The First Year of Abenomics – Part 2

An Overreliance on Short-Term Economic Stimulus Packages

— Public contributions have been put off to the future.

— Its real value will be tested after fiscal 2014.

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<Key Points>
- Abenomics has clearly achieved significant results in terms of an economic recovery.
- A noticeable slowdown in the growth rate will definitely be seen in fiscal 2014.
- The growth strategy features state control measures.

A year has passed since the administration of Prime Minister Abe Shinzo advocated its economic policies called Abenomics. With the improvement in the economy, the business community is also enjoying a more encouraging business environment. However, many difficult challenges lie ahead.

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Abenomics is generally considered to consist of three arrows: aggressive monetary easing, timely fiscal stimulation, and growth strategies (the narrow view of Abenomics). However, there seem to be certain characteristic developments in the management of the economic policy besides these three arrows. In that regard, this report will call the overall economic policies that the Abe administration has been carrying out the "broad view of Abenomics" and evaluate them.

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Abenomics has clearly achieved significant results in terms of an economic recovery. According to the ESP Forecast Survey (March, 2014), a survey regularly conducted by the Japan Center for Economic Research based on the economic forecasts of frontline economists, all 40 economists surveyed believed that the Japanese economy had bottomed out and started to expand in November 2012. The respondents also believed that the Japanese economy was likely to grow 2.3% (in real terms) in fiscal 2013, rather a high level for the Japanese economy. This shows that, with the emergence of Abenomics, the Japanese economy has started to grow at a particularly strong pace.

The environment for industry and the government has also improved. This appears to be the result of the effects of announcements following the change in administrations, in addition to the impact of the weaker yen and higher stock prices. During the reign of the Democratic Party of Japan, the government initiated a shift in focus from growth to happiness and from companies to lives with the aim of reducing public works, and strove to establish a government led by politicians, not by bureaucrats. Contrary to these initiatives, the Abe administration has clearly expressed its intention to focus on growth, companies, and more public works spending, and to restore its relationships with bureaucrats. In other words, Abenomics, which is considered to be a package of various policies that are friendly to a broad range of companies and bureaucrats, is believed to have brightened the economic environment.

However, the economy is likely to face challenges in fiscal 2014. That's because the growth rate is expected to fall significantly. According to the ESP Forecast Survey described above, the growth rate is expected to fall to 0.7% in fiscal 2014. Because this figure includes the impact of the \5 trillion economic stimulus package that was decided on in October 2013 (which will increase the growth rate by approximately 0.5%), without this impact, the growth rate would have been even lower than the above figure. This shows that, from the perspective of the growth rate, Abenomics will quite likely run out of steam in fiscal 2014.

Factors that will prompt changes in the growth rate in fiscal 2013 and 2014

	Fiscal 2013	Fiscal 2014
Additional public investments in fiscal 2013	Positive impact of approximately 0.5%	Zero or negative
Impact of last-minute demand	Positive impact of approximately 0.5%	Negative impact of approximately 1%
Negative impact from the consumption tax hike		Negative impact of approximately 0.5%
Impact from the \5 trillion economic stimulus package		Positive impact of approximately 0.5%
Forecast growth rates made by ESP Forecast (March, 2014)	2.30%	0.70%
* Forecast growth rates excluding temporary factors	Approximately 1.3%	Approximately 1.7%

Note**:** All figures except for those from the ESP Forecast have been calculated on a provisional basis by the author.

Why will the growth rate fall so much? Because several temporary factors boosted the growth rate in fiscal 2013 to a greater extent than usual, leading the growth rate in fiscal 2014 to fall as a result. First, the extensive public investments that were added and the last-minute demand before the consumption tax hike increased the growth rate in fiscal 2013, so, due to the end of these factors, the growth rate in fiscal 2014 will fall. In particular, the lack of last-minute demand will negatively impact fiscal 2014 growth twice as much as it had positively impacted it in fiscal 2013. The restraints on consumption as a result of the tax hike will also impact the growth rate in fiscal 2014.

The point that is necessary to note is that a slowdown in the growth rate in fiscal 2014 is unavoidable, and also something that must be endured. The fall in demand due to the absence of the last-minute buying spree before the consumption tax hike is actually a simple shift in the timing of consumption, and should end in a short period of time. The impact of consumption restraints is also considered to be unavoidable, given the implementation of the tax hike. Public investment cannot be endlessly increased, either. Excluding special factors, growth rates in fiscal 2013 and 2014 are in the same range of 1.73% and 1.7%, respectively, and it's not necessarily true that Japan's economic strength will decline in fiscal 2014. Despite this fact, in any event the Abe administration is keen to adopt economic policies to stop the slowdown of the abovementioned growth rates.

