

Abenomics' Rewards and Risks

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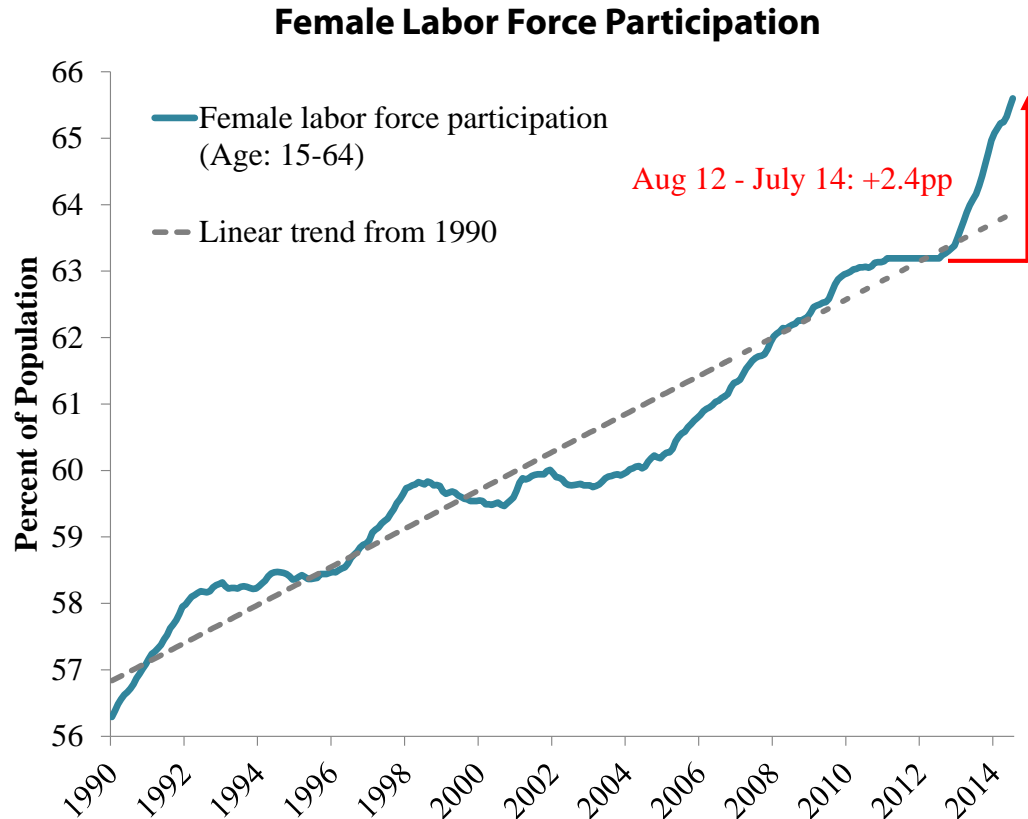
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Abenomics' Rewards and Risks

- The Japanese recovery is going right, even if it is not going well
 - The biggest structural reform is underway
 - The monetary regime change is effective
- Abenomics is real change, so its completion is uncertain
 - Risk #1: Agriculture protectionism foils TPP
 - Risk #2: Postponing VAT increase because of short-term impacts on GDP

