

# JAPAN POLICY: FISCAL BOOST, BOJ FUNDS AND DECEMBER ELECTIONS

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05/11/2016

Japanese policy makers are poised to deliver added pro-growth stimulus in the coming months. In our view, it will be a coordinated move, with both fiscal and [monetary policy](#) being eased—a supplementary budget of around 1% to 1.5% of [gross domestic product \(GDP\)](#) (5 trillion to 8 trillion yen), funded by the Bank of Japan (BOJ) raising its [Japanese government bond \(JGB\)](#) buying target. We expect these to be in place before the end of May. In our view, the BOJ did not add to its stimulus program precisely because its leadership recognizes the diminishing returns of central bank action on its own. Note that throughout the past four years of unprecedented BOJ policy action, the central bank's economists have actually continued to cut their estimates of Japan's potential GDP growth, from around 1% three years ago to just below 0.5% now. In a nutshell: Japan's best and brightest analysts outright deny a link between central bank action and the potential to create national welfare. For a leader as intellectually curious and thorough as BOJ governor Haruhiko Kuroda, the message is clear—the BOJ cannot do it alone. **All Eyes on Prime Minister Abe** The only way to link the central bank balance sheet to aggregate demand and future growth potential is through the combination of fiscal and structural policy. Prime minister Shinzo Abe understands this very well. His "[three arrows](#)" are the symbol of his commitment to lead and coordinate monetary, fiscal and regulatory policy because each arrow on its own can be snapped and broken, but all three together cannot. But while the "three arrows" political marketing campaign has matched sound economic policy advice for more than three years, concrete results are still lacking. After all, if [Abenomics](#) were working, Japan's best and brightest economic researchers would not be revising down the country's potential GDP estimates. The prime minister and his team are fully aware of this and will not rest before actually succeeding, in our view. However, it is important to realize that Abe's team is dominated by politicians, and politicians need to optimize for far greater complexity than just the dictates of financial markets. Elections matter, and so do global leadership events. In our view, the relative lack of urgency from team Abe on the economic policy front so far this year is primarily forced by Abe's desire to use his presidency of this year's [G-7](#) summit as the stage to demonstrate his global policy leadership. The G-7 summit will be held May 26-27 here in Japan; it will be preceded by a G-7 Finance Minister and Central Banker Summit May 20-21. The most likely time for Japan to present concrete fiscal and monetary stimulus would be shortly before the main summit, in our view. Prime Minister Abe and his Summit Sherpas are visiting European leaders with the explicit agenda of trying to get added fiscal stimulus from Europe on the agenda. If Abe is successful, this could create an important policy-induced inflection point for the global economy—Japan ease, plus Europe ease, plus China, which already added major fiscal expansion at the last Communist Party leadership conference a couple of months ago.

**Japan Policy Action—Concrete Scenario** For Japan, our main scenario calls for a supplementary fiscal package of 1% to 1.5% of GDP, 5 trillion to 8 trillion yen, with the BOJ committing to fund this budget by raising its JGB bond-buying target. In terms of content, we anticipate increased non-yen loan facilities for [ASEAN](#) infrastructure development, added funding for "Special Economic Zone" regional investment initiatives, earthquake rebuilding infrastructure spending, as well as a possible increase in cash transfers paid to families for elderly and child care and possibly increased transfers to working poor and/or low-income pensioners.

**Market Impact—Global Fiscal Boost to Lift [Blue-Chip](#) Exporters** In our view, the key market impact is poised to come from the potential boost to the global business cycle (i.e., a focus on exports in general, capital goods exports in particular). If Abe is successful in coordinating a global fiscal boost, Japan's blue-chip exporters are poised to begin to outperform. Meanwhile, we remain [bullish](#) on Japanese real estate and construction and small and mid-caps. **Delay 2017 Tax Hike Decision to November—for December Elections?** On the overarching issue of next year's tax hike, we are doubtful at this stage that Abe will commit anytime soon to postponing the tax hike (the consumption tax is slated to go from 8% to 10% beginning in April 2017). Instead, we expect Abe to reiterate his commitment to stay pragmatic and watch the development of the economy in response to the new supplementary budget. By not committing to the tax hike either way, Abe would extend his future options to keep the consumption tax as a possible electoral bargaining chip. If, for example, economic conditions do not improve

significantly by the autumn, Abe could very well call off the 2017 tax hike and use that “policy leadership” as a vote-winning tool. The latest opinion polls suggest that more than 60% of voters oppose the consumption tax hike. Specifically, this scenario could come into play if the July–September GDP report were to reveal a fallback into negative growth. The report is due mid-November, which is just the time when next year’s budget negotiations enter their crucial stage. As such, a lower house election in December could become reality. Another scenario would be an accelerated commitment by Abe to commit to the tax hike delay and use that as a vote-winner for a potential “double election” in July (when the upper house of Parliament holds its fixed-term elections—in contrast, the prime minister has the power to call elections for the more important lower house). However, Abe has recently made strong statements against thinking about dissolving the lower house for a double election in July. In practical power political terms, that makes sense—Abe has more to gain by holding on to the tax-hike-delay option for as long as possible. After all, calling an election is the prime minister’s most effective tool to keep the rank-and-file in his own ruling party under control.

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## DEFINITIONS

**Monetary policy** : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

**Gross domestic product (GDP)** : The sum total of all goods and services produced across an economy.

**Japanese Government Bond (JGB)** : A bond issued by the government of Japan. The government pays interest on the bond until the maturity date. At the maturity date, the full price of the bond is returned to the bondholder. Japanese government bonds play a key role in the financial securities market in Japan.

**Three-Arrow Policies** : This refers to three pointed economic policy of Shinzo Abe consisting of fiscal stimulus, monetary easing, and structural reforms.

**Abenomics** : Series of policies enacted after the election of Japanese Prime Minister Shinzo Abe on December 16, 2012 aimed at stimulating Japan's economic growth.

**G7** : The Group of 7 is a group consisting of Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

**ASEAN countries** : Association of Southeast Asian Nations. Indonesia, Malaysia, the Philippines, Singapore and Thailand comprise the original members.

**Blue chip** : Stocks that have the reputation for quality, reliability and the ability to operate profitably in good times and bad.

**Bullish** : a position that benefits when asset prices rise.