As Japan Falls Into Recession, Europe Looks to Avoid It

By LIZ ALDERMAN and JONATHAN SOBLE   NOV. 17, 2014

PARIS — Japan looked like the model for economic revival. Growth was back on track. The stock market was surging. Inflation, which had eluded Japan for decades, was even returning.

But Japan’s grand economic experiment, a combination of fiscal discipline and monetary stimulus, is collapsing. On Monday, the country unexpectedly fell into recession, a downturn that has painful implications for the rest of the world.

Japan’s unorthodox strategy was supposed to offer a road map for other troubled economies, notably Europe. Fiscal belt-tightening and tax increases, while leaning on the central bank to pump money into the economy, was expected to help overcome a malaise.

The formula, though, has failed to ignite a meaningful recovery in Japan — and has even added to its woes. Europe must now decide whether to follow Japan’s lead by injecting more money into the economy, as the region’s central bank considers a similarly aggressive bond-buying campaign known as quantitative easing. And the United States, which just ended its own six-year stimulus effort, doesn’t offer much of a cushion should other economies stumble further.

“The United States is about the only growth beacon in the global economy right now, and that is not a very nice place to be,” said Jacob Funk Kirkegaard, an economist at the Peterson Institute for International Economics in Washington. “An American growth pickup is positive, but it looks like the rest of the world is again going to be relying on the U.S. as a consumer of last resort.”
Japan’s prime minister, Shinzo Abe, won power two years ago on a promise to pull the economy out of nearly two decades of corrosive wage and price declines. The initial response of both Japanese consumers and global investors was ebullient: The economy surged during the first few months of his administration in early 2013, and Japanese stock prices soared.

Mr. Abe’s program, called Abenomics, at first relied on a one-two punch of government spending and financial support from the Bank of Japan, the country’s central bank. The bank sharply increased its program of buying government bonds and other assets, similar to the stimulus effort recently ended by the United States Federal Reserve.

In some ways, Japan has been more aggressive than the United States. Its bond-buying program, which was expanded last month, is now bigger relative to the size of its economy than the Fed’s was at its peak.

Much of the enthusiasm for Abenomics has evaporated, however. Some economists blame a lack of action by Mr. Abe’s government in areas beyond pump-priming stimulus, such as deregulation and trade.

A turn toward tighter fiscal policy has taken the majority of the blame. Government data released on Monday showed that the country unexpectedly fell into recession in the third quarter, hampered by rising sales taxes that have discouraged consumers from spending. Mr. Abe is expected to shelve a second tax increase, lest the Japanese economy and consumer confidence erode further.

“What Japan shows is that if you have longstanding economic stagnation, having an aggressive monetary policy and even sizable fiscal reform is not going to work without deep-rooted structural reform,” Mr. Kirkegaard said. “The experience of Japan must be at the top of the minds of European leaders.”

High on the agenda is whether Europe should pursue large-scale purchases of government bonds, so-called quantitative easing.

The European Central Bank recently said it was prepared to take additional steps to revive the struggling economy, by lending more to banks and buying bonds backed by mortgages and other assets. Critics say the bank has not acted nearly aggressively enough to help revive growth, which has essentially stagnated.

The similarities between the two places is strong, which has prompted some economists to wonder whether Europe will turn into another Japan.
Europe and Japan have stuck with various versions of austerity, neither pushing ahead with deep-seated changes to their economy that analysts say are needed to revive long-term growth. Europe is also increasingly facing down the Japan-like specter of deflation as a recovery lags.

The political debate is also developing along the same lines.

A number of countries, led by France and Italy, recently balked at European Union requirements to doggedly adhere to fiscal targets and eschew stimulus spending that some economists say is critical. Some economists say that Japan’s situation only adds to the argument that fiscal belt-tightening, while sometimes needed to mend a country’s finances, hurts growth when an economy is in decline.

European politicians now widely blame austerity policies for delaying a return to growth, but Chancellor Angela Merkel of Germany is wary of loosening requirements for fiscal discipline after runaway debt levels and high deficits helped generate the eurozone debt crisis. The region’s leaders are scheduled to meet in early December to discuss further strategies for growth.

“The main implication is we are beginning to see what it might look like in Europe if we go down that road,” said Bart van Ark, chief economist for the Conference Board, referring to Japan’s recession.

“Europe has the potential to become a second Japan in terms of significantly slowing demographics, and weak per capita income growth,” he said. The Japanese experience shows that efforts to keep the economy afloat with more inflation and growth don’t help sustain higher growth in the long term. What’s needed, he said, is a “reform agenda, and that is a very difficult strategy” for politicians to pursue in any country.

The problems in Europe and Japan put additional pressure on the United States and China, which face their own headwinds.

The United States increased at a healthy 3.5 percent annualized pace in the third quarter, and unemployment has fallen below 6 percent. But troubling signs remain, including less-than-robust consumer spending and a lift from military spending that may be temporary.

China, too, is under pressure. Growth in China has cooled to 7.3 percent. While that is the envy of many countries, a slow clip by Chinese standards has raised questions about the nation’s economic health.
The disparate issues — a weak recovery in Europe, slowing growth in China and other emerging markets, as well as Japan’s failure to sustain any sort of a turnaround — have rung alarm bells in Washington.

Last week, Treasury Secretary Jack Lew said in a speech in Seattle that the United States was increasingly being relied upon to perform as locomotive for a global recovery.

“But the global economy cannot prosper broadly relying on the United States to be the importer of first and last resort, nor can it rely on the United States to grow fast enough to make up for weak growth in major world economies,” he said.

Liz Alderman reported from Paris and Jonathan Soble from Tokyo.

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