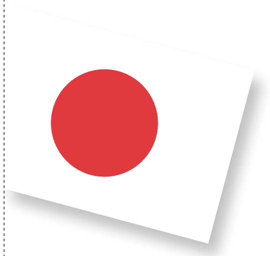

Japan

The world's third-largest economy is heading up, up and away on the back of Shinzō Abe's bold fiscal, monetary and socio-economic policies, says Charlie Metcalfe

The landslide victory of Japan's ruling coalition in the country's upper house elections in July was a big boost to Abenomics, the policy of expanding the economy through aggressive quantitative easing, public infrastructure spending and devaluation of the yen. Since 2005, the merry-go-round of changing prime ministers (there have been eight leadership switches in as many years) had created an absence of political leadership and a vacuum of creative long-term strategic thought. The two-thirds majority achieved by the Liberal Democrat/New Komeito parties in July's election indicates a level of consensus unprecedented in modern Japanese history and makes Shinzō Abe arguably the country's most powerful prime minister in the post-war period.

A nation that normally dislikes rapid change now seems to be crying out for it after two decades of deflation and stalemate. The bureaucracy-heavy, process-oriented government ministries will now step back from their usual obstructionist behaviour, if for no other reason than for fear of being seen as blocking the three-year window that Abe has until the next election.

Abe's speech in London following the meetings of the G8 leaders in June resembled a Reaganite/Thatcherite call to arms, confirming that nothing less than a shock to the Japanese system was required. In his speech, he referred to the three 'arrows' of economic revival, effectively making a comparison with the Yamaguchian legend of the three arrows whereby if three arrows are held together they are said to become unbreakable. In the same way, Abe's three-pronged policy will only work if it is applied in totality.

Now that the election has passed, Abe can be more specific and more assertive about his key social reforms, which constitute the third arrow along with his fiscal and monetary reforms. The Japanese people are already seeing the benefits of these first two arrows – massive and unprecedented fiscal stimulus and an unconventional and aggressive monetary policy aimed at stimulating inflation (Japan aims to double its monetary base by the end of 2014 through quantitative easing). The effects are startling. Data from early August show pipeline inflation (year-on-year) at 3.7% and annualised GDP growth (second quarter) at 3.8%. The economy is suddenly powering ahead faster than any other G8 country. Abe himself has openly said that failure to implement is not an option. He has told the world that his own name and dynastic political reputation is tied to success. Having disappointed once in 2007, when he served as prime minister for less than a year, and with a family tradition steeped in Japanese political leadership, Abe has nailed his colours to the mast. To hear him speak is to hear total conviction.

Country file

Population size in 2012: 127.6 million
Geographical area: 377,923.1 sq km
% growth in 2012: 1.9
Type of govt: Constitutional monarchy, parliamentary system
Official language: Japanese
Capital city & largest city: Tokyo
GDP in 2012: $5.960 trillion
Central govt debt as a proportion of GDP: 230%
Currency: Japanese yen

Super Abenomics

The sudden take-off of Japan's economy is now shifting Abenomics into what we can call Super Abenomics. The vicious cycle of deflation and contraction can be transformed into a virtuous circle of inflation, consumption, investment and growth. This transformation will be aided by the fact that Tokyo has been given the honour of hosting the 2020 Olympics, now considered to be the fourth arrow of Abenomics. Increasingly, there is empirical and anecdotal evidence that the Japanese themselves are taking their leadership revolution as a once-in-a-generation change, to be grasped and enthusiastically nurtured. Providing the government continues along the path of reform, a positive feedback mechanism between the real economy and the markets should ensure that both economic and market expansion are sustained.

The confidence created by the government's stability is already helping to drive consumer demand, which will lead to increased corporate capital expenditure and eventually greater housing investment. With Japanese companies now sitting

TOP TIPS FOR DOING BUSINESS IN JAPAN

1

When exchanging business cards, pay due consideration to those given to you and acknowledge them with respect.

2

When using a translator, speak slower than normal and use shorter sentences to get your point across.

3

If you are invited to a restaurant, assume that the food served will be chosen to suit a Western palate and simply follow the lead of your host.

4

If people in service roles honour you with a low bow, acknowledge this with a polite nod. Westerners are not expected to bow in return.

5

Sometimes 'yes' does not really mean yes. Japanese people may seek to avoid appearing negative to your proposal or idea.

Tokyo's dramatic cityscape, with Mount Fuji towering in the distance, behind the commercial area of Shinjuku

on record cash reserves of ¥225 trillion, according to the Bank of Japan, they can afford to spend. While the government's 2% inflation target is a slogan, it is designed to change people's expectations, shock them into action and get cash moving through the economy. When one factors in the $15 trillion in savings held by Japanese households (half of which earns nothing sitting on deposit), the potential impact of this 'wall of money' is monumental.

Interestingly, the special interest groups and low tax campaigners – which many feared would be insurmountable barriers to the implementation of structural reforms – are weakening in the face of the growing coalescence around a desire to see full execution of the reform agenda. Japan's touted 3% VAT hike, to be introduced next April, is now all but a done deal. Meanwhile, the bold approach taken by Haruhiko Kuroda, the governor of the Bank of Japan, has earned him credibility and plaudits, so that the planned tax rise is no longer considered the bogey that once drove a prime minister from office.

Other changes will come following the resumption of Trans-Pacific Partnership (TPP) negotiations in July. The TPP is a free trade agreement that aims to further liberalise the economies of the Asia-Pacific region. If Japan ends up participating in the TPP by the end of the year, some of its protected industries, such as farming, will be affected. And if Japan does become a member of the TPP, the geopolitical ramifications for the region – especially *vis à vis* China – will be immense. Super Abenomics is as much about a pivot in the regional balance of power as it is a domestic economic strategy. Again, like Reaganomics and Thatcherism, Super Abenomics – with the support of the US – may fundamentally change the position of Japan on the global scene.

Back on the domestic front, Super Abenomics is intended to underpin some bold socio-economic policies. In 1995, Japan's working population peaked at 87 million. That number is set to fall to 44 million by 2060. Labour market and immigration reforms, coupled with the creation of nearly 500,000 new day care places by 2018, will enable women to play a larger role in the workforce and help to offset the challenge of a declining working-age population. Likewise, restarting domestic nuclear power plants will create cheaper energy and dramatically reduce the trade deficit. Japan is also likely to permit the establishment of a controversial gambling industry and large-scale casino resorts, on top of kick-starting a $15 trillion infrastructure capex programme, which will add to economic regeneration.

Government policies, coupled with the fact that Japan's banking sector is in excellent health with robust capitalisation ratios (despite years of economic difficulties), mean that the country's economy is well primed to turn. Years of bank and corporate retrenchment and managed decline are coming to an end. Critics of optimistic forecasts have pointed out that the significant government expenditure that the third arrow may require could further increase Japan's already high debt-to-GDP ratio (its national debt is ¥1 quadrillion, according to its finance ministry – more than twice the size of its GDP). The counter argument is that while debt will no doubt increase, so will GDP – potentially at a faster rate. And since over 90% of Japanese government bonds are in domestic ownership, the success of Super Abenomics will not depend upon the support of participants from international bond markets.

Now that Abe has an approval rating that will allow him an unfettered three-year period of bold execution and a determination to fulfil his reforming zeal, we can hope that crises will stay away and Super Abenomics will become a much longed-for solution for Japan.

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