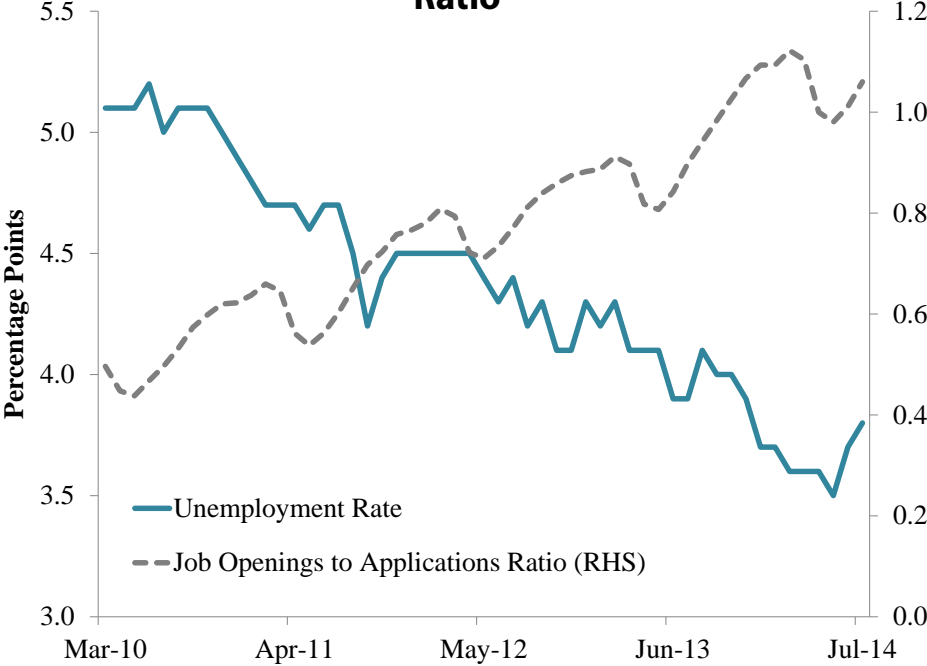
The Most Important Structural Reform is Underway: Womenomics



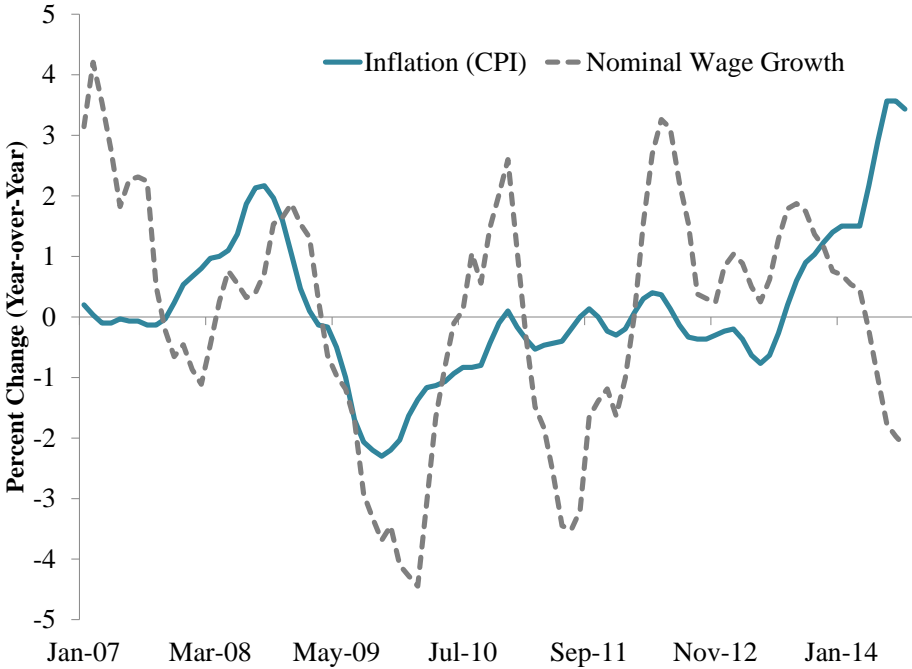
In the past 24 months, working age female labor force participation has increased by 2.4 percentage points.

