
JAPAN AFTER THE ELECTION — FOCUS ON ECONOMY, NOT CONSTITUTION

Jesper Koll — Senior Advisor

07/23/2019

Japanese prime minister Shinzo Abe and his ruling coalition won a very comfortable majority, but fell short of gaining the two-thirds supermajority required for fast-track constitutional reform, in Sunday's Upper House election. In our view, this is good news for financial markets as "Team Abe" will now stay focused on economic policy to maintain a strong "feel-good" factor, rather than divert even more political capital (and parliamentary time) to preparing to revise the constitution.

The record-low voter turnout—less than 50%—and the fact that the Liberal Democratic Party (LDP) returns to Parliament with fewer seats than it controlled before the election both suggest that PM Abe will have to work harder to get Japanese people excited about his policies and future vision. Make no mistake: In Japan, complacency is far more popular than Western-style populism.

Lack of credible (or unified) opposition is probably a key political factor behind his victory and the complacency that we expect. There appears to be no alternative to the LDP and Abe. On the economic policy front, the combination of record-high corporate profits, record-low unemployment and a steadfast rise in the purchasing power of the people has given "Team Abe" some of the most enviable leadership credentials in the [G20](#). There's no need to fix something that is not broken.

Of course, Prime Minister Abe was quick to comment after the election that, in his view, the popular mandate for constitutional reform remains strong. He still would like to try to complete the process during his premiership. However, in my view, the combination of the low voter turnout and the LDP's relative (albeit modest) losses in the Upper House election suggest concrete progress is unlikely to be made in the next one or two sessions of Parliament.

Constitutional Reform Endgame

For Abe's constitutional reform endgame, it is possible that he will eventually stake his legacy on the issue and call a snap election in the Lower House. In my view, this is a risk scenario to consider seriously for sometime after the 2020 Tokyo Olympics (September 2020) and before Abe's term as LDP President ends (September 2021). Between now and September next year, Team Abe will stay focused on the economy, particularly immediate and urgent challenges that exist.

Here are the key signposts and challenges immediately ahead for Japan:

- **Consumption tax freeze at 10%**

PM Abe made an election pledge of freezing the consumption tax at 10% for at least 10 years (after the tax goes up to 10% on October 1). In the coming months, it will be important to see repeated confirmation of this new policy, with both Ministry of Finance (MOF) and broader LDP next-gen leaders following PM Abe's lead. Signs of MOF

officials contradicting Abe's pledge would be a potential red flag for post-Abe LDP resolves.

- **Japan-Korea trade war escalation**

The imposition of tight controls for essential high-tech components on Japanese exports to Korea has sparked fears of not just short-term supply chain challenges, but potential further escalation of trade disruption between the two most advanced countries in Asia-Pacific. If the free flow of goods can no longer be taken for granted across Asia, both Asia and Japan markets may be forced to reprice required [risk premia](#). It is not easy to see how much political capital Team Abe will be prepared to invest in creating a resolution given the broad-based loss of trust between both nations.

- **Response to U.S. Weak Dollar Policy**

If U.S. monetary policy begins to shift toward outright stimulus, Japan will need to formulate a response. Cooperation between the MOF and Bank of Japan (BOJ) is running smoothly, and coordinated action involving added [monetary easing](#) via increased government bond issuance (i.e., a de facto monetized extra budget) is one possibility. The BOJ extending the [duration](#) of its [yield curve](#) cap is another (i.e., moving to cap the 15-year or 20-year yield, rather than just the current 10-year). We agree with Governor Kuroda that the BOJ has plenty of policy ammunition left, though we think markets still underestimate Japan's special coordination powers, including the ability to link monetary action directly to added fiscal expansion. After the election, Abe made clear that there is plenty of new potential fiscal power available to boost domestic demand, should further economic momentum be lost.

- **Revival of Pro-Growth Structural Reform Policies**

PM Abe does remain committed to promoting structural reform in general, and entrepreneurship and innovation policy in particular. I am hopeful that added tax incentives for venture capital, special economic zones and other measures to boost entrepreneurship will reemerge at center stage in the policy debates running up to the creation of next year's budget. In addition, new tax incentives for retail and pension investors to rebalance portfolios toward higher domestic equity allocations are poised to be forthcoming for 2020-21.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Kara Marciscano, Jianing Wu and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

G20 : Group of 20 of the world's largest economies that meets regularly in order to coordinate global economic policies.

Risk premium : Equity investments are not risk free, but it is thought that investors buy stocks because the returns they expect are high enough to allow them to take the risk.

Monetary easing policies : Actions undertaken by a central bank with the ultimate desired effect of lowering interest rates and stimulating the economy.

Duration : A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

Yield curve : Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.