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Japan's 'Abenomics' can survive quadruple-dip recession

No major country in the post-war era has ever attempted such a radical experiment in money creation, or attempted so brazenly to monetize the public debt stock

Premier Shinzo Abe is trying to head off a Japanese debt crisis Photo: EPA

By **Ambrose Evans-Pritchard**, **International Business Editor**

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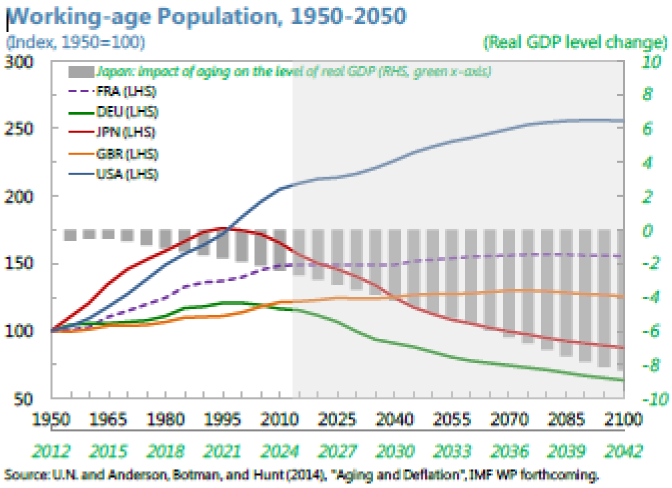
Abenomics is alive and well. Japan’s crash into its fourth recession since 2008 is a nasty surprise for premier Shinzo Abe but it tells us almost nothing about the central thrust of his reflation blitz.

The mini-slump is chiefly due to a one-off fiscal shock in April. Mr Abe defied warnings from Keynesian critics and unwisely stuck to plans drawn up by a previous (DPJ) government to raise the consumption tax from 5pc to 8pc.

The essence of Abenomics is monetary reflation a l’outrance to lift the country out of deflation after two Lost Decades. The unstated purpose of this “First Arrow” is to lower real interest rates and raise the growth of nominal GDP to 5pc, deemed the minimum necessary to stop Japan’s debt trajectory from spiralling out of control.

This is a formidable task and may ultimately fail. Public debt is already 245pc of GDP. Debt payments are 43pc of fiscal revenues. The population is expected to fall to from 127m to 87m by 2060. Given the grim mathematics of this, the inertia of the pre-Abe era was inexcusable.
Takuji Aida from Societe Generale said the tax rise was an “unnecessary diversion from Mr Abe’s reflationary goals” but will not have a lasting effect.
The contraction of Japanese GDP by 0.4pc in the third quarter – following a 1.8pc crash in the second quarter - is certainly a public relations embarrassment, but less dreadful than meets the eye.
The economy expanded by 0.2pc when adjusted for inventory effects. Machinery orders rose for a fourth month in September to 2.9pc. Retail sales jumped by 2.3pc. Danske Bank’s Fleming Nielsen says Japan’s economy will be growing at a 3pc rate again this winter.