Monetary Stimulus is Working: Labor Markets are Tightening

Unemployment Rate and Job Openings to Applications Ratio



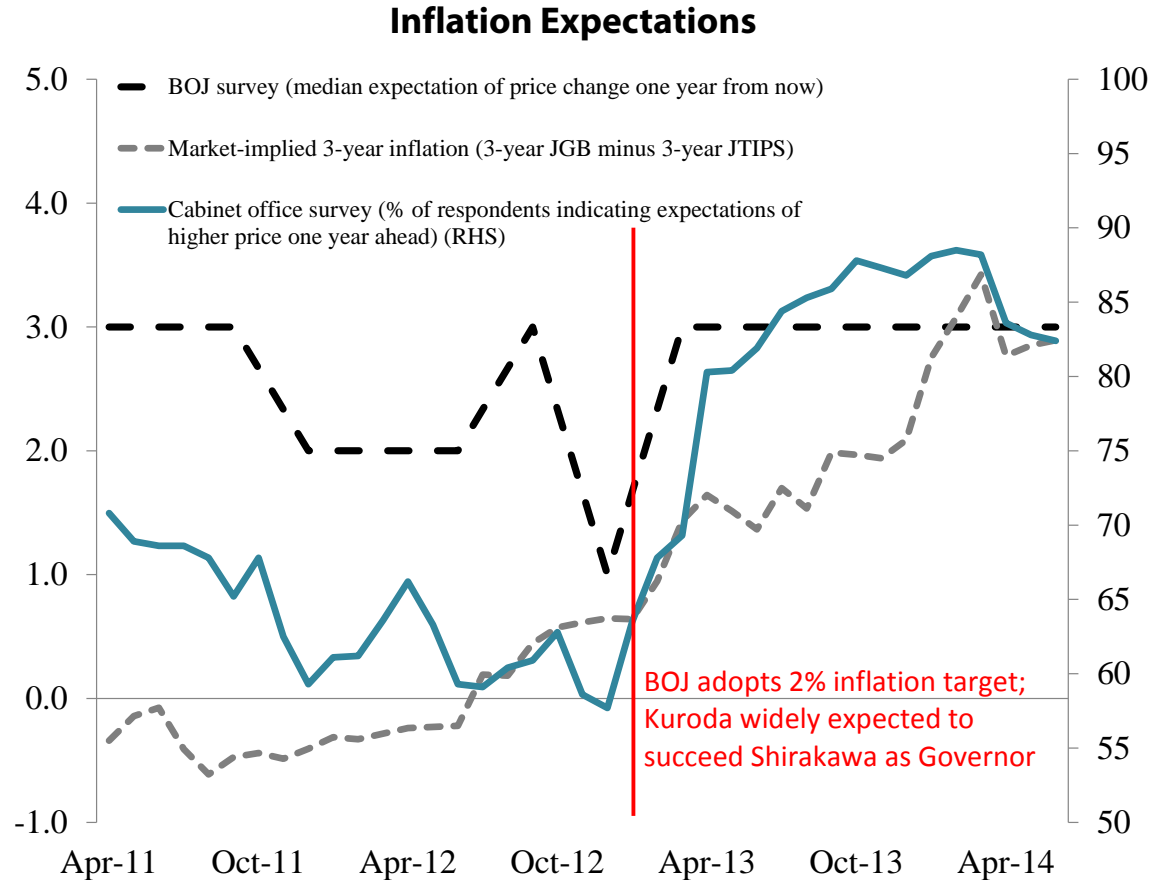
Inflation and Nominal Wage Growth



Even though wage growth now lags inflation, this is a healthy trend for the economy.

