

Politics re-invented: Abe-Koike rivalry to bring supply-side reforms

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Japan's upcoming election is poised to usher in a new era of policy competition and political accountability. Structural reform in general, supply-side reform in particular, is poised to accelerate if, as we suspect, Tokyo Governor Koike catapults herself into the never-imagined-before position of being both in power and in opposition: in power because she will continue to be the ruling Governor of Tokyo; and in opposition because she will be the leader of the second largest party in parliament (assuming current opinion polls are correct in their predictions). Given Governor Koike's long-standing credentials as a pro-business, pro-entrepreneur and pro-consumer-led growth policy maker and the fact that Tokyo is Japan's most important economic region (accounting for slightly more than one-third of GDP), the post-election government will immediately come under attack for obstructing local growth initiatives and not delivering structural reform. It is this coming tension between national rules and regulations against local ambitions and "animal spirits" that is, in my view, the key dynamics to watch in Japanese politics and policy making from here.

It remains to be seen, of course, how exactly this new dynamic will play out. Here, the power balance in parliament will be important. The weaker the LDP, the greater the supply-side reform ambitions will get. Note that Governor Koike's in-parliament party leader is likely to be the ex-leader of the Democratic Party, Seiji Maehara, who has the most impeccable de-regulation credentials: as Minister of Transport in the first Democratic Party government, it was Maehara who opened Tokyo's Haneda Airport to international flights. He accomplished in a couple of weeks what LDP leaders had not been able to do for decades because of vested interest loyalties to Narita. Arguably, the Haneda opening was the start of Japan's re-integration with Asia and the world with enormous positive economic multipliers. The fact that both Koike and Maehara insisted on ousting old-style politicians and closet socialists from their party's merger bodes well for the coming supply-side agenda of the new opposition, in my view.

What about tax hikes and nuclear power?

We are aware that the standard narrative on the election is more conservative. The media is trying hard to find comfort in familiar themes—Abe is for the consumption tax hike and pro-nuclear, while Koike is against the tax hike and anti-nuclear. In my view, these policy differences are more symbolic of personal character than policy conviction. Abe is presented as a leader who changed from fighting to challenge the powerful technocracy—he overruled against the previous tax hike—to an old-style LDP "insider," and Koike now takes his old place as challenger and outsider.

While there is nothing wrong with this narrative, we caution against taking the actual policy platforms too literally. After all, the tax hike decision is due only in December 2018 which leaves plenty of time to forget

and/or reconsider. Already, Abe's Chief Cabinet Spokesman suggested room for flexibility ("depending on economic conditions at the time..."). Meanwhile, Koike's no-nukes stance is equally pragmatic—the phase-out goal is in far-off 2030. Given that, currently, Japan has barely started to phase back-in after the all-nukes-out post-Fukushima—five reactors have re-started, with 43 still idle; nuclear accounts for less than 2% of all energy supply. So nothing radical here.

Fiscal dominance trumps BoJ Governor

Similarly, we do not see a link between the election outcome and monetary policy. This is because, in my view, Abe and Koike share the same deep-rooted pragmatism when it comes to macro-economic policy making: in Japan, monetary and fiscal policy are seen as de-facto one and the same. "Fiscal dominance" has been working well. For most policy advisors, there appears no pressing reason to change back the previous policy models that insist on central bank independence. If at all, there is growing pride amongst Japanese politicians that Japan's "new monetary policy" is breaking ground for a new standard. (See "Team Abe" having no qualms to push-back the primary budget targets; as well as the latest BoJ policy board vote, where the one dissenter advocated MORE easing...).

In my view, the principle threat to Governor Kuroda's re-appointment would be vocal opposition from Washington in general, the next Fed-Chair in particular. At this point, this seems an unlikely obstacle.

All said, we see the upcoming elections as an important inflection point for Japanese policy making. While macro policy stays put—fiscal dominance and BoJ zero yield curve control—a true supply-side pro-business, pro-deregulation and pro-growth agenda is poised to emerge as "Team Abe's" monopoly on power gets challenged and held accountable for more decisive action. The new force is the never-seen-before power of a united large parliamentary opposition led by the powerful Governor of Tokyo, Japan's most important economic powerhouse, global financial center, and showcase for the world.

A Japan-first coalition?

Now that the candidates have been announced, we still expect the LDP coalition to return with a stable majority of around 240-260 of the 465 seats, while Koike's Party of Hope becomes the largest opposition with 120-180 seats. Interestingly, Governor Koike has already opened the door for a potential coalition with the LDP. After all, Koike, Maehara and Abe do share a strong patriotic ideology that, in my view, goes back to the rallying cry of the Meiji-era elites who modernised Japan—"Fukoku Kyohei": strong country, strong army. The bigger the loss of the LDP's current coalition partner Komeito, the greater the chances of a new "Japan first" coalition between Abe's LDP and Koike's Party of Hope. In my view, I expect this scenario to become more likely after the next national elections, the mid-2019 upper house elections.

For now, the competition between Abe and Koike—that is, between the central government establishment and the local Tokyo "disrupters"—is poised to deliver accelerated supply-side reform, in my view.

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