

Mizuho Economic Outlook & Analysis

Five years of Abenomics and policy issues going forward

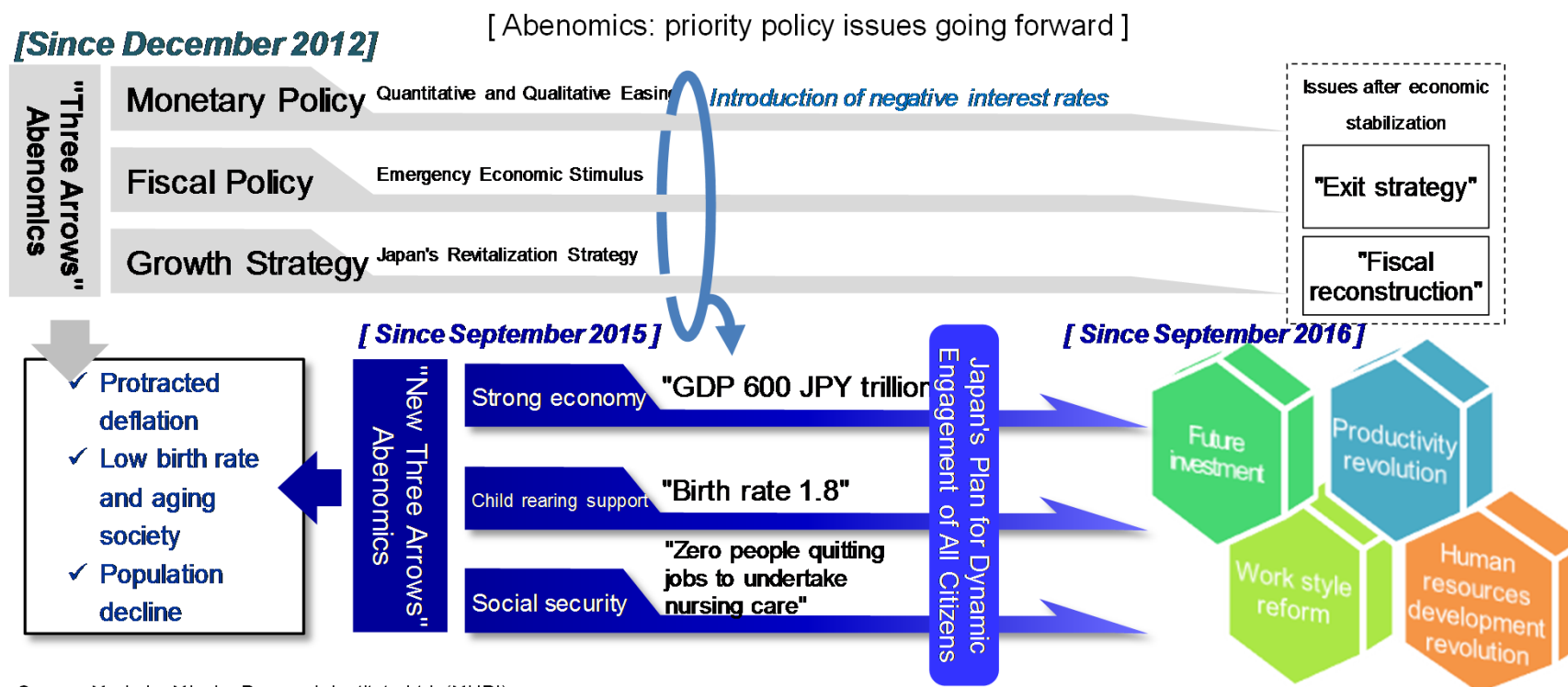
- Japan's economic revival remains the Abe administration's focus as it takes a step toward a long-term administration -

December 21, 2017

Mizuho Research Institute

Five years of the Abe administration: Abenomics entered its second stage from autumn 2015

- ❑ After its inauguration in December 2012 the second Abe administration formulated the “Abenomics” policy package comprised of “Three Arrows”.
 - The initial “Three Arrows” were aggressive monetary policy, flexible fiscal policy, and growth strategy including structural reform.
- ❑ From the autumn of 2015, the administration advocated the “New Three Arrows” as the “second stage” of Abenomics.
 - The “New Three Arrows” are comprised of a “strong economy”, “child rearing support”, and “social security”. Subsequently, the priorities shifted to “work style reform” and “human resources development revolution”.
- ❑ Abenomics has evolved from “full mobilization of macroeconomic policy” to a “policy with a strengthened focus on people, including income redistribution and human resources investment, etc.”

