

## **Japan: Abenomics with light and shadow**

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For Japan's government, developing the economy is once again to become the top priority "with immediate effect". This was the announcement made by Prime Minister Shinzo Abe at a press conference on 24th September 2015, where he presented a new version of his "Abenomics" economic programme. Although the head of government primarily justified the parliamentary elections held in December 2014 as a way of gaining a new mandate for his economic platform, following his clear victory in the vote, he actually focused mainly on getting new and controversial security legislation through parliament. This legislation was passed by the upper house on 19th September 2015. The time-consuming discussions meant that the government spent significantly less time and energy on implementing its economic programme than in the past.

"Abenomics" in its original form, i.e. the combination of an extremely relaxed monetary policy, flexible fiscal policy and structural reforms, initially received a great deal of approval both at home and abroad. This was largely because it promised to lift Japan's economy out of the lethargy it had displayed for the last twenty years. The policy was not without its successes, as economic output grew by 1.6% in 2013 (adjusted for prices). The pronounced devaluation of the yen helped exports and allowed profits to soar, particularly at large


export-based enterprises. Prices on the Tokyo Stock Exchange temporarily rose to heights that had not been seen for a long time.

However, development has slowed significantly in the meantime. There are now even fears that Japan may have slipped back into recession between June and September 2015. External factors, i.e. the slowdown in global economic growth, a drop in business with the People's Republic of China, as well as the drop in international prices for raw materials, are having a visible effect on Japanese exports. However, the numerous domestic problems are at least as important and are proving difficult to resolve. Japan's population is getting smaller and ageing rapidly. Wages and salaries are only increasing moderately and this is influencing the propensity to consume. In addition, companies are not displaying much in the way of willingness to invest domestically, even when profits are healthy. Many are disappointed that Abe's announced intention to "boldly" reform the outdated structures and deregulate the market has not really materialised as yet.

Most economic researchers do not believe that Japan's economy is likely to suffer indefinitely from the many problems it currently faces. However, even they have downwards corrected their short-term forecasts. The International Monetary Fund (IMF), for example, is only anticipating real growth of 0.6% for 2015, despite having believed in summer 2015 that 0.8% would be achievable. The general sentiment, both at home and abroad, is that the economy is likely to recover in 2016 (e.g. IMF: +1.0%).

### **Abenomics 2.0**

With a revised programme – "Abenomics 2.0" – the Japanese Prime Minister is now determined to take the offensive again. Alt-



though battling deflation and securing economic recovery remain the top priority, social and demographic components are now also being included. By adopting this approach, the government is also reacting to demographic surveys, such as the one published by the Japanese newspaper Nikkei at the start of October 2015: Half of those surveyed here said they considered reforming the pension and social security systems to be the cabinet's most important task. Surveys of this kind are currently gaining even more ground, as a new upper house is to be elected in Japan in the summer of 2016 and Abe requires every vote if he does not wish to abandon his top political goal of revising the Japanese constitution.

Under the heading of "A strong economy", the Prime Minister is putting forward the goal of increasing domestic economic output by around 22% to a nominal figure of 600 trillion yen over the course of the next few years. Although he is not willing to be pinned down on a definite timescale, there has been talk of 2020/2021 in official forecasts issued by the government on mid-term economic development. To achieve the goal, the elements of the first version of "Abenomics" are to be incorporated into this focus.


The second "pillar" of the new "Abenomics" plan is greater support for families. Japan's population is constantly shrinking. To counter this trend, Japanese women are to bear more children. The target in terms of statistical averages is for each woman to have 1.8 children, compared with just 1.4 back in 2013. Abe has also promised that Japan will still have 100 million residents in 50 years. However, current forecasts are a good deal more sceptical: According to figures released by Japan's National Institute of Population and Social Security Research in 2012, there are only likely to be 87 mil-

lion Japanese in 2060. Thirdly, Abe has announced that he wishes to reform social security funds in such a way that nobody then needs to give up work to look after family members.

