

# From “Abe Envy” to “Japan Premium”

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Prime Minister Abe won a decisive victory in Sunday’s Upper House polls. His ruling coalition now holds a “super majority” control of both houses of parliament, i.e. holds de-facto more than two-thirds of all Parliamentary seats[1]. In contrast to many western democracies that appear to have entered a cycle of power vacuums and leadership uncertainty, “Team Abe” has emerged as the undisputed power champion amongst democratically elected global leaders.

“Abe-Envy” is now spreading amongst the global political elite. If, as I expect, “Team Abe” demonstrates strong economic policy leadership credentials in the coming three-four months, a “Japan Premium” should start to develop in Japanese risk asset markets. In my personal view, Japan’s stimulus will be sizable, creative and coordinated – total stimulus of around 2% of GDP; the start of “Drone Money” direct cash transfers to targeted groups of households; and de-facto direct funding from the Bank of Japan (BOJ).

## **What will Prime Minister Abe do with his historically unprecedented parliamentary power?**

Many commentators worry that the Prime Minister will now focus on an issue dear to his heart, constitutional reform. Technically, the two-thirds majority allows him to do so; and it is true that Abe is deeply convinced that Japan deserves a constitution written by its own people, rather than the current one which was given to Japan by the Americans after the Pacific War. Abe has been very open about this and there is no question that the constitutional reform agenda remains a key part of his Japan agenda[2].

However, the view that political capital will be spent primarily on constitutional reform is a profound misunderstanding of Abe’s fundamental philosophy and vision for Japan, in my view. Prime Minister Abe’s basic philosophy and vision is modelled on the rallying cry of the old Meiji elite “Fukoku Kyohei” – “Strong Country, Strong Army”. It is not a “zero sum game” of either—or, but a highly interdependent relationship: without a strong economy, constitutional reform becomes meaningless.

## **Global Ambition**

In our understanding, Abe knows that constitutional reform carries a high risk of backfiring politically - both at home and abroad – if the economy continues to stagnate. Abe’s goal is to make Japan a country that is admired and respected by Asian and global leaders. This becomes impossible without a strong economy. Neither America nor China will have respect for a leader who promises growth and prosperity but fails to deliver. From a global power perspective, if “Abenomics” fails, Japan slides back into irrelevance.

After all, nationalism based on economic stagnation poses neither a threat nor an opportunity to the outside world -- without “Abenomics” succeeding, Abe simply cannot finance his national ambitions. If at all, the weaker the economy gets, the greater Japan’s dependency on global capital, technology or labor will become.

## **Domestic Credibility**

At home, a nationalist agenda and lop-sided focus on constitutional reform would also become meaningless without the success of “Abenomics”. If Abe cannot create a “feel good factor” for the people and corporate stakeholders, they are poised to turn against him sooner or later. Japan is, after all, a functioning democracy with plenty of local- regional- and national elections. If “Abenomics” fails to deliver, strong-arming constitutional reform would quickly expose a one-party power grab, which is poised to unify and incentivise opposition forces.

If at all, the clear mandate given to “Abenomics” in yesterday’s election has raised the stakes for strong economic leadership from Abe – he now has no excuse and has to deliver that “feel good factor” he promised to the people and corporate stakeholders. The pressure is on -- Abe’s leadership term expires in two years (September 2018).

### **Abe’s Agenda – Linking Bank of Japan (BoJ) and Ministry of Finance (MoF) into one package**

From here, the economic policy agenda is relatively straightforward. First and foremost, fiscal policy will be expanded. Prime Minister Abe has already ordered the compilation of a supplementary stimulus package. Here, the focus is not just on size, but on actually linking fiscal expansion with added monetary stimulus. Almost all of Abe’s economic advisers agree that monetary policy alone has become increasingly ineffective to stimulate growth. Key focus is “Team Abe” leadership actually linking the BoJ agenda directly to the MoF agenda. Clear speak: the next BoJ move is poised to be the de-facto financing of the coming supplementary budget.

Note here that, unlikely previous years, Japan has no excess tax revenues that could be used to fund added expenditures. Deficit finance is therefore the only option, although in Japan there exists an off-balance option: added public investment can be funded by the Fiscal Investment and Loan Program (FILP), which would issue so-called “Zaito Bonds”[3]. The technical difference to deficit bonds is that these are project based and cannot be paid back using tax revenues. However, for the bond market the “Zaito Bonds” trade just like any other JGB – and the BoJ is allowed to buy “Zaito Bonds”. Assuming a supplementary budget of around Y8-10 trillion, or 1.5% to 2% of GDP, we expect the BoJ to raise its Quantitative Ease balance sheet growth target from the current Y80 trillion to Y88-90 trillion.

### **Size matters**

How big will the supplementary budget be? Government economists estimate the current GDP output gap to be around Y5-6 trillion, i.e. about 1% to 1.2% of GDP. This is the baseline starting point. Perhaps not coincidentally, technocrats estimate that reconstruction projects to fix the recent earthquake damage in Kumamoto may come to around Y4-5 trillion.

In addition, promotion of Abe’s new “Industry 4.0” initiative – FINTEC, Robotics, healthcare, R&D etc – could come to Y1-3 trillion.

### **“Drone Money”**

Over-and-above this, there is the Abenomics focus on economic inclusion for working poor, women, poor pensioners and youth. Direct cash-transfers to these constituents are now part of the policy debate.

While media refers to this as “helicopter money”, we prefer “Drone Money” as it is pin-point delivery to specific targets of the population. Technical details of how exactly to transfer funds from the treasury to these targeted constituents will still have to be worked out, but, in our view, a total of around ¥1.5-2 trillion of direct cash transfers to the household sector could be expected.

### **When to expect what**

The technical aspects of compiling an “unorthodox” fiscal package – one that includes “Drone Money” cash transfers to specifically targeted groups amongst households – will take at least four-six weeks to work out. Prime Minister Abe also appears to have hinted at re-shuffling his cabinet around mid-August<sup>[4]</sup>. Here focus will fall on the Ministry of Finance portfolio, the Ministry of Health, Welfare and Labor, as well as the Economic Coordination Minister, in our view. Moreover, the Advisory Council on Rules and Regulations is also due a re-shuffle, including private sector leaders. “Team Abe” is very conscious of the need to revitalise the public image of the economic leadership team, in our understanding. Either way, a firm commitment to specific fiscal spending is unlikely to come before the new ministerial portfolio responsibilities have been allocated.

All said, we expect full-details of added fiscal and money stimulus to be presented in early September – just before PM Abe goes to deliver a keynote speech at the annual UN General Assembly. In our view, “Team Abe” is determined to demonstrate strong economic policy leadership to the world. The stimulus will be sizable, creative and coordinated – total stimulus of around 2% of GDP; the use of “Drone Money” direct cash transfers to targeted groups of households; and de-facto direct funding from the Bank of Japan.

[1] Yoko Wakatsuki and Juliet Perry, “Japanese Election: Shinzo Abe Declares Victory”, CNN (July 2016)

[2] Yoko Wakatsuki and Juliet Perry, “Japanese Election: Shinzo Abe Declares Victory”, CNN (July 2016)

[3] Jiji, “Japan Mulling Cut in Minimum Interest on ‘Zaito’ Fiscal Loans”, The Japan Times (June 2016)

[4] Isabel Reynolds and Andy Sharp, “After Convincing Election Win, Abe Set for Some Tough Battles”, Bloomberg (July 2016)

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