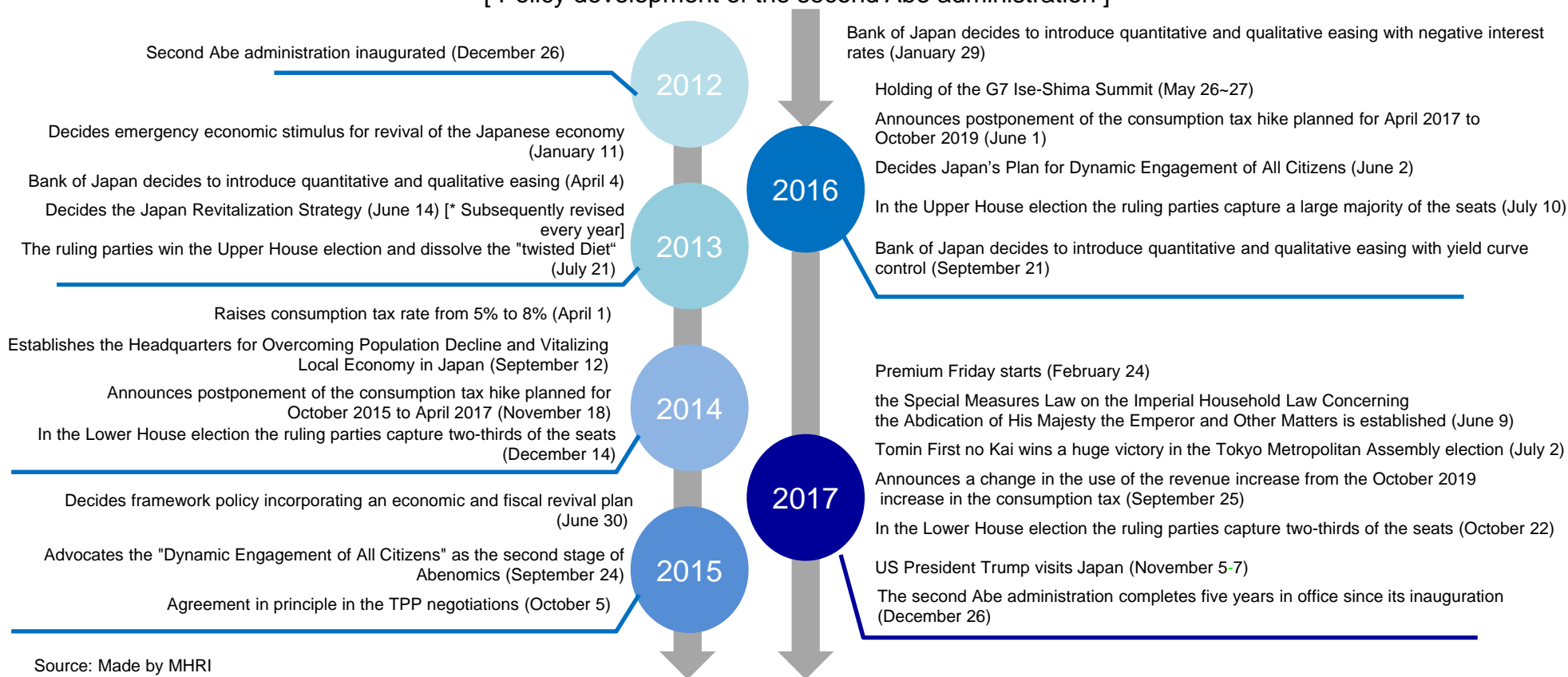


Source: Made by Mizuho Research Institute Ltd. (MHIRI)

Five years of the Abe administration: road to economic revival

- ❑ The second Abe administration has lasted for five years as of December 26, 2017.
 - In its second stage from autumn 2015, Abenomics focuses upon persons and regions which have thus far been left behind (the child-rearing generation, low income earners, rural areas, etc.) under the “Japan's Plan for Dynamic Engagement of All Citizens”. Furthermore, the consumption tax hike was postponed twice.
- ❑ Japan’s economic revival still remains an ongoing issue. Among the pending issues are the improvement of growth potential through structural reforms, and the formation of a virtuous cycle in the economy.

[Policy development of the second Abe administration]



Five years of the Abe administration: growth strategy revised every year

- ❑ In its initial stage, the growth strategy in the Abe administration placed greater stress upon issues such as regulatory reform, expansion of investment, and industrial reorganization.
- ❑ From 2016, it targets the realization of "Society 5.0" and facilitation of the fourth industrial revolution (the rapid progress of IoT, robots, and AI) to society.
 - Society 5.0 is a vision of a society in which issues are solved by the provision of goods and services tailored to individual needs through the spread of advanced technologies.

[Transitions in the sectors prioritized in Abe's growth strategies]

→ The second stage of Abenomics

	Sector	Growth Strategy 2013	Growth Strategy 2014	Growth Strategy 2015	Growth Strategy 2016	Growth Strategy 2017
Promising markets	Health, medical care and nursing care	✓	✓	✓	✓✓	✓✓
	The fourth industrial revolution (IoT, AI, robots, etc.)		✓	✓	✓✓	✓✓
	Transport services and distribution				✓	✓✓
	FinTech			✓	✓	✓✓
	Next-generation supply chains				✓	✓✓
	Energy / the environment	✓	✓	✓	✓	✓
	Existing and reformed housing market			✓	✓	✓
Regional economies	Support for SMEs	✓	✓	✓	✓	✓
	Agriculture	✓	✓	✓	✓	✓
	Tourism	✓	✓	✓	✓	✓
	Service industry			✓	✓	✓
Foreign policy	Trade policy (economic partnership negotiations)	✓	✓	✓	✓	✓
	Inward direct investment	✓	✓	✓	✓	✓
	Infrastructure and contents exports	✓	✓	✓	✓	✓
Infrastructure development	PPP · PFI	✓	✓	✓	✓	✓
	IT utilization / cyber security	✓	✓	✓	✓✓	✓✓
	Use of human resources / work-style reform	✓	✓✓	✓✓	✓✓	✓✓
	Innovation / venture capital	✓	✓	✓	✓	✓
Regulatory reform	National Strategic Special Zones / the regulatory sandbox	✓✓	✓✓	✓	✓	✓✓
	Corporate tax reform/ investment tax credits	✓✓	✓✓	✓✓		
	Corporate governance	✓	✓✓	✓✓	✓✓	✓
	Other reforms	Industrial Competitiveness Enhancement Act, establishment of a System to Eliminate Regulatory Gray Zones, etc.	✓	GPIF reform	GPIF reform	Regulatory reform, simplified administrative procedures, integrated promotion of IT

Note: On the basis of a qualitative analysis, policies seen as a high priority for the government are assigned a "✓✓", those as being proportionately important with a "✓".

Source: Compiled by MHRI based on respective annual growth strategies.

Macroeconomic situation: despite the improvement of corporate earnings and employment, it still has to ripple through to consumer spending

- Even though economic conditions have generally improved compared to before the inauguration of the Abe administration, a full-fledged economic revival is yet to be achieved.
 - Corporate earnings are strong and stock prices are rising. The ongoing improvement of employment is also commendable.
 - The increase of personal consumption through wage rises remains as an issue.

