

TEN SURPRISES FOR JAPAN IN 2019

Jesper Koll — Senior Advisor
01/04/2019

2019 is likely to be a good year for Japan. While worries about U.S. and China recessions create global headwinds and uncertainty, domestic Japan is well placed to decouple from the global cycle and deliver rising employment and increased purchasing power for its people. However, there are bound to be surprises—that is, scenarios not captured by experts' current quantitative models or the crowd's consensus opinion. For Japan in 2019, here are the outlier scenarios that I personally worry about. Improbable as they may seem, any movement toward their far-out direction will force a true about-face in the current consensus. That's why surprises are so powerful. Enjoy, and best wishes for a prosperous and happy new year 2019.

1) The 2019 *shunto* wage negotiations result in a 4% pay raise, up from the 2% delivered last year.

Japan's economy needs a more powerful engine to drive domestic consumer spending. After years of wage restraint and company unions preferring long-term job stability over short-term wage gains, the labor market is now so tight that wage growth should start to accelerate. If I am right and the 2019 *shunto* results in a de facto doubling of the pay base, consumption-led growth could become a reality. The higher the *shunto*, the greater the chances of Japan decoupling in a positive way from a global downturn.

2) Prime Minister Abe convinces China to join the new Trans-Pacific Partnership (TPP).

2019 is likely to see a turning point in Japan-China relations. After their successful summit in October 2018, Prime Minister Shinzo Abe and President Xi Jinping are committed to not just improved bilateral relations but also to assert a more credible joint leadership role in Asia. For China, nothing would demonstrate a true commitment to accountable Asian leadership better than joining the new multilateral TPP free trade agreement. For Japan, bringing China into the new TPP would irrevocably elevate its status as global leader and protector of multilateral rulemaking. Moreover, Abe would go down in history as the statesman who built a positive buffer for all Pacific nations against their fears of the unilateral rise of China—cooperative engagement, not unilateral submission.

3) The United States moves from trade war to currency war as the [Federal Reserve \(Fed\)](#) is forced to cut U.S. [interest rates](#).

As U.S. recession risks rise, the probability of a U-turn in U.S. interest rate policy goes up—after four [rate hikes](#) in 2018, the Fed could actually start cutting rates by next summer. In turn, U.S. rate cuts will forcefully push down the dollar. Unfortunately, neither China nor Europe is in a position to tolerate this. China in particular is already very outspoken in its opposition to a new Plaza Accord (where Europe and Japan agreed to a U.S.-imposed weak-dollar policy in 1985). Make no mistake—the next U.S. recession is likely to trigger a global currency war (i.e., competitive devaluations). Importantly, it is no longer the U.S.-Japan but the U.S.-China exchange rate that will dictate global fortunes in 2019 and beyond.

4) A Japanese mega-bank buys a major U.S. bank.

Some good news for Japan: The fall in the U.S. stock market has lowered the price to buy American companies. Japanese banks have been eager to expand in the U.S. but were put off by the high prices and valuations of U.S. banks in the past couple of years. Now that the U.S. cycle has turned, Japanese bank CEOs may finally get their chance to act out

their strong global ambitions and buy a “cheap” U.S. bank in 2019.

5) The Bank of Japan (BOJ) and the Finance Ministry cooperate to sell the BOJ’s exchange-traded fund (ETF) equity holdings to Japanese savers.

The BOJ owns almost 6% of the Japanese equity market through its buying program for ETFs. While justifiable as an emergency measure to help overcome deflation, the central bank’s de facto nationalization of equity capital has become counterproductive for many reasons. The biggest one is that nobody can conceive a smooth exit—if the BOJ starts selling, surely the market will crash. Who is there to buy the BOJ equity overhang? There is only one answer: Japanese savers in general, the older generation in particular (the over 65-year-olds own more than 70% of the net financial assets). To get an elderly saver to swap from bank deposits into risky ETFs will require a real incentive carrot: the inheritance tax. If the BOJ and the Finance Ministry can cooperate and devise a scheme in which any individual who buys ETFs directly from the BOJ will have these ETFs exempt from the inheritance tax, I am certain the central bank could clean up its balance sheet within a couple of weeks. The net result would be a reprivatization of Japanese equities, a healthier corporate ownership profile, and a better risk-return profile for household sector balance sheets.

6) A “flying car” shuttle service for the 2020 Olympic medal winners is announced by the Tokyo governor and Toyota.

The Tokyo Olympics want to showcase Japan’s innovation power. In 1964, it was the Shinkansen bullet train; in 2020 it could be “flying cars.” Watch for the governor of Tokyo and Toyota Motor Corp. to announce a flying car shuttle service for the 2020 Olympians in general, medal winners in particular. For a true quantum leap in mobility, forget self-driving ground transportation—flying cars could become Japan’s next big thing.

7) The Liberal Democratic Party (LDP) commits to a “no more tax hikes” policy.

In 2019, the consumption tax will rise from 8% to 10% on October 1. A positive surprise would be Team Abe and the LDP committing to a “no more tax hikes” policy before the 2019 Upper House election. Clearly, nothing depresses consumer confidence more than the prospect of taxes going up again and again. A “freeze at 10%” pledge from the LDP would boost the credibility of self-sustaining consumer-led growth. It would also empower post-Abe LDP leaders to restrain runaway budget deficits by cutting expenditures and privatizing government services.

8) Japan’s public and private pension funds commit ¥1 trillion to a joint incubator fund.

Innovation and entrepreneurship are on everyone’s agenda, but little concrete action is taken to actually create a more entrepreneurial culture. This is a complex issue, but a sure way to start is to offer funding for start-ups. A public-private partnership incubator fund, where both the public and private pension funds commit to ¥1 trillion of investments in domestic start-ups, should help develop a new ecosystem. Ironically, the biggest obstacle here appears to be not a lack of credible start-ups and entrepreneurs but the lack of professional expertise among Japan’s pension managers and other institutional fiduciaries.

9) A peaceful invasion of Taiwan is launched, with 100,000 Chinese arriving by boat to live in Taiwan.

War and aggression scenario games continue to evolve, but a very real threat could come from neither hard weaponry nor cyber hackers. In the case of Taiwan, a “peaceful invasion” may unfold, with a fleet of, say, 100,000 mainland Chinese civilians arriving by private boats with the intention of settling and living in Taiwan. Surely an incredible test of the “One China” policy and definitely a potential game-changer in South China Sea geopolitics.

10) Japan’s rugby team fights gloriously and makes it to the finals of the 2019 Rugby World Cup.

The host team of the 2019 Rugby World Cup is ready to fight gloriously for honor and country. Wouldn’t it be poetic justice if the Brave Blossoms go all the way in the first Rugby World Cup of the new Imperial era? Ah, to dream is always

so much better than to be surprised.

For the top 10 holdings of DXJ please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/equity/dxj>

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, Brian Manby and Scott Welch 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

Shunto : the Japanese word for the annual spring round of wage negotiations conducted between big business and trade unions within Japan.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.