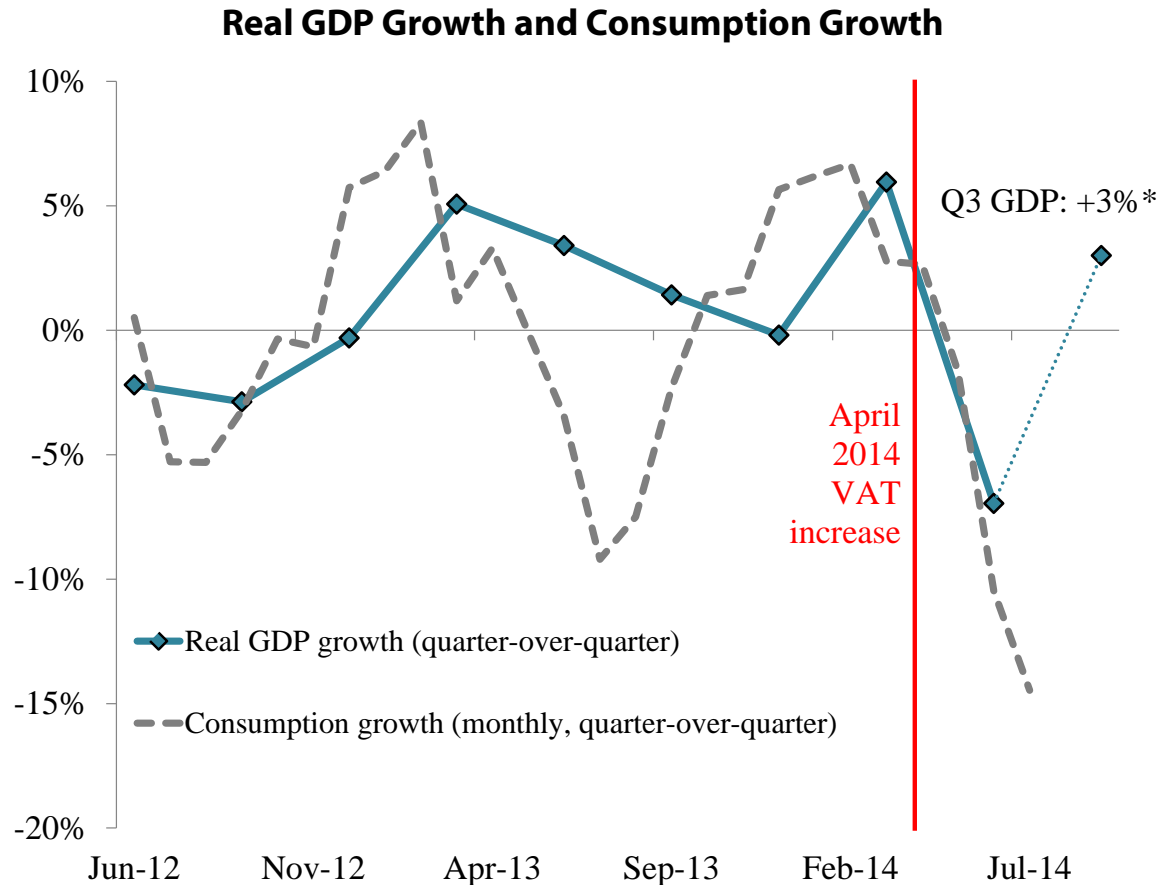
Sources: Japan Ministry of Health, Labor, and Welfare; Bloomberg; OECD

Monetary Stimulus is Working: Inflation Expectations are Rising



Growth did not cause inflation under the old monetary regime

Of course tax increases are contractionary, but the impact should be temporary



The economy can rebound better than in 1997

The BOJ is More Optimistic Than the Market – Reality Will Be Closer to the BOJ Forecast

Evolution of Real GDP Forecasts for 2014 & 2015

Source	Forecasts for 2014			Forecasts for 2015		
	Current	as of Q1 14	as of Q4 13	Current	as of Q1 14	as of Q4 13
FY Cabinet Office	1.2%	1.4%	1.0%	1.4%	1.7%	2.0%
FY Bank of Japan	1.1%	1.4%	1.5%	1.5%	1.5%	1.5%
FY Avg of bank estimates 1/	0.1%	0.5%	1.0%	1.2%	1.2%	1.5%
CY IMF WEO	1.6%	1.4%	1.2%	1.1%	1.0%	1.1%
CY OECD	0.9%	1.2%	1.5%	1.1%	1.2%	1.0%
CY Consensus	1.2%	1.4%	1.6%	1.3%	1.3%	
CY PIIE / AP	1.3%	1.5%	1.5%	1.5%	1.3%	1.9%

