

Abe declares 2014 Year of Japanese “Wage Surprise”

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In 2013, Japanese markets led the global markets and had their best showing since Japan's equity bubble burst in 1990. Much of the optimism for Japan's stock market stems from prime minister Shinzo Abe, who has embarked on what he refers to as a “three-arrow policy” to end Japan's deflationary slump and reignite Japan's economic vigor. I would say the first arrow, aggressive monetary policy, has been right on the mark. The unprecedented monetary easing by the Bank of Japan—which is set to become the most aggressive central bank in the world as the Fed begins to taper its balance sheet expansion—improved sentiment in Japan, caused the yen to weaken, and bolstered the markets while stimulating inflation. But can the positive momentum seen in equity prices in 2013 continue into 2014? There are many skeptics of the progress Abe has made on his third arrow, the “growth strategy” of structural reform to the economy. I believe investors should take Abe's word that he is committed to Abenomics and that important changes are in the works. Abe recently wrote an op-ed where he made some important points, and I want to bring attention to his remarks. Abe admitted that the third arrow takes more time because, *“by definition, structural reforms take more time than changes in monetary and fiscal policy do. Many will require legislation, on which my colleagues in the Diet have been spending much of their time over the last couple of months. During this process, with its seemingly endless and convoluted floor debates, observers should not lose sight of the forest for the trees.”*¹

Abe's Forest: A Wage Surprise in 2014 A key to navigating Abe's forest in 2014: a coming **“wage surprise.”** I believe Abe is trying his best to make sure investors are not surprised when the wage “surprise” occurs. It all started with a positive shift in confidence, for individual Japanese consumers as well as businesses. Abe declared, *“Abenomics, I am proud to say, has been successful in a more fundamental sense: we have rebooted Japan's collective psyche.”*

Initiatives that have been a part of his third arrow, structural reform to promote growth: *From joining the negotiations for the Trans-Pacific Partnership (TPP) to introducing specially deregulated zones (my own office will oversee their implementation), my government is committed to catalyzing economic recovery by all means available.*

But Abe wants to draw attention to the “wage surprise” as a key part of the third arrow: *[T]he wage surprise stands out, because only when the long-missing link between corporate profitability and wages is restored will investment in houses, cars, and other durables, and household consumption in general, finally rid Japan of its deflation and put its economy on a sustained growth path.* Abe believes Japan is experiencing the emergence of a “national consensus” or “a shared sense that the government, major industries, and organized labor should work together to increase wages and bonuses (while facilitating incentives that could enhance productivity).” Abe has been a part of discussions with government leaders, union leaders and company executives, so I think he has a good sense of the budgeting plans that are

in store. One such example is the head of Toyota, a company that reportedly has not raised wages since 2008.² Moreover, unions such as the All Toyota Workers Union have pushed for higher wages, and revenue at many of the exporters has been growing due to the weakening yen, giving some flexibility in the budgets. Wage growth will be a key to generating consistent inflation. In December, Japan's cash wages stabilized after 17 straight months of decline.³ We need to see this metric start to rise in the coming months, as Abe suggests. Only when consumers and business leaders have confidence that their income prospects are good and set to grow will they choose to increase their spending. A continued boost to wages both this year and in the future will be a key element to Japan resetting inflation expectations toward the 2% that Abe and the Bank of Japan desire. More positive wage growth trends, if they emerge, will be a key sign Abenomics is still on track. I believe investors will continue to look for the Japanese investment themes that stem from Abenomics, and I think we are still only in the beginning phases of Japan's economic and equity market revitalization. Throughout this week I will discuss new ways to participate in Abenomics via specific equity themes geared to these trends. *For current holdings of WisdomTree Funds, please visit wisdomtree.com*

¹Source: Shinzo Abe, "Why Wages in Japan Are Set to Rise," World Economic Forum Blog, 1/7/14 (<https://forumblog.org/2014/01/why-wages-in-japan-are-set-to-rise/>). ²Source: Tom Essaye, "Wage-Push Inflation Is Japan's Next Bullish Driver," Forbes, 12/31/2013. ³Source: Ben McLannahan, "Japan Wages Halt 17-Month Decline," Financial Time, 12/27/13.

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