# Abenomics Skepticism Grows as Price Gauge Retreats: Japan Credit

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By Mariko Ishikawa, Yumi Ikeda and Kevin Buckland

Aug. 20 (Bloomberg) -- Traders are growing more skeptical Prime Minister Shinzo Abe will achieve his 2 percent inflation target after a sales tax increase derailed growth.

The 10-year break-even rate, a gauge of expectations for consumer-price gains in inflation-linked bonds, dropped to 1.16 percent yesterday, the lowest close since March 17. It's down from 1.4 percent in June, the highest since the government resumed sales of the securities in October. The equivalent gauge in the U.S. was at 2.19 percent.

Abe needs to push through structural reforms to spur the world's third-largest economy, Fitch Ratings said in a report last week, after gross domestic product shrank the most in three years last quarter. Japan isn't alone in facing reduced inflation expectations as stagnant wages in countries from the U.S. to Germany and Australia threaten to slow economic growth.

"Japan's economy has taken a severe knock which, inevitably, calls into question the credibility of the government's reflationary program," Nicholas Spiro, managing director at Spiro Sovereign Strategy in London, said in an e- mailed response to questions yesterday. "Abenomics is far from dead and buried but it's increasingly on life support."

GDP plunged an annualized 6.8 percent in the three-months through June, the sharpest contraction since the first quarter of 2011, the Cabinet Office said on Aug. 13. That clouds the government's plan to raise sales tax next year to 10 percent after a three percentage-point increase in April to 8 percent.

## Disapproval Rating

Three-quarters of people said they oppose a further levy, according to a Jiji survey conducted Aug. 7-10. The cabinet's disapproval rating rose to 35.1 percent, the highest since Abe took office in December 2012.

"The 'Abenomics' fiscal and monetary stimulus policies have been sufficient to bring Japan out of deflation, but this is proving a double-edged sword as wages are not keeping up with prices," Fitch, which has an A+ grade on Japanese sovereign debt with a negative outlook, said on Aug. 13.

“Sustained real wage contraction would risk tipping Japan back into sluggish growth around or below potential.”

The cost of living in Japan grew at three times the pace of wage increases in June. Core consumer prices excluding fresh food rose 3.3 percent from a year earlier, while average overall monthly earnings gained 1 percent. When the effects of the consumption levy are excluded, inflation stood at 1.3 percent.

## Wage Dilemma

Average hourly earnings in the U.S. have yet to recover from the recession that ended in June 2009. German labor cost growth in January-March was the weakest since 2010, while costs in Australia climbed at the slowest annual pace since at least 1998. Subdued wage growth has helped fuel bond gains worldwide.

Japan’s benchmark 10-year yield plunged to 0.495 percent on Aug. 15, the lowest since April 2013 when the Bank of Japan unveiled unprecedented easing. It was at 0.5 percent yesterday.

The U.S. 10-year yield and its Australian counterpart fell to the lowest since June 2013 this month at 2.3 percent and 3.3 percent respectively. The yen was at 102.61 per dollar as of

5:49 p.m. in Tokyo yesterday.

“If the inflation rate drops below 1 percent, that would raise the likelihood of additional BOJ easing,” said Naoki Murakami, market strategist in Tokyo at AllianceBernstein Japan Ltd. “We haven’t seen any deterioration to the extent that requires a policy change just yet.”

Half of 34 economists expect the BOJ to bolster stimulus by the end of February 2015, according to a Bloomberg survey conducted between July 30 to Aug. 1.

The BOJ isn’t on track to reach its price goal and inflation is showing signs of peaking, Robert Feldman, head of Japan economic research at Morgan Stanley MUFG Securities Co. in Tokyo, wrote in a research note dated yesterday. Abe’s plans for tax, labor and election reforms lack concrete goals and tight timelines, he wrote.

“Abenomics is in trouble,” Feldman wrote. “Weak economic data pose a high hurdle for recovery of confidence.”

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