Risk to Abenomics' Success #1: Agriculture Blocking TPP Gains

Economics Gains from the TPP

Economy	2025 Baseline GDP	Income gains (bil. 2007 USD)		Percent change from 2025 baseline	
		TPP11	TPP12 (with Japan)	TPP11	TPP12 (with Japan)
Japan	5,338	(1.2)	104.6	0.0	2.0
United States	20,273	23.9	76.6	0.1	0.4
Rest of TPP 11	7,434	82.8	103.7	1.1	1.4
China	17,249	(20.2)	(34.8)	(0.1)	(0.2)

Sources: Petri, Plummer, Zhai (2012)

Japan has more to gain from a comprehensive TPP deal than anyone – precisely because it would be structural reform

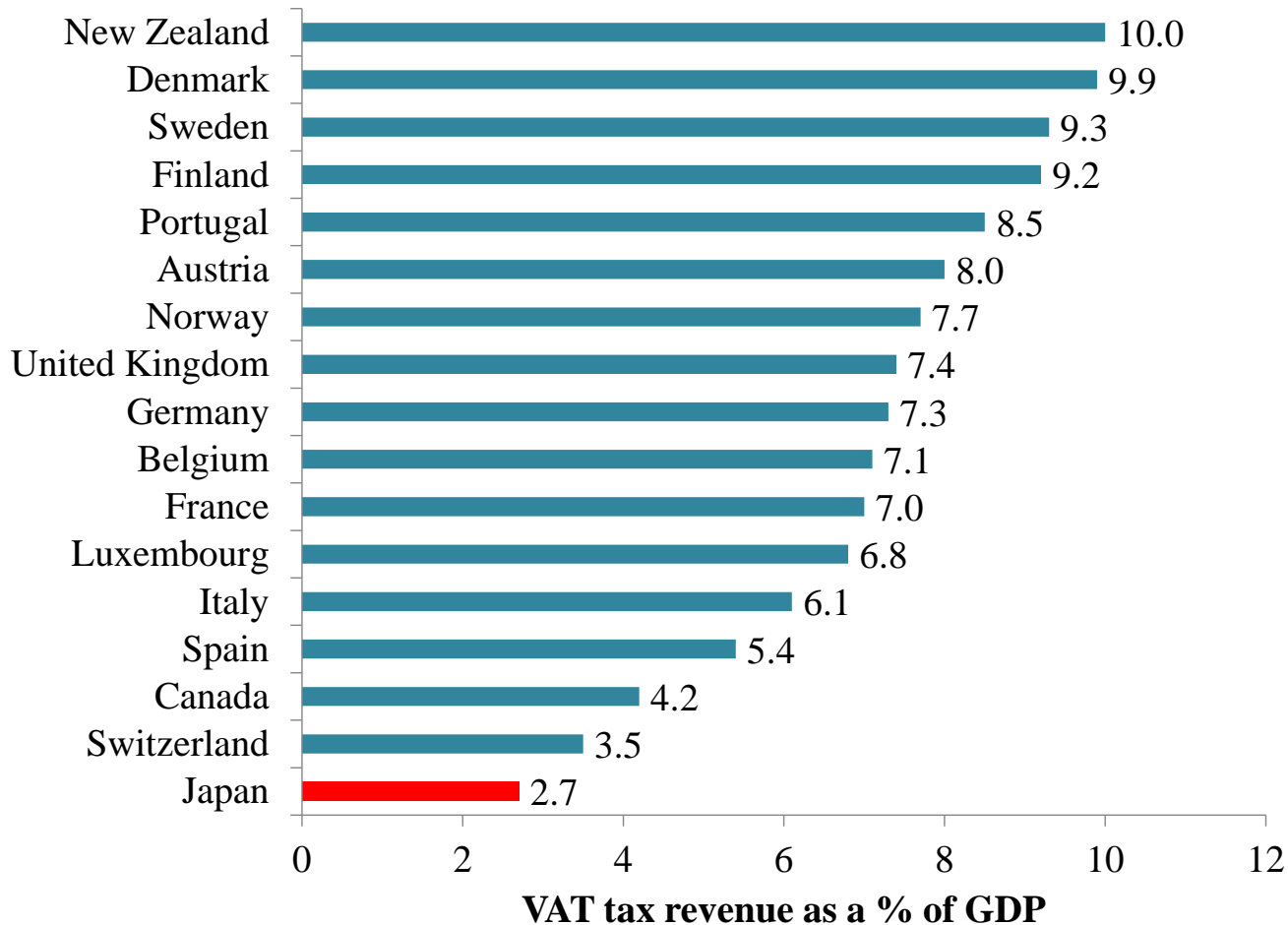
- Japanese households spend nearly 14% of their income on food, compared with 9% and 7% in the UK and US, respectively (OECD data).