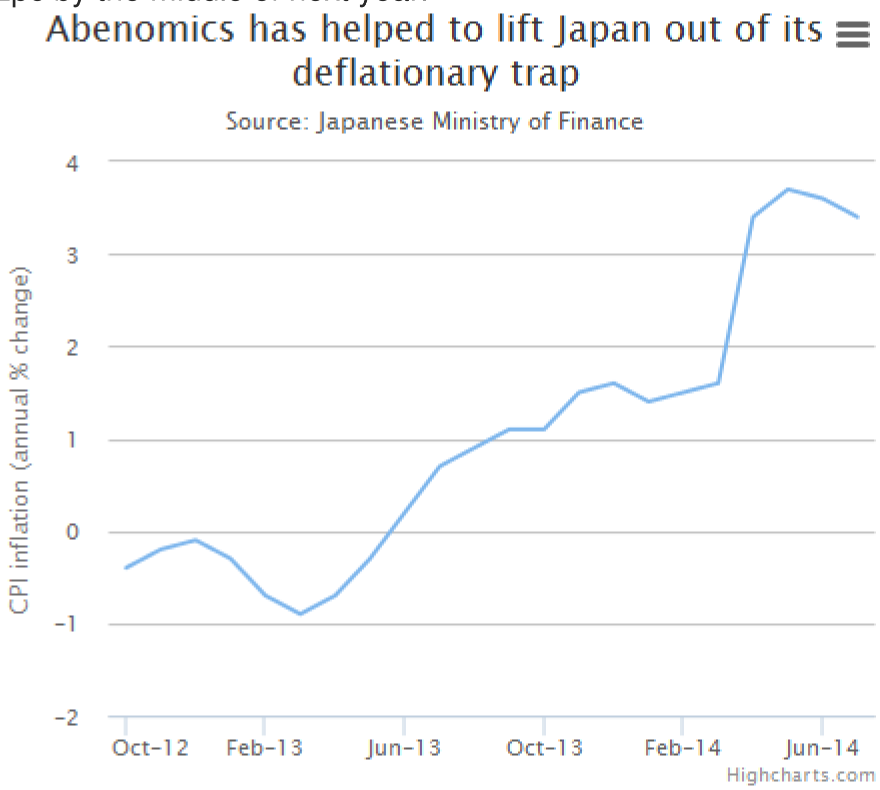
Mr Abe has shrugged off the tax debacle without much political damage. He is likely to call a snap election for December, win heartily, and suspend plans for a further rise in the sales tax to 10pc next October, ditching a policy he never liked anyway.
The Bank of Japan is learning - after a false start - how to pack a punch. The first round of quantitative easing by Goveror Haruihiko Kuroda was botched. A large chunk of the $75bn of asset purchases each month was squandered on a futile attempt to increase bank reserves and double the monetary base.
“This is completely useless. It has no impact on the economy,” said Professor Richard Werner from Southampton University, the man who invented the term QE as an adviser to the BoJ in the 1990s. “This largely repeats what they did from 2001 to 2006. They need to buy bonds from outside the banking system.”

Tim Congdon from International Monetary Research said QE is potent only if the assets are bought from “non-banks” such as pension funds and life insurers. They typically hold longer-term bonds.

This is increasingly happening. The “Kuroda II” package unveiled last month adds a further $12bn or more of stimulus, heavily weighted to government bonds of 7-10 year maturities. It is an open secret in Tokyo that the BoJ will mop up bond holdings due for sale by the $1.2 trillion government pension fund (GPIF) as it shifts to equities under new portfolio rules. “The second round of stimulus should be much more effective,” he said.

Mr Congdon said ‘broad’ M3 money in Japan has been growing at a rate of almost 5pc over the last three months (seasonally adjusted), suggesting that the foundations for a strong recovery six to twelve months later are coming into place. “If there is a further pick-up in M3, Japan could enjoy an economic surge not seen since the 1980s,” he said.

Core inflation has slipped back to a six-month low of 1pc, but this is a far cry from the chronic deflation before Mr Kuroda took over the BoJ with his allies in the Spring of 2013. He says that headline inflation will reach the BoJ’s target of 2pc by the middle of next year.



Mr Kuroda insists that a “virtuous circle of economic recovery” is under way, with the labour market tightening as the jobless rate falls to 3.5pc. “There is almost no slack in the labour market. An increase in nominal wages has been evident since this spring," he said. The reported fall in real wages as a statistical distortion caused by the sales tax rise.

Monetary policy works with famously "long and variable" lag times, and no major country in the post-war era has ever attempted such a radical experiment in money creation, or attempted quite so brazenly to monetize so much of the public debt stock.

Mr Abe says he has modelled his reflation drive on the monetary revolution of Takahashi Korekiyo, who ordered the BoJ to go for broke in 1932, to a chorus of ridicule from the voices of orthodoxy across the globe. They said Mr Takahashi was bound to fail.

Japan was recovering by 1933, and booming by 1934. Those dancing on the grave of Abenomics today may be just as premature.