[Changes in macroeconomic indicators over five years of Abenomics]

		Abenomics period		
		FY2012	FY2013~2016 average	Most recent
GDP demand	Real GDP(%)	0.8	➔	1.2
	Real consumption expenditures (%)	1.6	➔	0.3
	Real capital investment (%)	2.4	➔	3.4
Employment	Real employee compensation (%)	-0.5	➔	0.1
	No. of employees (%)	0.3	➔	1.1
	Nominal wages (%)	-1	➔	0.2
Output gap	Output gap (%)	-0.7	➔	0.1
	Production capacity DI (% Pt)	6.0 (December 2012)	➔	0.4
	Unemployment rate (%)	4.3 (December 2012)	➔	3.4 (December 2014)
Consumer prices	Core CPI (%)	-20.00%	➔	0.3 <small>(ex impact of consumption tax)</small>
	Core core CPI (%)	-60.00%	➔	0.4 <small>(ex impact of consumption tax)</small>
Corporate sector	Ordinary income (JPY trillion)	12.4 (October ~ December 2012)	➔	17.1 (quarterly average)
Fiscal conditions	Tax revenue (JPY trillion)	43.9 JPY trillion (settlement amount)	➔	53.2 (settlement amount)
Finance	Nikkei Stock Average (JPY)	10,080 (December 25, 2012)	➔	17,426
	Household financial assets (JPY trillion)	1,606.5 (December 2012)	➔	1,738.7
				1.8 (FY2017 forecast)
				1.1 (FY2017 forecast)
				3.6 (FY2017 forecast)
				1.3 (October 2017)
				1.1 (October 2017)
				0.6 (October 2017)
				0.5 (FY2017 forecast)
				-5.0 (December 2017)
				2.8 (October 2017)
				0.8 (October 2017)
				0.0 (October 2017)
				20.4 (July ~ September 2017 quarter)
				57.7 (FY2017 budget amount)
				22,892 (December 20, 2017)
				1,844.9 (September 2017)

The strength of corporate earnings is not having a sufficient ripple effect

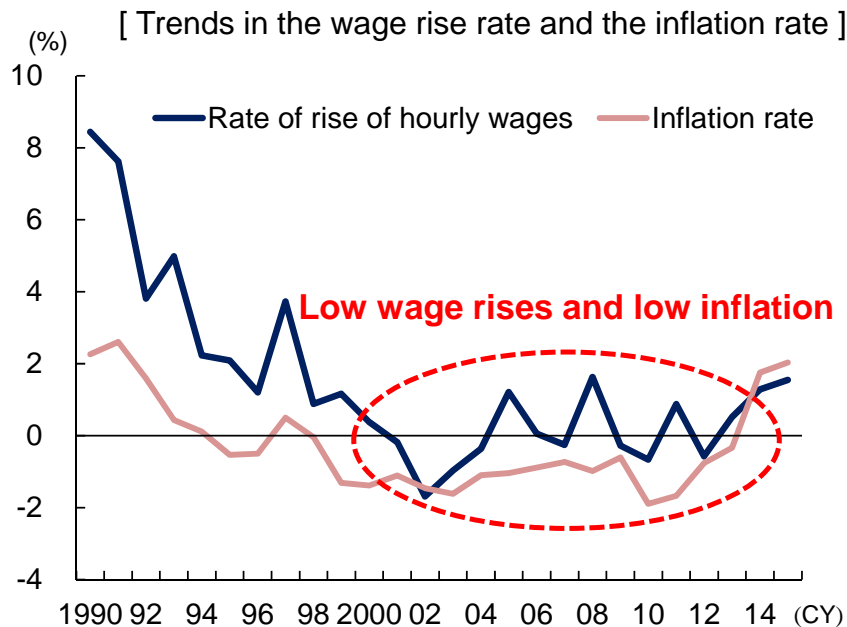
The strength of corporate earnings has a ripple effect

Goal of the Bank of Japan (2%) not achieved

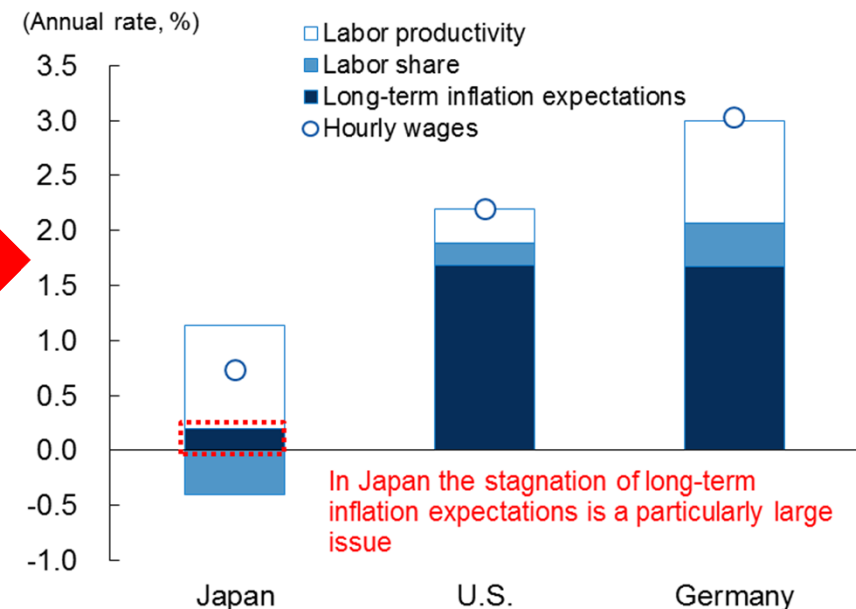
Source: Made by MHRI based on the Cabinet Office, *National Accounts*, etc.

Macroeconomic conditions: improvement of of long-term inflation expectations is necessary for wage rises

- Even though inflation has turned positive during the Abe administration, this has not led to the strong rise of wages.
 - Given a prolonged period without wage hikes and rise of inflation since 2000, a state of tepid wage rises and low inflation has become the “standard (= the norm)”.
 - Comparing the factors behind the stagnation of wages with the US and Germany, the stagnation of long-term inflation expectations is the most serious in Japan.
- Raising long-term inflation expectations of companies and households is necessary for the rise of wages.