Risk to Abenomics' Success #2: VAT Increase Postponement

Time	Event
April 1, 2014	First consumption tax increase from 5% to 8%
August 13, 2014	GDP release shows large drop in consumption
November 16, 2014	Q3 2014 GDP data to be released
November 2014	Government to start "discussion" on whether to go ahead with 2015 increase, based on the data released
December 2014	Government scheduled to take the decision on whether to allow the scheduled consumption tax increase to occur
October 1, 2015	Second planned consumption tax increase from 8% to 10%

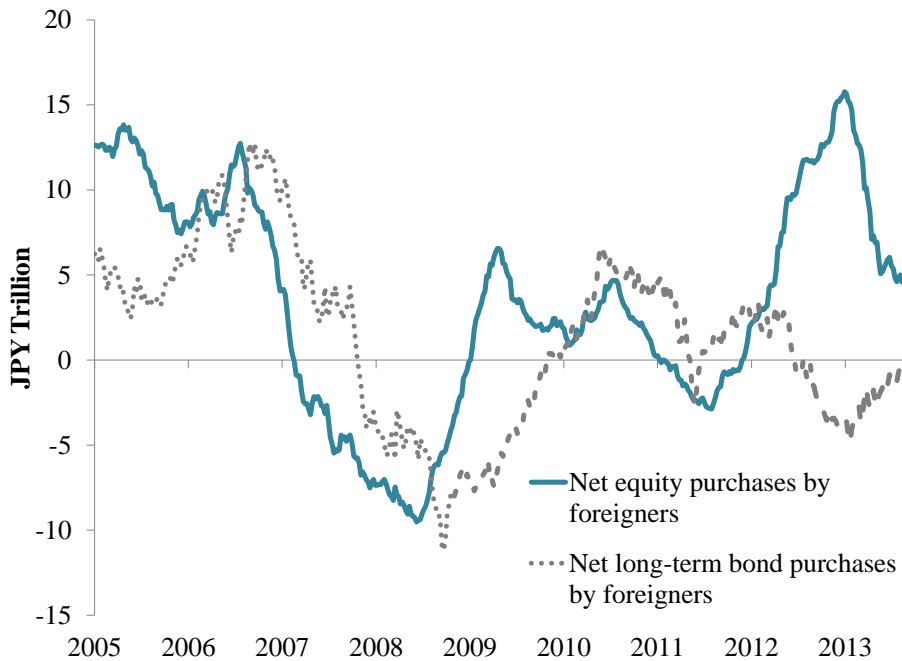
Risk to Abenomics' Success #2: Sustainability based on use of room to tax