The government's short-term response to the economy is as described above. So what about its long-term response? Under its growth strategy, the government has started to consider developing a new targeting policy in which it develops certain growth sectors, and creates special national strategic zones, in which it adopts deregulation to create growth in specific areas.

As for fiscal management, the government has disclosed its policies of halving the primary budget deficit to the nominal GDP ratio in fiscal 2015 compared with the fiscal 2010 level, turning this deficit into a surplus by fiscal 2020, and lowering the debt to GDP ratio after fiscal 2020. Of these targets, the government may manage to achieve the fiscal 2015 target, but it still isn't clear how the fiscal 2020 target can be achieved.

In accordance with the preliminary calculations made by the Cabinet Office in January 2014, even if the consumption tax is raised to 10% and the nominal growth rate is around 3%, the primary budget deficit will remain at 1.9% (\11.9 trillion) vs. GDP in fiscal 2020. This situation will further deteriorate after fiscal 2020. That's because, by that time, the government is likely to face a situation in which long-term interest rates will have risen in tandem with higher prices, and no matter how much debts are reduced, interest payments will still increase.

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Based on these analyses, the measures adopted by the broad view of Abenomics have the following characteristics. First, they target short-term goals. The increased public investment prompted by the second arrow will inevitably only have short-term effects. The decision to adopt a \5 trillion economic stimulus package also indicates the nature of measures that focus on short-term results. If a slowdown in growth, which is inevitable in the first place, is avoided through public spending, it is only natural that the fiscal situation will deteriorate. A deterioration in the fiscal situation will harm the credibility of Japanese government bonds in the long run, throwing people's lives into chaos.

There are also similar aspects regarding the country's fiscal policies. According to the Governor of the Bank of Japan, Kuroda Haruhiko, it isn't clear right now whether or not the ongoing aggressive monetary easing will achieve the Bank's goals, but it appears to be very clear that it will be very difficult for prices to easily return to their normal level once they actually start to rise. That's because it will be difficult to sell the government bonds that have been purchased to a significant extent back to the market, and, if they are left unattended, prices and interest rates will increase further. Despite this, there have been no discussions regarding the process for long-term exit strategies.

The second characteristic is that Abenomics consists of a strong belief that the government's initiatives will lead the economy. For example, Prime Minister Abe has asked business associations to raise their workers' wages and asked companies to voluntarily adopt a three-year childcare leave system and appoint more female executives.

Moreover, under its growth strategy, the government has adopted a new targeting policy in which the government first establishes targets, such as the extension of healthy longevity, and then specifies which industries and markets will contribute to the solution for achieving these targets. The national strategic special zones, the featured initiative under the growth strategy, are another program in which the government first establishes a deregulation framework, and then tax systems and other incentive measures are introduced. As a result, the national strategic special zones characteristically involve strong intervention by the government, compared with the existing special structural reform zones, which are mainly comprised of locally developed systems without the need to adopt tax or fiscal measures.

All these measures are based on the precondition that the government is better positioned than companies or markets to accurately determine the ideal style of companies and future leading industries. This could be described as paternalism to use a mild phrase, or state control to use a more direct phrase.

Third, Abenomics is seen as a policy that passes its costs on to future generations. There is the possibility that significant costs will be incurred when exiting the easy monetary policies, and increases in public investment will have to be paid by future generations as the fiscal deficit grows larger. Moreover, it is essential to combine initiatives to reduce social security expenses and raise taxes when dealing with fiscal reconstruction, but no sign of the implementation of these initiatives has been seen. Indeed, any policies that could increase people's burdens have been put off to the future.

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The three characteristics mentioned above are mutually related. The improvement in the economic environment has been attributed to the focus on short-term economic expansion. On the other hand, because the introduction of any policies that would increase people's cost burden has been postponed, the administration has currently been managing to avoid facing a rising disapproval rate. Because the administration has achieved an economic turnaround, the business community has also shown a willingness to cooperate with the administration's paternalistic approach. In this way, Abenomics in a broad sense has been working properly.

However, it is also possible to say that the burdens that have been put off need to be eventually paid up in any event in the future, and a growth strategy that is pursued under state control will increase future uncertainty, contrary to the government's intention. The true value of Abenomics will be tested when an improvement in the economy due to the implementation of policies that focus on short-term returns runs out of steam.

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