[Contribution analysis of wages (2010~2015 average)]



Notes 1: Contribution analysis based on the following formula.

$$\text{Per-hour wages} = \text{employee salaries} / \text{total labor hours} = (\text{employee salaries} / \text{nominal GDP}) \times (\text{nominal GDP} / \text{real GDP}) \times (\text{real GDP} / \text{total labor hours})$$

$$= \text{labor's share} \times \text{GDP deflator} \times \text{labor productivity}$$

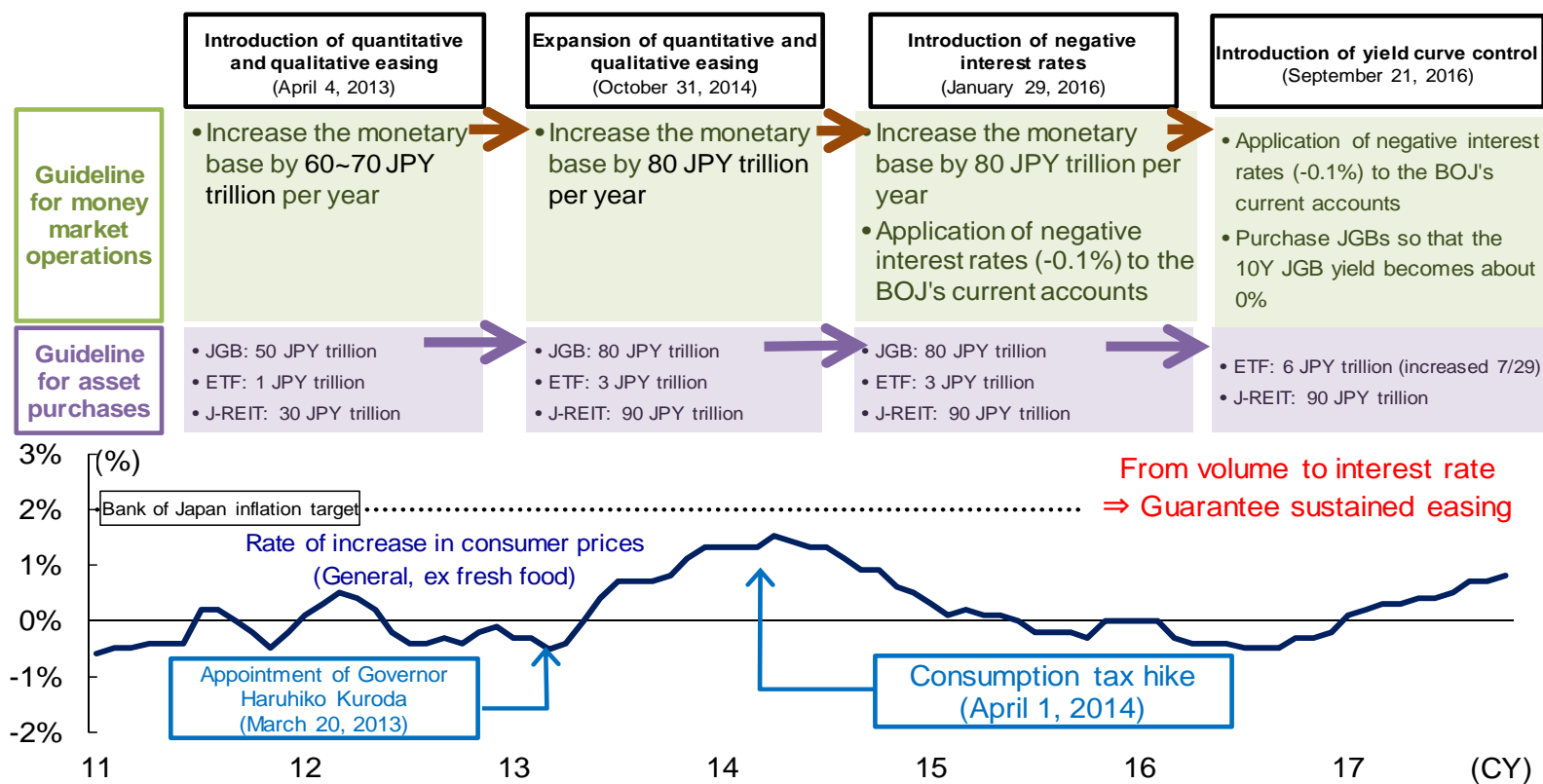
2: In the figure, we use the long-term fluctuation rate over five years so we have interpreted the GDP deflator factor to be "long-term inflation expectations" (= the trend inflation rate).

Source: Made by MHRI based on the OECD, *National Accounts*

BOJ monetary policy: shift from policy aimed at short-term results to a sustainable framework over the long-term

- Since the appointment of Haruhiko Kuroda as Governor, the Bank of Japan (BOJ) has resorted to monetary easing aimed at producing short-term results. However, after the September 2016 *Comprehensive Assessment*, it has shifted to a sustainable framework over the long-term.
 - In April 2013, the BOJ introduced quantitative and qualitative monetary easing. Subsequently, it strengthened monetary easing to address the downside risks of inflation expectations due to the consumption tax hike.
 - However, given the difficulty to achieve the inflation target, the BOJ shifted to a framework of long-term sustained monetary easing after the *Comprehensive Assessment* in September 2016.

[Shifts in Monetary Easing Policy]