Consumption Tax Revenue as a % of GDP Across Select Developed Countries

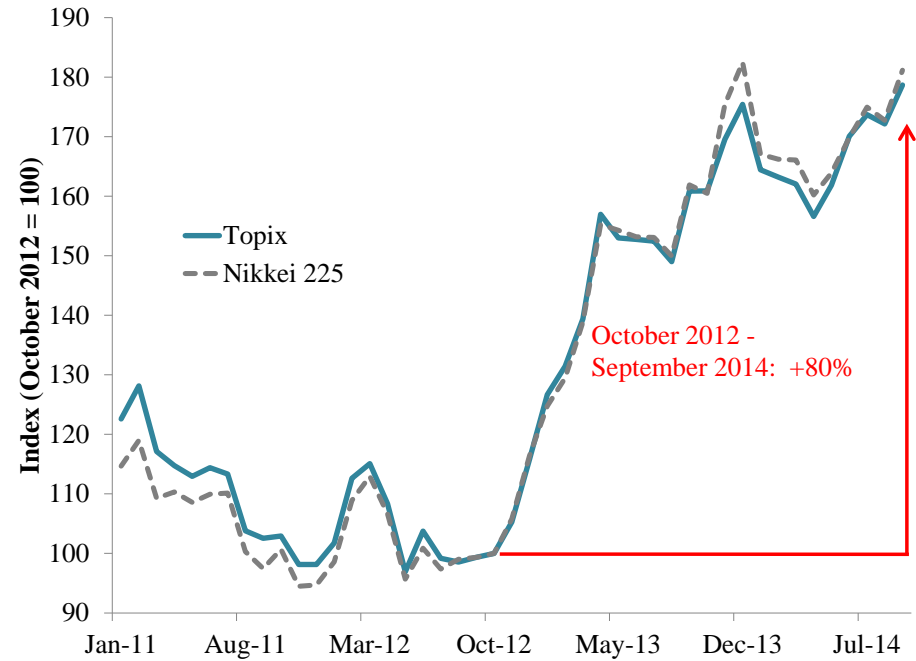


Risk to Abenomics' Success #2: Equities and Yen (not JGBs) vulnerable

Net Purchases of Japanese Financial Assets by Foreign Investors



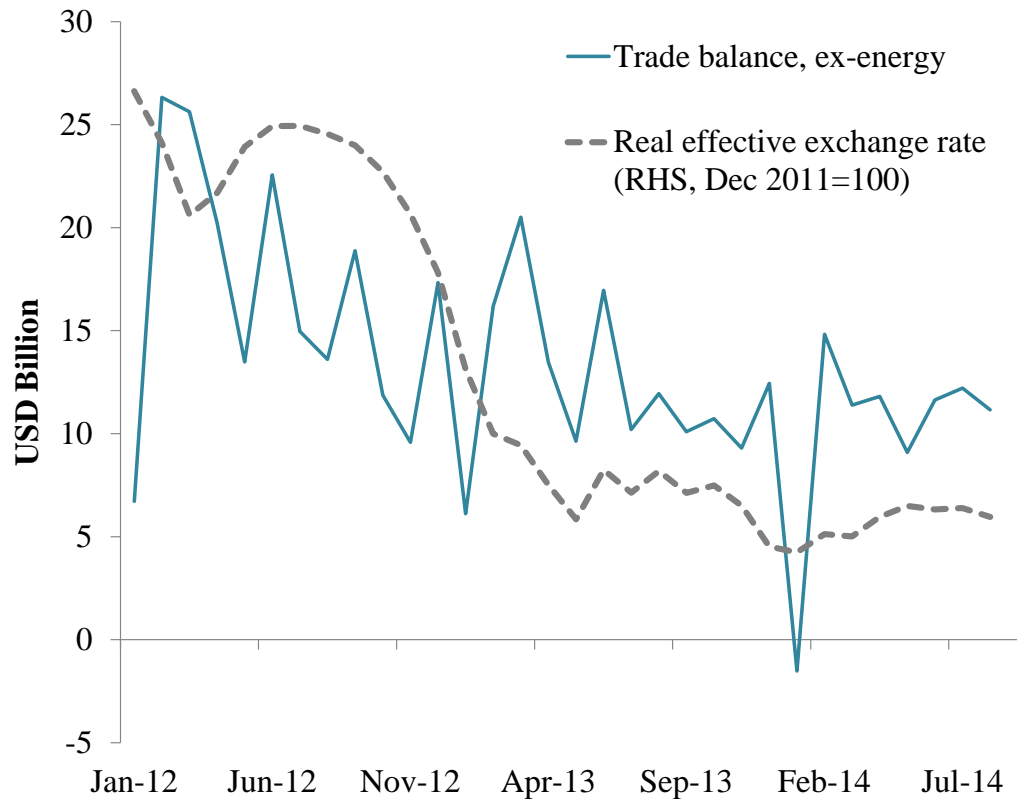
Japanese Equity Index



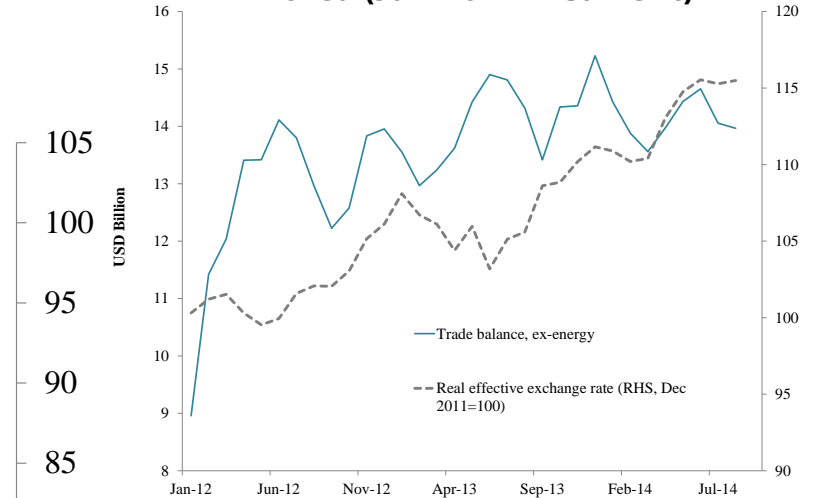
Balancing (over)reaction to (temporary) slowdown versus (potential) hit to wealth without tax revenue gain

Risk to Abenomics' Success #2: A Sharp Yen Fall is Not a Winner for Today's Japan

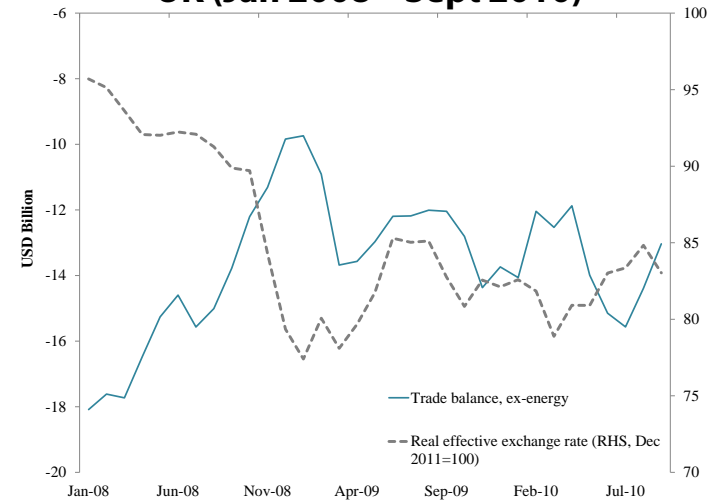
Trade Balance (ex-Energy) and the Real Effective Exchange Rate: Japan (Jan 2012 – Current)



Korea (Jan 2012 – Current)



UK (Jan 2008 – Sept 2010)



Abenomics' Rewards and Risks

- The biggest reform – Womenomics – is underway, and other labor market reforms are helping
- The monetary regime shift is having the desired impact on the domestic economy
- Japan's economy will bounce back from VAT hike, and inflation will resume rising
- Postponing reform, however, presents real risks:
 - Foregoing comprehensive TPP to protect a few farmers will cost a lot
 - Postponing the next VAT hike risks causing similar hit to GDP, but also missing revenue and losing confidence