japan buys trillions of yen worth of government bonds through its QE programme.

On the positive side, unemployment figures are coming down – October 2014 figures were 11.4% lower year-on-year. If we were to follow the indicators typically used by economists at the US Federal Reserve, we could also add that prices on the Nikkei 225 rose by 72% between 17th December 2013 and 16th December 2014 – and that's not just a snapshot, prices have risen consistently over the year. However, I don't believe that indicates whether a wide cross-section of the population is wealthier or not. In fact Japanese who live outside the big cities complain that there is no improvement, and perhaps even a worsening, in their standard of living.⁸

Abe may have the comfort of a brand new mandate, but he needs to act quickly to avoid Japan falling further away.

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⁷ <http://lexicon.ft.com/Term?term=abenomics>

⁸ <http://www.economist.com/news/asia/21635609-shinzo-abes-expected-victory-next-weeks-snap-election-will-leave-him-no-excuse-further?zid=306&cah=1b164dbd43b0cb27ba0d4c3b12a5e227>

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