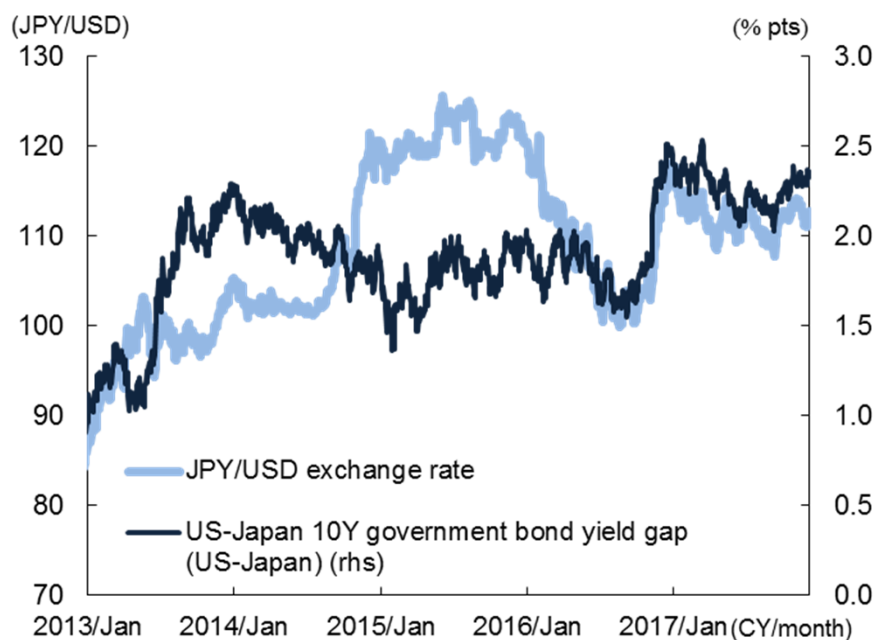


Source: Made by MHRI

BOJ monetary policy: yen weakening/stock market rise since QQE in April 2013

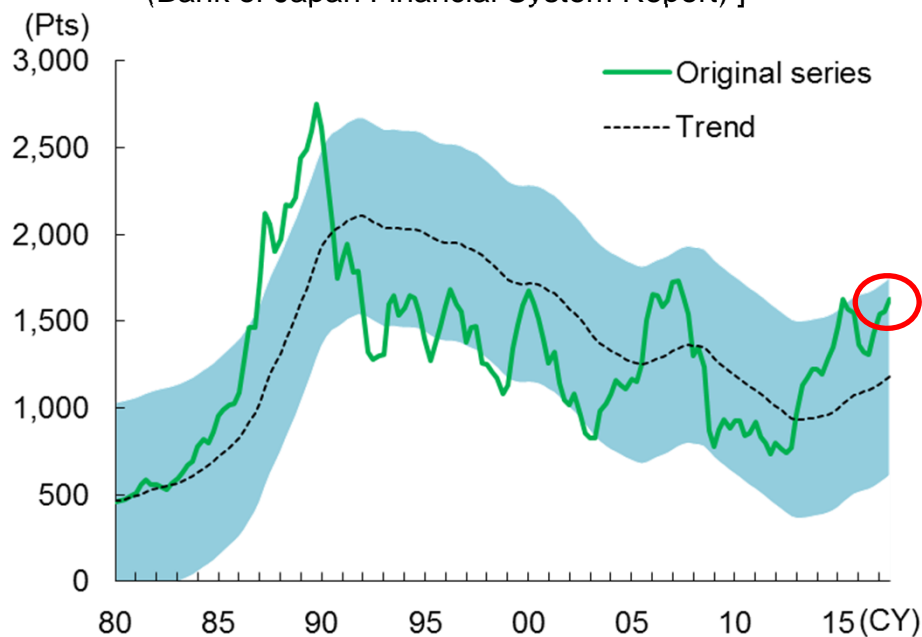
- Since the April 2013 quantitative and qualitative monetary easing (“QQE”), the yen continued to weaken, temporarily reaching JPY125/USD in mid-2015. Furthermore, stock prices also followed an uptrend.
 - However, as US government bond yields trend low, the subsequent depreciation of the yen has been limited.
 - On the other hand, given the difference in direction of monetary policy between Japan and the US and Europe, the upside of the yen is currently heavy (serving to prop up stock prices).
- The BOJ is purchasing ETFs in a bid to push down the risk premium. However, given recent signs of overheating in stock prices, there is some market speculation on a shift in the BOJ’s policy of purchasing ETFs.

[Japan and US long-term interest rates and exchange rates]



Source: Made by MHRI based on Bloomberg

[Stock prices (TOPIX) and deviation from the trend (Bank of Japan Financial System Report)]



Source: Bank of Japan, *Financial System Report* (October 2017)

The Abe administration's economic policy: even though there have been significant results in tourism, regional revitalization is struggling

- The Abe administration has implemented appropriate measures in its priority policy areas. However, there are areas where its policy effect has been insufficient.
 - Tourism (inbound) is the area in which Abenomics has yielded the most remarkable achievements. Likewise in trade policy, there has been great progress in the area of mega-FTA negotiations.
 - As for regional revitalization, the initiatives have fallen short of achieving a major shift in the direction of demographic flows.

[Evaluation of priority policy areas]

Policy areas	Evaluation
Corporate governance reform	○ "Formal" responses such as the appointment of outside directors, etc. have made progress. Going forward "real" results such as improved company performance, etc. are required
GPIF reform	◎ Expanded management of risk assets and reforms of governance aspects have progressed, and this is one factor behind stock price rises
Act on Strengthening Industrial Competitiveness/corporation tax reduction	○ Comprehensive support measures tailored to the development stage of companies. Due to substantial corporate tax reductions the effective tax rate of corporations has fallen below 30%
Empowerment of women	○ Through the publication of information about the empowerment of women and the "outside eye" including the certification mark, etc., the initiatives of companies are gradually becoming more active
Work style reform	○ A certain amount of progress is expected in the "efforts to address long working hours" and "improvement of the treatment of people in irregular employment." Improvement of labor productivity is an ongoing issue
Trade policy	◎ Due to the withdrawal of the US from the TPP the numerical target of a "FTA ratio of 70%" has not been achieved but the mega-FTA negotiations have made great progress overall
Regional revitalization	△ Large-scale excessive relocation to the Tokyo area and major urban centers is continuing, so tenacious local initiatives continue to be important
Agricultural reform	○ Reforms of agricultural land, rice production, farm management, exports, agricultural cooperatives, etc. are progressing but the manifestation of effects is slow-paced
Tourism (inbound)	◎ The number of foreign travelers visiting Japan has greatly increased under the Abe administration. Attracting tourists to local areas is an issue going forward
National strategic special zones	○ To date 10 zones have been certified, and more than 50 items of regulatory reform have been realized. However, there are also zones with striking delays in the progress of the project
Electric power reform	○ A 3-stage electric power system reform is under way. Many carriers have entered the market due to retail liberalization but penetration to users is limited
National resilience/earthquake disaster reconstruction	○ Reinforcement of a resilient nation that is prepared for large-scale natural disasters, etc. over all of its territory. Going forward continuing initiatives are necessary

