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Abenomics pumps life into listless Japan

Shinzo Abe is an unlikely risk-taker, but he is on a mission to end Japan's decline with three 'arrows' of monetary policy

Michael Sheridan, Tokyo, Published: 9 June 2013

Working hard: Shinzo Abe has a three-arrow plan to keep Japan buoyant

ALL THE tables for a champagne afternoon — yes, afternoon — at a top Tokyo hotel were sold out to satisfied-looking middle-aged patrons. The bars in the financial district were abuzz with a youthful after-work crowd. Animal spirits seemed back in the air last week.

It is all down to "Abenomics" — the word for Japan's bold experiment with the "first arrow" (cheap money through quantitative easing, or QE), the "second arrow" (fiscal spending to boost the economy) and the "third arrow" (a restructured and revitalised Japan Inc).

On the face of it, Shinzo Abe, the prime minister, is an unlikely risk-taker. Scion of an elite political family that is conservative to the core, Abe, 58, is the Japanese establishment personified. His first term as premier ended prematurely in illness, indecision and ignominy.

But to general surprise, he has returned as a nationalist on a mission to end Japan's era of deflation and decline. He will come to the G8 meeting in Northern Ireland heralded as the most significant Japanese leader in a decade, and one whose policies hold deep implications for the global economy.

On his watch, Japan has ditched its traditional central bank doctrine and dumped its austere central banker in favour of a new governor, Haruhiko Kuroda, who has ordered a vast expansion of the money supply, following America's Federal Reserve and the Bank of England.

Long a nest of vigilant anti-inflation hawks, the central bank is now explicitly aiming at an inflation target of 2% and a nominal GDP growth rate of 3%.

Clear out the bureaucrats, the vested interests and the politicians that have choked our economy for too long"The Bank of Japan has decided to step further into uncharted territory of monetary policy," admitted Ryuzo Miyao, a member of the BoJ policy board. The minutes of the bank's meeting on April 26 show that the board's members were split on whether QE would work. Meanwhile, the central bank has watched the yen slide steadily from 79 to the dollar to about 100, restoring competitiveness for Japanese exporters and handily increasing the price of imported food and goods.

As soon as Abe took power in his second stint as prime minister, Japan seemed like a one-way punt. Stocks would go up and the yen would go down. Hedge funds and institutions piled in.

At first, the markets surged. Foreign investors bought equities worth nine trillion yen (£60bn) in the past six months as the stock market shot up faster than the currency depreciated. Those who placed a bet have been rewarded.

Then the rally staggered. Dealers waited for Abe to spell out what the "third arrow" — Thatcherism, Japan-style — would mean.

Then, discouraged by a speech listing a raft of half-measures, the markets sank again, even though many investors are sitting on handsome gains. Now Abe faces a test of confidence in his ambitious project.

Elections for Japan's upper house of parliament are expected on July 21, when Abe's coalition of his Liberal Democratic party (LDP) and its allies in the New Komeito party aim to consolidate their grip on power. They won control of the lower house last December.

Next month's House of Councillors contest is for 73 prefectural constituency seats and 48 elected by proportional representation. Polls indicate Abe's team will win a majority.

For the premier, who stepped down from his first term in office citing a stress-related health condition, there is no time to lose. He sees the revival of Japan as a patriotic duty in the face of a rising China, not just a contest of GDP numbers.

Abe has not taken a holiday apart from a short break in early May at his summer home near Lake Kawaguchi in central Japan.

When the stock market had its first stumble, losing 1,100 points on May 23, the prime minister was flying back from a market-opening trip to Burma, the first by a Japanese leader since 1977. Reaching his house in Shibuya, western Tokyo, he was on the phone to government bond market analysts at 1am.

The message? Stay calm. The cabinet secretary, Yoshihide Suga, who occupies the key position in any Japanese administration, told Abe there was no need to react because the real economy was still rebounding. The cabinet had to keep its nerve.

On May 30, the Nikkei index fell another 700 points. Quietly, it was decided that Abe needed to bring forward his speech spelling out the “third arrow” in his strategy to revive the nation. It is a matter of survival for Japan’s ageing society and its diminishing population of 127m, dispersed along an earthquake-prone archipelago devoid of most natural resources.

The signs are incremental but, for the premier, encouraging. The IMD business school in Lausanne has raised Japan’s competitiveness from 27th to 24th in the world. It tops the global list on the Gini coefficient, a measure of income equality.

The International Monetary Fund has endorsed Abenomics, saying that monetary easing and a weaker yen do not pose problems as long as the government pursues structural and fiscal reform.