However, he did not provide any specifics as to how all of these concepts can be combined with one another or even financed in light of the high level of public debt. As such, the reactions to "Abenomics 2.0" from economic and financial circles have generally been rather reserved to date. Although Yoshimitsu Kobayashi, President of the Japan Association of Corporate Executives (Keizai Doyukai), did welcome the government's decision to refocus on the economy, he considers the target of generating a domestic product of 600 trillion yen as merely a kind of "political message" and not a realistic stipulation ("Keizai Doyukai chief: No way to achieve Abe's GDP goal", AJW/Asahi, 30th September 2015).

### **Targeting greater consumption through higher earned income?**

If Japan wishes to grow sustainably, a "positive cycle" needs to be set in motion. When employees earn more, they can consume more. Prices rise and this then motivates companies to produce and invest more. Despite great efforts from the world of politics, the economy was initially rather reluctant to follow this concept of "Abenomics". Although numerous companies increased the bonuses for their employees in 2014, regular wages and salaries only rose very slightly in many cases. This changed somewhat in the 2015 financial year. As the Keidanren employers association determined through surveys in mid-April 2015, staff at 62 large companies with more than 500 employees receive an average of 2.59% more. In absolute terms, this corresponds to a wage and salary increase of 8502 yen per month. This would be the greatest in-



crease in 17 years (Nikkei Asian Review, 17th April 2015). Furthermore, some 461 SMEs are keen to increase wages by an average of 1.87% or 4702 yen per month.

Yet despite this, the wage increases do not reflect the tense situation on the labour market (OECD, Employment Outlook 2015). Finding staff is extremely difficult. At 3.4% (August 2015), the unemployment rate is at a level not seen since 1997. One reason for the discrepancy is that remuneration is only reacting slowly to changes on the labour market in light of the low mobility of the Japanese workforce (OECD, Economic Survey Japan 2015, page 18 onwards).

Set against this background, private consumption and prices are only developing slowly in the hoped and desired direction. Monthly consumer spending in households with more than two people only increased again in May 2015, having previously dropped off sharply following the increase in excise duty from 5% to 8% on 1st April 2014. Consumer prices, which consistently hovered around 2% to 3% above the previous year until the end of 2014, have once again begun to decline since April 2015; in August 2015, the index (excluding fresh foods) even hit -0.1%. Falling energy prices due to mineral oil products becoming more affordable are one key reason for this. Without this effect, the price increase was 0.8%.


Although central bank governor Kuroda stated at the start of October 2015 that Japan had overcome deflation ("Japan out of inflation, Kuroda says", Nikkei Asian Review, 8th October 2015), the inflation target of 2% that was announced at the start of "Abenomics" is still a long way off. According to Takahide Kiuchi, a director at the Bank of Japan, this mark is unlikely to be reached before the start of 2018 (Reuters, 3rd September 2015).

### **Domestic investments: Companies are hesitant**

Although Japan's large companies have in particular been able to considerably increase their revenues over the last three years, among other things due to the devaluation of the yen, they have displayed great reservations when it comes to the procurement of new domestic systems and equipment. For example, the large corporations in the manufacturing industry only increased their investments in the 2014 fiscal year by 3.7% over the previous year, despite having indicated that investments could be increased by as much as 18.5% (corporate survey undertaken by the Development Bank of Japan (DBJ), June 2015, only in Japanese).

The government would love to see companies send out more positive signals and is actively encouraging them to raise their level of commitment ("Government urges businesses to increase investment to lift economy", Nikkei Asian Review, 16th October 2015). For their part, companies make reference to the many structural problems, such as excessively high corporation tax and, most importantly, a lack of workers.

One way the government wishes to lighten the load on the labour market is by integrating more women into the world of work. Although some progress has been made in this regard, the IMF believes that more reforms are needed (IMF Survey - Japan: Ramping up Policy Actions for Lasting Economic Change, 30th July 2015). One approach would be to create more childcare facilities through deregulation. Based on the DBJ survey, the companies themselves believe that the solution to the shortage of workers could lie in hiring more women, as well as older people. By contrast, only a comparatively small number of companies



are currently considering hiring more foreigners, although this is also an issue that is being keenly debated in both the economic and political arena. In addition, many companies in the manufacturing sector are considering investing more heavily in labour-saving equipment.