Note: ◎, ○ and △ represents qualitative evaluations of the implementation and effects of the policies etc. Each of the marks represent the following evaluations:

◎: "the policy has made great progress, or marked policy effects have appeared",

○: "the policy has progressed to some degree, but the manifestation of the policy effects is not necessarily sufficient",

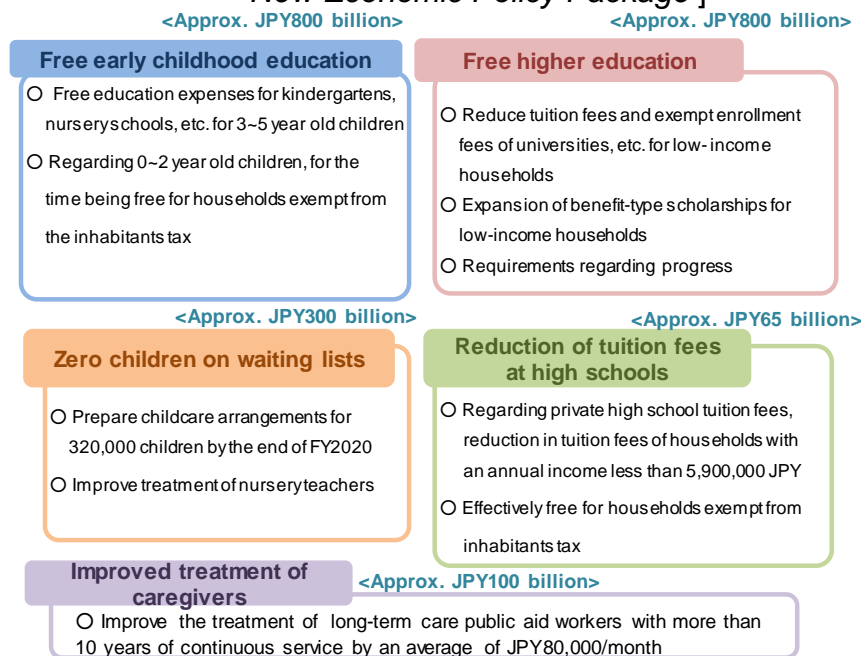
△: "many policy measures that should be implemented remain, or the policy effects are largely unconfirmed"

Source: Made by MHR1

New pillars of the Abe administration's economic policy: "human resources development revolution" that strengthens investment in education

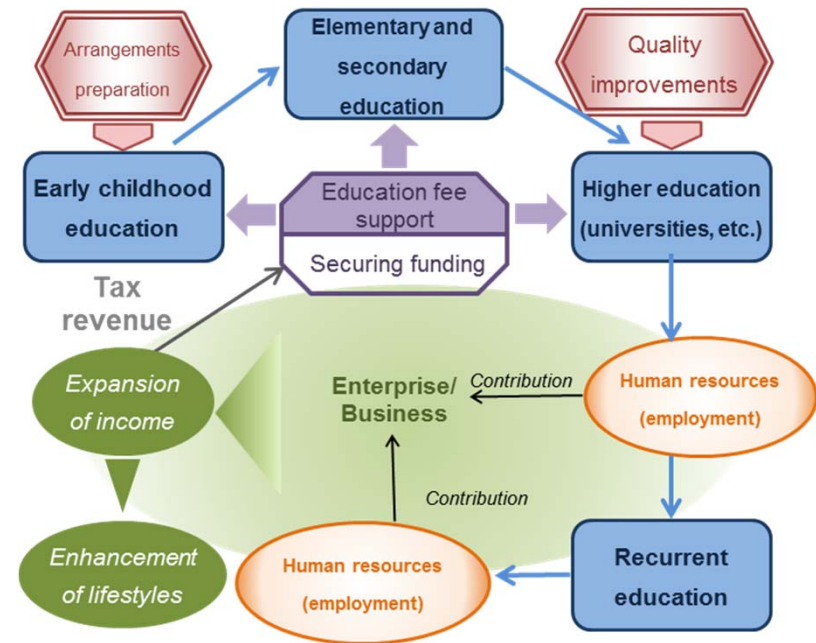
- The fourth Abe Cabinet inaugurated in November 2017 advocates "human resources development revolution" and "productivity revolution" as its new priority policy themes.
 - These two policy themes are set forth as the main pillars of the *New Economic Policy Package* decided by the Cabinet on December 8.
- The human resources development revolution aims to make early childhood education free, decrease to zero the number of children on nursery waiting lists, make higher education free, and improve the treatment of nursing care workers, etc.
 - Funding is an issue regarding the initiative to make education free. If income restrictions are not established, there is a concern that disparities will be promoted.
 - For human resources development comprehensive initiatives taking a long-term perspective are important. From this perspective, improvement of the quality of education is also an issue.

[Measures for the human resources development revolution in the *New Economic Policy Package*]



Note: The amounts inside the brackets (< >) are the required amounts.
 Source: Made by MHRI based on *New Economic Policy Package* (December 8, 2017 Cabinet Decision), etc.

