Abenomics: Off target
By Jonathan Soble

After the excitement about the BoJ’s stimulus, the economy has shown virtually zero real growth

It is never a good sign for a world leader when golfing becomes an object of scandal.

As Barack Obama faces criticism in the US for playing while racial protests roil Ferguson, Missouri, and Islamist fanatics revel in the beheading of an American journalist in Syria, Shinzo Abe, his Japanese counterpart, is also under fire for golfing during a crisis.

In Mr Abe’s case, the charge is that he went ahead with a game after receiving reports of landslides in Hiroshima prefecture that have killed more than 50 people amid a torrential spate of rain. Yet like the attacks on Mr Obama, the criticism – opposition parties have called for a parliamentary inquiry – feels like a symptom of deeper vulnerabilities: the once untouchably popular architect of “Abenomics” is having a humbling summer.

There are several reasons why. Mr Abe has spent political capital freely on causes that he believes are important for Japan but that are unloved by the public, such as peeling back constitutional limits on the military and restarting nuclear power plants idled after the 2011 Fukushima meltdown.

A bigger reason, though, may be dissatisfaction with Mr Abe’s economic policies – previously his greatest political asset. Even before a jarring 6.8 per cent annualised contraction in second-quarter gross domestic product was confirmed by government data this month, doubts were growing about the premier’s campaign to stimulate growth.

The normally Abe-supporting Sankei newspaper declared a “shadow” over Abenomics in July, after its pollsters found more people disapproved of the government’s handling of the economy than approved. In multiple opinion surveys, Mr Abe’s overall support stands at less than 50 per cent, down sharply from the 70-plus per cent ratings he enjoyed for most of his first year in office.

“Abenomics is in trouble,” says Robert Feldman, chief Japan economist at Morgan Stanley MUFG, who points to a loss of confidence among investors as well as the general public. Although some economic indicators have started pointing upward after the bruising...
second quarter, “the pace is too slow to warrant hope of a sharp rebound”, he worries.

The most commonly heard question about Abenomics used to be whether Mr Abe could carry out growth-enhancing structural reforms – the so-called third arrow of his three-point revival strategy. It still has not been answered: the record so far looks like a mix of achievements, compromises and missed opportunities. In any case, even optimists concede deregulation and other initiatives will take years to implement and even longer to have any effect on growth.

Now scepticism is being trained on what was thought to be Abenomics’ core competency: goosing the economy through fiscal and, especially, monetary stimulus.

The problem is not so much the latest GDP data – a downturn had been universally expected due to an increase in the national sales tax that took effect on April 1. And while the contraction was bigger than experts had initially predicted, so was the surge in economic activity in the quarter before the rise. Essentially, a lot of people moved their spending forward to beat the deadline.

More troubling is a broader economic picture that has some people raising concerns about stagflation. Once the tax-related GDP gyrations are averaged out, the economy experienced virtually zero real growth between mid-2013 and mid-2014. Meanwhile, aggressive monetary stimulus from the Bank of Japan has stoked inflation. Despite a slight pick-up in wages in June, a larger increase in prices meant that real incomes were 3.2 per cent below what they were a year earlier.

Even Abenomics’ sponsors admit things are not going exactly to plan. Inflation per se is not what bothers them, since escaping persistent consumer price declines was a central goal of their strategy.

But the virtuous circle of “good” inflation that they promised, with price rises feeding through to comparable increases in incomes, has looked distinctly lopsided, with a bulge on the prices side that is making people poorer.

Haruhiko Kuroda, the BoJ governor, addressed the issue at a meeting of central bankers in Jackson Hole, Wyoming, at the weekend. He called the failure of wages to be swept up in his monetary deluge “a troublesome problem” and said Japan was only “halfway” to beating deflation. But he predicted incomes would catch up once businesses and workers came to accept rising prices as Japan’s new normal.

“Once the bank has succeeded in firmly anchoring inflation expectations at 2 per cent, this could provide the basis on which wage negotiations between management and labour are conducted,” he said. On that view, Abenomics is simply passing through an awkward adolescence – but one that even Mr Kuroda conceded might persist for “some time”.

Certainly, the softness in wages looks like a mystery. Corporate profits are at record highs and Japan is in effect at full employment, with joblessness comfortably under 4 per cent – ideal conditions in which to demand higher pay. Yet while economists expect incomes to pick up, structural issues could limit how far they rise.

“Labour market dynamics appear to have changed in Japan since the current recovery began around November 2012,” says Kyohei Morita, an economist at Barclays. “In part, this is a matter of demographics.”

In short: baby boomers are retiring and taking the best-paid jobs with them. Their replacements are far more likely be part-timers, contractors or other lower-wage workers, including their own offspring. A wave of mothers born during the baby-boom “echo” is re-entering the workforce, mostly for less pay, as their youngest children reach school age.

Such shifts are creating a paradox in which the pay of those in work is rising across the economy yet average incomes are stagnant because the highest-paid jobs are disappearing.

Structural changes are impeding Abenomics elsewhere. Giving big exporters such as Toyota and Sony a competitive boost by weakening the yen used to be a reliable way to stimulate Japan’s economy, but a decline of more than 20 per cent in the currency under Mr Abe has not done the trick this time round.

That is in part because Japan became a net importer after Fukushima, owing to increased purchases of foreign oil and gas. But exports have not grown as expected either. Many believe that is because companies make more of their products outside Japan – in the case of carmakers, for instance, foreign production volume has risen by 80 per cent since the last comparable period of yen weakness almost a decade ago, while domestic output has declined.

Mr Abe must decide this year whether to go ahead with another sales tax increase in October 2015, the
He can stop it if he deems the economy too fragile. But the combination of an expected GDP rebound in the third quarter and continued political pressure to tackle Japan’s debt – not least from the powerful finance ministry – has many betting that he will still give the green light.

In a survey published by the Nikkei business daily on Monday, just 30 per cent said the next rise should go ahead, down 6 points from last month.

The next rise is smaller – 2 percentage points against 3 percentage points in April – but the political stakes look higher: Mr Abe must face voters again by the middle of 2016.

**Testing times**

Important events for Mr Abe and Abenomics through the end of 2014:

September: Crucial advisers will keep their cabinet jobs but trouble could come from those who are passed over. Party discipline has been unusually strong under Mr Abe but there is a long waiting list for posts, and those who end up disappointed could feel freer to criticise the administration.

September: Tokyo and Pyongyang are negotiating the return of Japanese citizens kidnapped by North Korea in the 1970s and 80s. If a deal is struck and Mr Abe jets to Pyongyang to “bring back” Japanese abductees, his popularity could surge.

October and November: Elections will be held in the disenchanted regions of Fukushima and Okinawa. Fukushima for the disruption from the 2011 nuclear accident and Okinawa for an unpopular Abe-backed plan to relocate a US military base. Defeat of Liberal Democrat-backed candidates could be taken as a rebuke of the prime minister.

November: Mr Abe is trying to convince Xi Jinping, China’s president, to meet him on the sidelines of an Apec gathering in Beijing. Japan-China relations are at a low point over historical and territorial disputes, and a meeting – it would be their first – could defuse tensions that have hurt business as well as diplomacy.

December: A second sales tax rise, from 8 to 10 per cent, is planned for October 2015, and Mr Abe must decide this year whether to let it happen or stop it on the grounds that the economy is too fragile. Despite the disruption caused by the April rise, the betting is still that he will give the green light.

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