There is comfort, too, in the fact that although Japanese public debt amounts to some 240% of GDP, more than 90% of government securities are held by domestic investors. Bond market analysts add that some debt is, in effect, a crossholding by one part of the state in another. Japan remains the third-largest economy and the leading creditor nation in the world.

The foreign verdict on Abenomics is broadly approving. Last week it got an endorsement from the rockstar economist Jeffrey Sachs, who flew in for a government conference and held a room of listeners overlooking the Imperial Palace in downtown Tokyo enthralled with his sweeping exposition of its virtues.

“Japan [is] not doing anything that violates the rules of the game — it’s just late to the game,” Sachs said. “The world will accept these policies.” He also told the government to keep its nerve, calling its monetary policy “appropriate and, I would say, overdue”.

Asked if a rise in nominal interest rates on Japanese government bonds (JGBs) to about 1% was an omen of failure, he disagreed. “In economic logic, with an expanding money supply, the real interest rate comes down a bit even as the nominal rate goes up a bit,” he argued.

“The monetary expansion has already created a new impulse in the economy . . . and these are understandable fluctuations around a trend that is fundamental.”

However, sceptics abound at home and abroad, most of them doubting Abe will take the really hard decisions.

“Abe-san is right; deregulation is the answer to Japan’s fundamental problems,” said Genri Goto, a businessman. His online pharmaceutical firm, kenko.com, will benefit from the liberalisation announced by Abe last week.

But for Goto, who fought cartels and regulators all the way to victory in the Supreme Court, vindication for himself is not enough.

“The third arrow is like a triple bypass to clear out the bureaucrats, the vested interests and the politicians that have choked our economy for too long,” Goto told the Foreign Correspondents’ Club of Japan.

“These non-transparent relationships are widespread. They are the basis of political and bureaucratic power in Japan. And they are the biggest obstacle to our economic revival.”

Nobody knows that better than Michael Woodford. While Abe was laying out his plans in Tokyo, the executive who challenged the status quo as chief executive of Olympus, the imaging giant that turned out to be mired in scandal, was following his speech at home in England.

“Today was a disappointment,” Woodford told The Sunday Times, “It is hard decisions on things like labour reforms, or turning on the nuclear reactors, or allowing hostile takeovers that will test if it is real or not — so far we haven’t seen any.”

Woodford singled out as a classic evasion the premier’s announcement that companies must have at least one independent director on the board — unless they can provide an explanation why not.

“Out of the 1,600 listed companies, more than 1,000 don’t have an outside director — what kind of world is this?” he asked.

The prime minister’s defenders predict that Abenomics will harden up if the government prevails in the upper house elections next month. A few days from now the cabinet is due to endorse more precise proposals than those laid out by Abe.

The premier does seem determined to restart 48 of Japan’s 50 nuclear reactors, which were shut down after the Fukushima meltdown in the earthquake and tsunami disaster of 2011. The resulting energy bill is huge, although fortune and the commodities markets have favoured Japan with lower prices for liquefied natural gas.

“The market is the market,” said Jesper Koll, director of equity research at JP Morgan in Tokyo. “These are healthy adjustments and I think corporate restructuring and the earnings power of corporate Japan are going to very much surprise on the upside."

There is also talk of a "fourth arrow" — restoring rectitude in the public finances. The cabinet is said to have agreed on a goal to cut the primary deficit to 3.2% of GDP in fiscal 2015. But, as with so much of the tough stuff inside Abenomics, the detail is still lacking.

By one interpretation, Abe was testing the political water with his talk last week of modest corporate tax cuts, measures to ease mergers and acquisitions, a push to expand Japan's free trade agreements and subsidies to enhance labour mobility and to encourage women into the workforce.

But for an impatient generation of Japanese entrepreneurs, this is just the old LDP formula of heavy fiscal spending and economic tinkering by bureaucratic fiat.

"I think the best kind of support would be for the government not to do anything — not to get involved," said Takafumi Horie, an unrepentant upstart who shot to fame with Livedoor, a pioneering internet firm, but who ended up spending 21 months in jail for accounting fraud.

Horie stoutly protests his innocence to this day, saying he was done down by the financial establishment, and has returned to the commercial fray. Like Goto, he burns with a frustration shared by many younger Japanese.

For Woodford, who took on the Tokyo insiders and won a moral victory, the ways of Old Japan will doom the nation unless Abe really means to change them.

"Clearly the weaker yen has helped but it's not enough," he said, "That country needs an economic renaissance more than ever."