[Formation of a virtuous cycle through education and necessary policy initiatives]

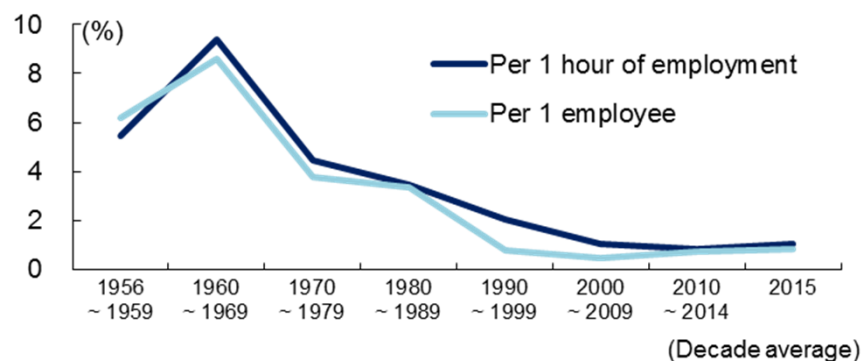


Source: Made by MHRI

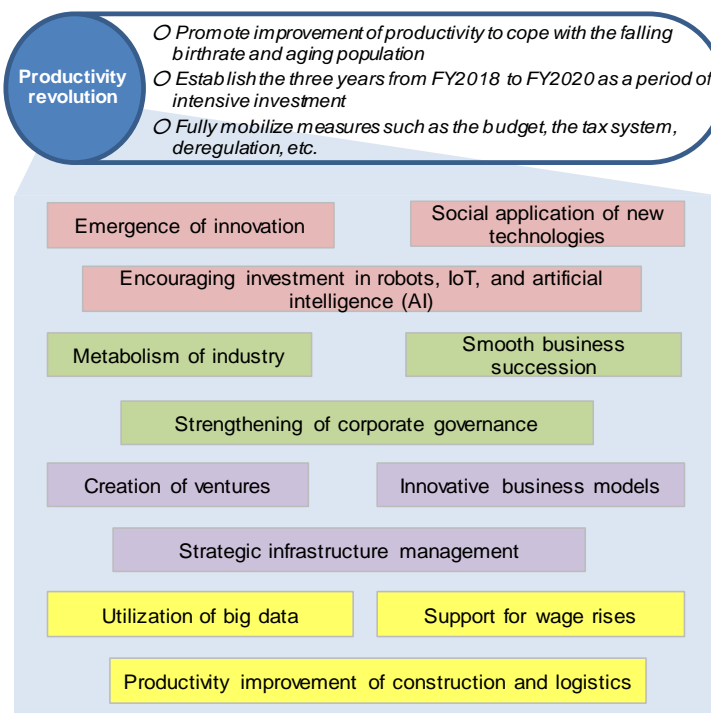
New policies of the Abe administration: “productivity revolution” up to 2020

- Productivity gains are essential for raising Japan’s growth potential, which is facing a decline of the labor force population.
 - The rate of the rise in labor productivity and total factor productivity in Japan fell sharply in the 1990s, and has continued to stagnate. The strengthening of policies and the initiatives of companies leading to the improvement of productivity are important for raising the potential growth rate.
- The fourth Abe Cabinet has positioned the three years from FY2018 to FY2020 as the "intensive investment period" of the productivity revolution, and is poised to implement policies encouraging investment in robots, IoT, and AI, and the stimulation of innovation, etc.

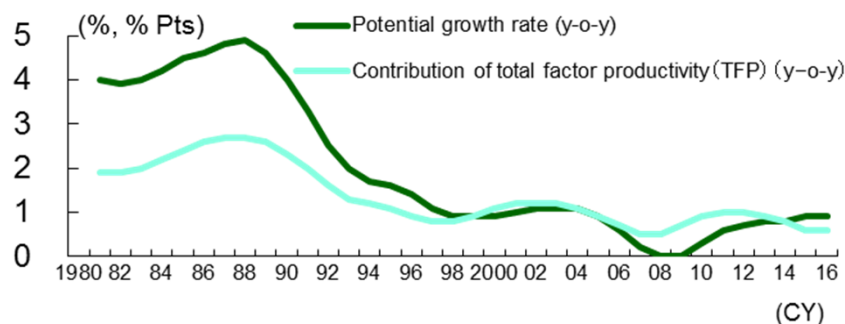
[Rate of rise of real labor productivity]



[Measures for the productivity revolution in the New Economic Policy Package]



[Potential growth rate and the contribution of total factor productivity]



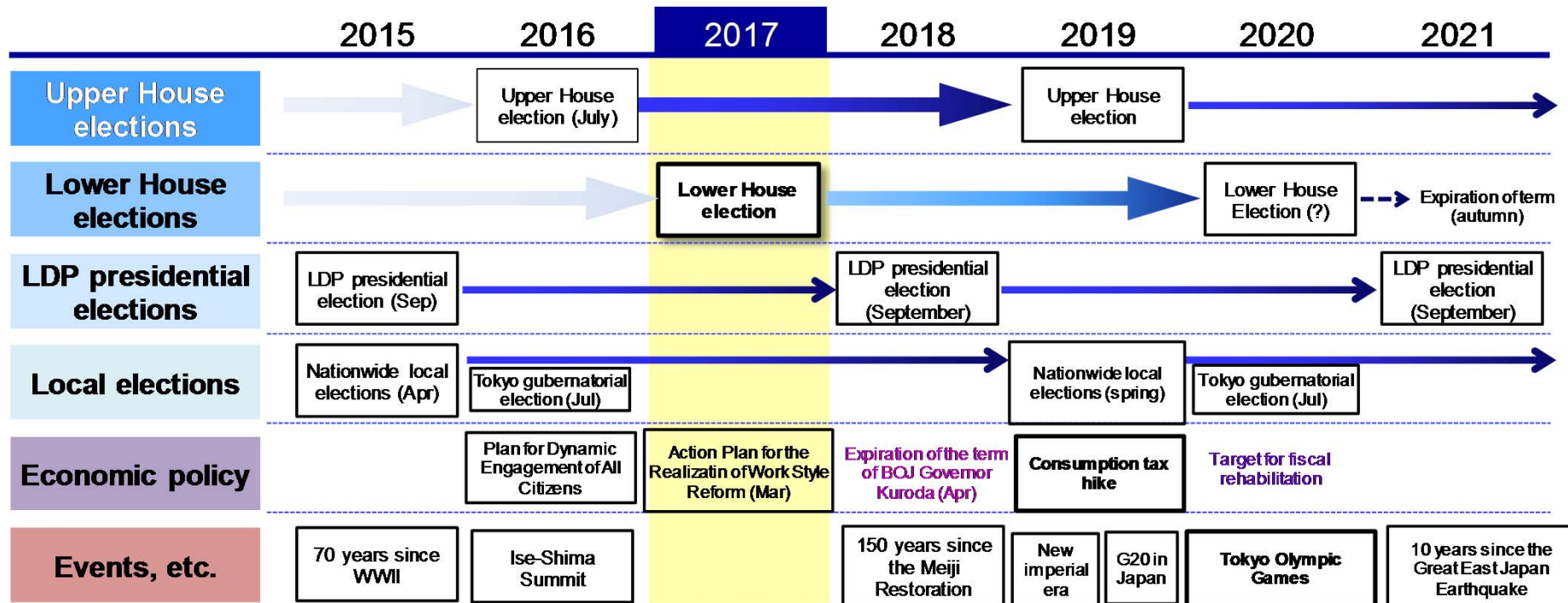
Source: Made by MHRI based on Japan Productivity Center materials and Cabinet Office materials

