

JAPAN MONETARY POLICY OUTLOOK— ONE DREAM, ONE TEAM

Jesper Koll — Senior Advisor

09/21/2015

Pro-growth economic policy making is poised to make a comeback in Japan over the coming six to eight weeks, in our view. With the controversial new security bill now largely in the rearview mirror, “Team Abe”¹ will want to re-establish economic policy-making credentials as quickly as possible. The sense of urgency is heightened by the fact that both domestic and external demand has fallen below expectations in recent months. Specifically, the Cabinet Office now estimates that Japan’s [“output gap”](#) was stuck at a deflationary -1.6% between January and March 2015, and the 1.6% contraction in [gross domestic product \(GDP\)](#) from April through June must have pushed the output gap further down the deflationary pit.² **Yes, Fiscal Policy** The first focus of counter-policy is likely to be added fiscal stimulus. Here, “shovel-ready” public works projects have recently returned center stage due to various typhoon-damage related rebuilding needs. Specifically, the outdated and failing river dam infrastructure in many regions has become a bit of a national embarrassment, as has the growing awareness of outdated and increasingly dangerous road and rail tunneling in many of the regional economies. All said, a ¥2–3 trillion boost to public works via a supplementary budget is probably in the cards. Add to that increased spending for more general regional economic development and support for the elderly, and we are likely to see a headline supplementary budget of at least around ¥5 trillion, i.e., around 1% of GDP. **Yes, Monetary Policy** The Bank of Japan (BOJ) is very likely to complement the supplementary budget and increased public spending with stepped up liquidity provisions. A de-facto matching of the increased [fiscal deficit](#) by added BOJ bond purchases is very likely, in our view. Philosophically, the BOJ, in our view, is very much opposed to using [monetary stimulus](#) as the only added [reflation](#) tool, but it is not opposed to support a reflationary policy push in combination with increased public spending. Increasing debt monetization for specific projects is welcome, but not for general budget overruns. In our view, the key to Team Abe’s credibility rests exactly here: to regain confidence and credibility among market players, they must demonstrate that both the Ministry of Finance and the BOJ are indeed working toward the same goal of an all-out pro-growth policy. This is the real challenge for Team Abe in the coming four to six weeks: one team, one dream. **Timing & Catalysts** Timing upcoming policy events is relatively straightforward. First of all, Prime Minister Abe is due to make several presentations to U.S. investors while in New York for the UN General Assembly. Then, from mid-October on, the basic platform of a supplementary budget is poised to be presented. Then, on October 30, the BOJ will present its semiannual review of its board members’ central tendency forecasts (which is likely to result in further revisions to both the [Consumer Price Index \(CPI\)](#) and growth outlook). Whether the BOJ will act as early as October 30 depends primarily on the state of the supplementary budget debate. In addition, international money flow developments in response to changing Federal Reserve policy will also be monitored carefully, although the BOJ debate’s main focus is domestic, in our view. In short, we think it likely that added stimulus from both money and fiscal policy will be in place by the end of November. Importantly, the coming policy activism in Japan is an extra effort, over and above the normal budget and tax policy cycle that culminates in the presentation of a draft budget by the end of December. Here, a cut in corporate taxes (expected to be around 3 percentage points to basically 29%) is the hallmark for investors, effective from next fiscal year. For Team Abe, the key issue now is to demonstrate a sense of urgency to get growth going again, and that requires the supplementary action outlined above. The coming six to eight weeks are key, in our view. **Unless otherwise stated, all sources are Bloomberg, as of 9/17/15.** ¹Refers to Japanese prime minister Shinzo Abe and his supporters. ²Source: Japan’s Cabinet Office.

Important Risks Related to this Article

Investments focused in Japan increase the impact of events and developments associated with the region, which can adversely affect performance.

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

Output gap : The difference between actual GDP or actual output and potential GDP or potential output.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Fiscal Policy : Government spending policies that influence macroeconomic conditions. These policies affect tax rates, interest rates and government spending, in an effort to control the economy.

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

Fiscal deficit : Situation where government spending exceeds government revenue.

Monetary stimulus : refers to attempts to use monetary policy like lowering interest rates or quantitative easing to stimulate the economy.

Reflation : The term is used to describe the first phase of economic recovery after a period of contraction. This period is typically characterized by the act of stimulating the economy through accommodative central bank policies and reducing taxes, to bring growth and inflation back up to the long-term trend.

Consumer Price Index (CPI) : A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.