

Sayonara Abenomics? Not so fast

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Japan's political stability in general, Prime Minister Abe's strong grip on power, have been the centrepiece 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 to Abe is serious enough to force a think about possible post-Abe Japan scenarios.

First, the good news. It is a fact that currently there are no major economic policy issue 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). So, no risk of government shutdown. And monetary policy is also on a stable track, with Bank of Japan Governor Kuroda and two new deputies already past their parliamentary approvals.

For "Team Abe", the big economic agenda item for 2018 was labour market reform, but that was killed off by internal LDP 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 minimizes the possible damage to the economy, should the government fall or be disrupted. Clear speak – Japan's economy is on autopilot.

The bad news is that, yes, "Team Abe" will be a near impossible act to follow (from an investors 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 within 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 – Abe was created as a counter-attack 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 begun her territorial claims on the Senkaku Islands). It was no accident that, once elected, "Team Abe" launched an aggressive marketing a branding campaign that captured the imagination of the world, called "Abenomics"; and immediately implemented a strategy of key personal changes in the key Ministries.

Against this pro-active build-up and broad-based back-up, 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 Defence 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, are known to rely primarily on elite technocrats for economic policy advice.

Meanwhile, speculation of a possible new generation samurai (like exPM Koizumi's son Shinjiro Koizumi (36)) emerging is, in my view, pre-mature. Abe's long-term rule has left many old-generation LDP members deeply entrenched and aggressively putting younger challengers into their place.

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 – eventually an election will have to be called; 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 Machiavellian instincts. The ruling party knows it is not ready for a post-Abe world, knows that the current two-thirds supermajority in parliament will be lost if Abe leaves now; and, in my personal 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 and please superiors by removing possibly embarrassing "facts" – a practice called "Sontaku" in Japanese culture (pleasing your superior by "following an order that has not been given") – the damage is 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 re-build trust in his government.

Investment implications: although more than a storm in a tea cup, the "Moritomo Affair" only undermines the structural bull-case for Japan if "Team Abe" were to be forced into a pre-mature exit. This, in my view, is unlikely at this juncture.

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