
RISING JAPAN METABOLISM—BETTER GROWTH, TOKYO BACKLASH AND RISING GEOPOLITICAL TENSIONS

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07/07/2017

The news cycle from Japan has picked up this week. There is more evidence of an accelerating business cycle being compounded by a voter backlash against Prime Minister Shinzo Abe's ruling party in the Tokyo Metropolitan Assembly election held Sunday, as well as growing evidence of rising geopolitical tensions in North Asia (with President Trump calling both PM Abe and China President Xi Jinping over the weekend). While the rising geopolitical tension adds an unfortunate new layer of complexity, the impact of the latest developments adds to our conviction that policy complacency is about to turn into pro-growth, pro-reform policy activism in Japan. Specifically, we expect rising evidence of added [fiscal stimulus](#) to be presented in coming quarters, with [monetary policy](#) following suit because of the de facto monetization of the added [fiscal deficit](#).

Capex Cycle Accelerating

On the data front, the latest TANKAN survey confirmed a [general upward trend in business conditions, led by blue-chip exporters reporting a larger-than-expected uptick](#). More importantly, business investment plans were revised sharply upward, from growth of .6% one quarter ago to growth of 8% expected now.¹ If, as we suspect, this will lead to a pickup in machinery orders growth in coming months, confidence in Japan's economic and profit growth performance potential will rise, in our view. Bottom line: today's TANKAN suggests 2017 and 2018 [gross domestic product \(GDP\)](#) growth could be closer to 2% to 2.5% rather than the 1% to 1.5% expected currently by the analyst consensus.

Tokyo Voter Backlash a Wake-up Call for PM Abe

On the political front, the Tokyo Metropolitan Assembly election was as much a victory for the charismatic Tokyo Governor Yuriko Koike as it was a loss for PM Abe's ruling Liberal Democratic Party (LDP). Governor Koike's newly established Tokyo Residents First party and its coalition partners won 79 of the 127 seats of the Tokyo Assembly, leaving Abe's LDP with only 23 seats for its worst showing in postwar history.² A combination of factors drove this result, with the LDP ensnared in a series of scandals. While the substance of these allegations is generally viewed as relatively minor in nature, even stout supporters of "Team Abe" admit that the way LDP leadership has dealt with them revealed a certain "arrogance of power." The Tokyo voter backlash confirmed that, after four years in power, the ruling LDP may have become a little complacent and insensitive to the demands of its true power base, the Japanese people. For PM Abe, the loss in Tokyo serves as a welcome wake-up call and, in our view, pro-growth policy activism is likely to have an effect in coming months.

Pro-Reform Agenda Gains Local Credibility

Realistically, the Tokyo Metropolitan Assembly has very limited real political clout. For example, most of the Tokyo budget is hostage to central government top-down decision-making, and the Tokyo government has de facto zero power of tax and tax-incentive policies. The principal power comes in the form of rules and regulation implementation

with important implications for things such as “ease of doing business” and “quality of life.”

Specifically, Governor Koike’s push to revitalize Tokyo as a global financial center may now become a more and more credible force in setting the national agenda. In short, Governor Koike’s landslide victory is likely to raise pressure on PM Abe to re-accelerate the structural reform agenda.

Tokyo Is Tokyo, NOT Japan

Having said this, from a macroeconomic policy perspective, Tokyo has de facto zero influence on national tax and spending policy. This gets decided by the National Diet, where PM Abe’s LDP controls a supermajority of two-thirds of all seats. There is little doubt that the historic loss in Tokyo will force the LDP to reconsider its policy priorities. However, a serious challenge to PM Abe’s rule is very unlikely, in our view.

Time Is on Abe’s Side

Most importantly, the political calendar is very much on PM Abe’s side. [He faces re-election as LDP president in September 2018](#) and does not have to call another general election until December 2018. This leaves ample time to re-engage in more proactive policy management to convince the Japanese people that his policy leadership vision for Japan is indeed in Japan’s best interest.

The trick will be, in my view, to show greater humility and demonstrate to the people that his structural growth and deregulation policies are indeed focused on empowering the people and new entrepreneurs, and that his vision for a new Japan constitution is not just a personal vanity project but indeed is in the best interest of Japan’s future.

All said, the combination of the rising visibility of economic growth acceleration combined with a political wake-up call against complacency makes me more confident that pro-growth structural reform initiatives and pro-growth fiscal policy is back on the agenda in Japan.

¹Bank of Japan.

²Japan PM’s Party Suffers Historic Defeat in Tokyo Poll, Popular Governor Wins Big,” Reuters, 7/3/17.

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DEFINITIONS

Fiscal Stimulus : Using fiscal policy as a tool to provide economic growth.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Fiscal deficit : Situation where government spending exceeds government revenue.

Capex : Funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment. This type of outlay is made by companies to maintain or increase the scope of their operations.

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