To strengthen domestic manufacturing, the government's primary objective is to improve productivity in the economy. In this vein, Japan is set to address the "fourth industrial revolution" in far more depth: Keywords here include "Internet of Things", "Big Data", "Artificial Intelligence" and the concept of "Industry 4.0", which has proven very popular in Germany. Since 17th September 2015, the Department of Trade and Industry (METI) has been collaborating with the private sector to draw up a new industrial strategy.

### **Foreign trade: The great opportunities of the Trans-Pacific Partnership (TPP)**

Despite the devaluation of the yen and a global economy that is currently healthy, Japan's exports have displayed comparably poor development over the last few years. In 2014, exports totalled 73.1 trillion yen. Although this figure represents a 4.8% increase over the previous year, it is still some 13% lower than the figure from the record year in 2007. Over the course of 2015, exports slowed even further and in September were only 0.6% above the results from the same month in the previous year. The main reasons for this are the economic weakness of the emerging economies, revolving in particular around China, Japan's largest trade partner. However, the uncertain situation in Europe is also having a negative effect.

In addition, structural problems are preventing Japanese exports from returning to the glorious days of the past. As the IMF

writes, the fact that Japanese companies have been relocating parts or all of their production operations overseas for many years and have been serving the global market from these overseas locations has had a negative impact on exports from Japan itself (IMF Survey, Japan, a.a.O., page 22). This is not likely to change, even if there are still some isolated cases of production actually being moved back to Japan or of investments increasing faster domestically than overseas (DBJ survey).

Following five years of negotiations, twelve states in the Asia-Pacific region, including Japan, the US and Australia, finally agreed on the key aspects of a free trade agreement (Trans-Pacific Partnership (TPP)) at the start of October 2015. Japan's government expects to see great benefit from this. "It is the trump card of the growth strategy," declared Abe after signing the agreement (Japan Times, 10th October 2015).

However, it remains unclear when the agreement is actually to be ratified, as the parliaments of all countries must give their approval and numerous points are still being debated. It has been agreed that customs duties for more than 99% of Japanese industrial products are to be reduced in a step-by-step approach following introduction. This would favour exports in a whole host of sectors, for example in the supply industry or chemicals industry. Japan has also agreed to do the same, among other things for almost 1900 agricultural, forestry and fish industry products.

The TPP is not only important for foreign trade. Even more important for the mid and long-term development of the Japanese economy is the fact that comprehensive deregulation can be addressed with the treaty, for example in the agricultural industry and the services sector. The TPP can also be a great help with regard to the

elimination of tariff and non-tariff trade barriers which impair economic development in many areas. (IMF survey).

## Outlook

One key question that Japan's government needs to answer quickly is how it intends to establish a healthy relationship between growth and financial consolidation. National debt stands at 246% of gross domestic product, and the island state is slipping further and further into the red. Greater tax revenue and spending cuts are unavoidable in this situation. The 2% increase in excise duty to 10% from 1st April 2017 was originally intended for introduction in October 2015, yet Abe decided to postpone this in November 2014 following the highly negative reaction to the first step. Should the economy not significantly improve, a further postponement is also conceivable. The concept of offering reduced rates for individual product groups has also been in discussion since September 2015.

With regard to financial consolidation, the government is keen to present a reform plan within one year, as announced by Abe at the start of October 2015. Changes to social security funds are also to be expected here. For example, the spending increase for providing social security to the aged population is to be capped. According to newspaper reports, the question as to whether the co-payments made by patients when visiting the doctor should be increased is "only in the discussion phase" (Nikkei Asian Review, 8th October 2015).

Observers at home and abroad agree that "Abenomics" can only be successful in the long term if these fine-sounding words are backed up by genuine action (Nikkei Asian Review, 15th October 2015). If this does not happen, weak domestic demand and

incomplete financial and structural reforms could lead to stagnation in the mid-term and raise doubts about the sustainability of public finances (IMF Survey Magazine, Japan). However, this would cause great damage to the country.

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