

Ten Surprises for Japan in 2019

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2019 is likely to be a good year for Japan. While worries about US 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 labour market is now so tight that wage growth should start to accelerate. If I am right and the 2019 shunto (the annual spring round of wage negotiations conducted between big business and trade unions within Japan) 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 US interest rates.

As US recession risks rise, the probability of a U-turn in US interest rate policy goes up—after four rate hikes in 2018, the Fed could actually start cutting rates by next summer. In turn, US rate cuts could 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 US-imposed weak-dollar policy in 1985). Make no mistake—the next US recession is likely to

trigger a global currency war (i.e., competitive devaluations). Importantly, it is no longer the US-Japan but the US-China exchange rate that will dictate global fortunes in 2019 and beyond.

4) A Japanese mega-bank buys a major US bank.

Some good news for Japan: The fall in the US stock market has lowered the price to buy American companies. Japanese banks have been eager to expand in the US but were put off by the high prices and valuations of US banks in the past couple of years. Now that the US cycle has turned, Japanese bank CEOs may finally get their chance to act out their strong global ambitions and buy a “cheap” US 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 1 October. 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 yen 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 yen 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 honour 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.

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