
JAPAN'S PRO-GROWTH AGENDA: HOW "ABE-ISM" WILL REIGNITE ABENOMICS

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After a period of relative calm and no new initiatives, Japanese politics is likely to move back into global headlines in the coming months. This is because Prime Minister Shinzo Abe has now presented a concrete timeline for reforming Japan's constitution: the goal is to clear all the necessary parliamentary hurdles by the summer of 2018 so that the required national referendum can be called before the end of that year. This ambitious agenda will not only push Japan back into global headlines but will reignite Japan's pro-growth policies into 2018 and 2019. In our view, a "double election"—lower house and constitutional referendum—seems likely in autumn 2018, ushered in by added easing of [fiscal policy](#) in general, postponing the next tax hike, as well as greater Bank of Japan (BoJ) commitment to push real rates down to at least negative 2%.

From [Abenomics](#) to "Abe-ism": Interdependent Policy Activism

Both at home and abroad, Abe's newfound urgency to press for constitutional reform is likely to raise worries. Is Abenomics morphing into "Abe-ism"—that is, will political capital now be squandered on a nationalist agenda rather than economic reform?

Personally, I am not worried about an either/or situation. Yes, there can be no doubt about the deep-rooted patriotic agenda driving "Team Abe"; however, this agenda is pragmatic and Machiavellian, inspired by the "Fukoku Kyohei—Strong Country, Strong Army" philosophy embraced by the samurai leaders who led Japan's modernization and reform in the late 19th century.

Clear speak: Yes, Abe's principal goal is to secure Japan's undisputed status as a tier-one nation, but to get there, Japan must have a top-tier economy. Just as the Meiji reformers did more than one century ago, Team Abe knows that, to be taken seriously by the two big global powers—China and America—Japan's corporate, financial and human capital must be restructured to generate performance levels envied by the world. Team Abe is convinced that without successful Abenomics, Abe-ism is doomed to fail.

More to the point, Abe's timeline on constitutional reform hints at the coming positive feedback between national agenda and pro-growth economic policy. Not only can we safely rule out a premature [policy tightening](#), but now the probability of added [policy easing](#) has risen. The more ambitious the constitutional agenda, the greater the imperative to create a stronger "feel-good" factor for the voting public.

Power Politics with Options

It is no coincidence that Abe's "constitution referendum by the end of 2018" goal is in total sync with the most important [macro](#) policy decision facing Japan: by the end of next year, the government will have to decide whether the next consumption tax hike will go ahead. It is currently scheduled for October 2019, but the final decision will only be made in the 2019 draft budget debate, due to be completed by December 2018. Machiavellian bonus: Abe must call the next general election by the same December 2018.

Practically speaking, the threat of election will keep his Liberal Democratic Party in line, and the tax hike decision creates options. Empirically, tax hikes are three-for-three triggering economic downturns, which is why Team Abe forced a postponement of one in early-2016. Standing up against the powerful bureaucracy and its tax-hike lobby was a key factor securing his landslide victory in the upper house election a couple of months later. A repeat performance is likely, in our view—postpone the unpopular tax hike as a bargaining chip for the controversial constitutional reform.

Fiscal Dominance = No Urgency for Hike Taxes

Here, it is important to note that Japan's current [monetary policy](#) regime has reduced the urgency of fiscal consolidation. The BoJ now explicitly guarantees zero-rate funding costs for treasury debt and promises to keep this anchor until inflation exceeds 2%. Real 10-year bond yields are poised to drop by at least 150 [basis points \(bps\)](#), which in turn could cut real interest expense by as much as ¥15 trillion. With total consumption tax revenues at just above ¥17 trillion,¹ fiscally conservative economists will be hard-pressed to convince Team Abe that they should risk an almost certain recession (by hiking the tax) against an almost certain "free ride"—provided the BoJ holds its course. A guarantee to stay the course would appear to be the minimum necessary job requirement for Abe's choice as the next BoJ governor (Governor Haruhiko Kuroda's first term ends April 2018).

Market Implication: Higher Risk, Higher Return

All said, a double election—lower house and constitutional referendum—coming in the autumn of 2018 looks like a reasonable assumption. This should be good news for Japanese risk assets, if we are right and the coming pickup in Japan's political metabolism results in a revival of pro-growth policies.

Two important triggers: first, evidence of easier fiscal policy coming into 2018/2019; and second, rising evidence that the BoJ will hold on to its current target of pushing real rates to at least negative 2%. Easier fiscal policy plus easier monetary policy should result in both a weaker yen and a rising equity market.

While economists may describe Japan as "Fiscal Dominance," "Political Dominance" may be a more appropriate description for what lies ahead for Japan over the coming 12 to 18 months. The fact that both the constitutional and the economic agenda are controversial and unprecedented raises risks in Japan—and thus potential returns.

In our view, Abe's ambitious constitutional agenda (Abe-ism) – is making the success of Abenomics more likely.

¹Japan Ministry of Finance, April 2017.

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DEFINITIONS

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.

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.

Monetary tightening : A course of action undertaken by the Federal Reserve to constrict spending in an economy that is seen to be growing too quickly or to curb inflation when it is rising too fast.

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

Macro : Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies.

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.

Basis point : 1/100th of 1 percent.