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# SAYONARA ABENOMICS? NOT SO FAST

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03/14/2018

Japan's political stability in general, and Prime Minister Shinzo Abe's strong grip on power in particular, have been the centerpiece of the "[bullish](#) Japan thesis" for many investors. "Team Abe" has had a fundamental pro-growth and pro-business bias and, in the final analysis, has had a good track record of getting things done. Unfortunately, in recent days, the "Moritomo affair" has evolved in a way that could force an end to Abe's undisputed premiership. While we do think Abe is more likely to survive than not, the threat is serious enough to force us to think about possible post-Abe Japan scenarios.

First, the good news. It is a fact that there are no major economic policy issues on the agenda. Fiscal policy is on track for a modest boost to domestic demand—a supplementary budget got ratified in parliament earlier this year, and the FY2018 main budget was approved in the lower house on February 28 (which means it will automatically become law at the start of the new fiscal year on April 1, even if upper house deliberations get delayed). There is no risk of government shutdown. And [monetary policy](#) is also on a stable track, with Bank of Japan Governor Haruhiko Kuroda and two new deputies already past their parliamentary approvals.

For Team Abe, the big economic agenda item for 2018 was labor market reform, but that was killed off by internal Liberal Democratic Party opposition. Apart from this, the agenda is empty. Sad but true—from an economic policy perspective, the fact that "[Abenomics](#)" has no concrete agenda at the moment actually minimizes the possible damage to the economy should the government fall or be disrupted. In short, Japan's economy is on autopilot.

The bad news is that, yes, Team Abe will be a nearly impossible act to follow (from an investor's perspective). Should Abe be forced to resign—and, at this stage, I don't think he will have to—the LDP is bound to elect a de facto caretaker government, elected from among the LDP members but not legitimized by the public (there is no need to call a general election).

Unlike Abe, who, together with a select group of his closest friends, was groomed for years by a powerful combination of big-business leaders, media tycoons and elite technocrats, the immediate next generation of LDP leaders has neither strong backers nor trustworthy power networks for support.

Remember, Team Abe was created as a counterattack to win power back from the Democrats at home and to win back the trust of America as a worthy strategic partner. China had just began its territorial claims on the Senkaku Islands. It was no accident that, once elected, Abe launched an aggressive marketing and branding campaign, called Abenomics, that captured the imagination of the world and immediately implemented a strategy of personnel changes in the key ministries.

Against this proactive build-up and broad-based backup, Abe's successors look weak, lacking not just an agenda but also credible networks into Japan's private sector power elites. Unlike Abe, their main advisers are technocrats, not private sector leaders and entrepreneurs.

Specifically, the most likely challengers/successors from within the LDP are Fumio Kishida, 60 years old, and Shigeru Ishiba, 61. While Ishiba is a former minister of defense and strong advocate for constitutional reform, Kishida is a former minister of foreign affairs and currently serves as the head of the LDP's policy research council. Neither is known for

having strong opinions or ideas for economic policy, and, more importantly, they are known to rely primarily on elite technocrats for economic policy advice.

Meanwhile, speculation of a possible new-generation samurai like ex-PM Junichiro Koizumi's son Shinjiro Koizumi, 36, emerging is, in my view, premature. Abe's long-term rule has left many old-generation LDP members deeply entrenched.

So in my view, a forced breakup of Team Abe would most likely leave Japan without a pro-growth and pro-business agenda. The base case would be a technocratic caretaker agenda focused on winning support from Japan's vested interest groups rather than a new agenda capable of capturing the imagination and dreams of global and local investors.

### **Why Will Abenomics Survive?**

The simple answer is because of the LDP's Machiavellian instincts. The ruling party knows it is not ready for a post-Abe world, it knows that the current two-thirds supermajority in parliament will be lost if Abe leaves now and, in my view, the main contenders are savvy enough to not want to start from a weak position. Of course, all bets are off if Abe were to be found guilty of having ordered the cover-up that officials of the Ministry of Finance admitted to in recent days.

However, if the technocrats acted on their own, perhaps intending to try to please superiors by removing possibly embarrassing "facts"—a practice called "sontaku" (pleasing your superior by "following an order that has not been given") in Japanese culture—the damage would be a confirmation that Japanese politics and administration is in urgent need of its own governance reform. Sontaku may be tradition, but it goes counter to the most basic principles of good governance, accountability and transparency. Perhaps ironically, Abe's deep-rooted belief in the supremacy of Japanese traditional values may save him this time, but ultimately the sontaku problem will have to be resolved to rebuild trust in his government.

Investment implications: Although more than a tempest in a teapot, the Moritomo affair only undermines the structural bull case for Japan if Team Abe were to be forced into a premature exit. This, in my view, is unlikely at this juncture.

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## DEFINITIONS

**Bullish** : a position that benefits when asset prices rise.

**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.

**Abenomics** : Series of policies enacted after the election of Japanese Prime Minister Shinzo Abe on December 16, 2012 aimed at stimulating Japan's economic growth.