Source: Made by MHRI based on the New Economic Policy Package (December 8, 2017 Cabinet Decision), etc.

Political schedule going forward: Lower House election victory places Prime Minister Abe on course to a long-term administration

- As a result of the October 2017 Lower House election victory of the ruling parties, the Abe administration secured a strong power base enabling the continuity of its policy measures.
 - If Prime Minister Abe is re-elected in the 2018 Liberal Democratic Party presidential election, there is a possibility that he will lead the longest administration since the Meiji era.
- The focus is whether the administration will be in its best condition to host the G20 in Japan in 2019 and the Tokyo Olympics in 2020, while staying on course for economic revival.

[Major medium-term schedule for politics, policy, etc.]

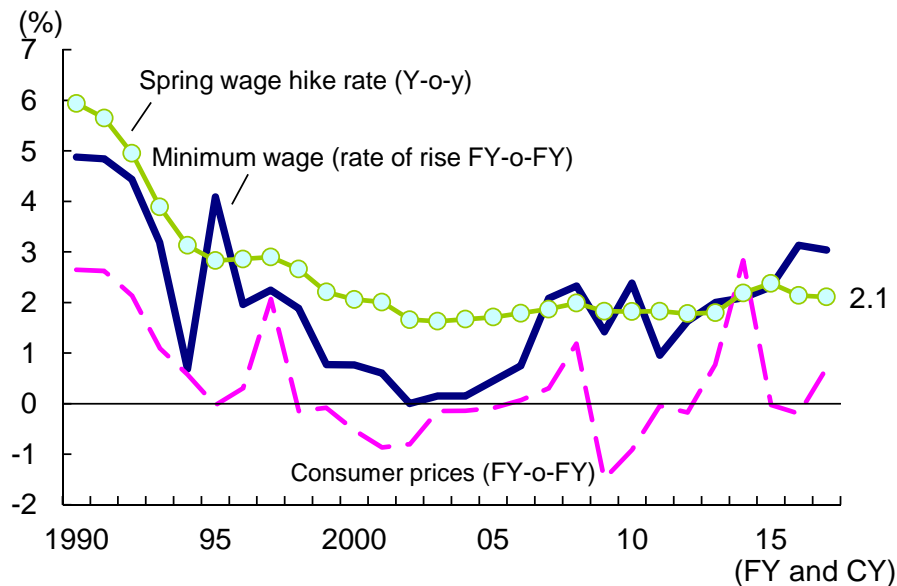


Source: Made by MHRI

Emergence out of deflation: virtuous cycle led by the wage hikes

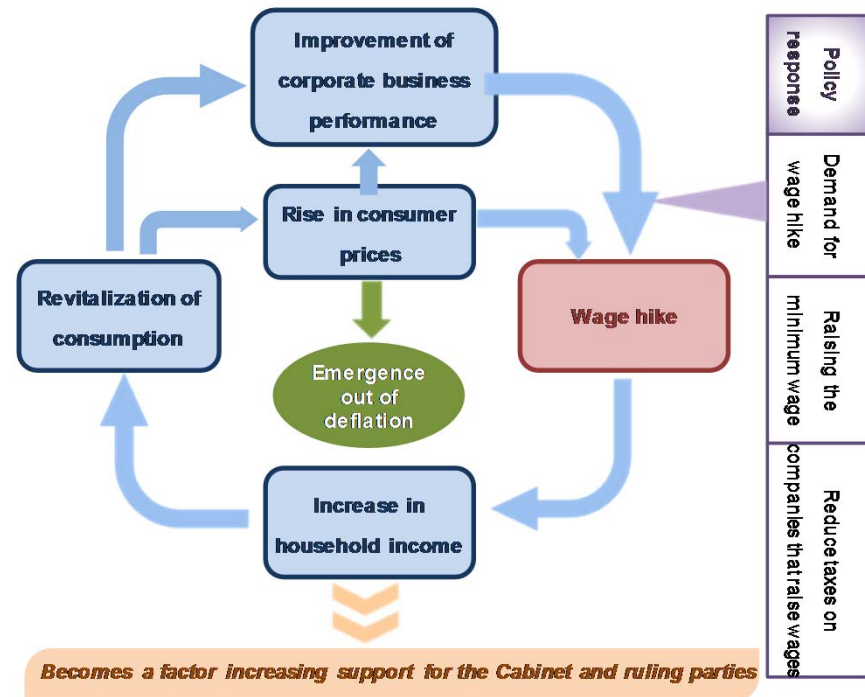
- ❑ One of the most important targets of "Abenomics" is to emerge completely out of deflation. The focal point is whether the administration can go far enough to issue a declaration that Japan has emerged out of deflation.
 - The y-o-y change of consumer prices has emerged out of negative territory but it has not reached the BOJ's inflation target. Wage hikes also have not been able to get out of their suppressed condition.
- ❑ Wage hikes are key for a "emergence out of deflation" and "formation of a virtuous cycle in the economy".
 - Prime Minister Abe is sending the message to business leaders that he expects 3% wage hikes.

[Trends in consumer prices, the minimum wage, and the spring wage hike rate]



Note: The consumer prices are nationwide general prices excluding fresh food (the FY2017 values are forecasts by MHRI).
 The minimum wage is the rate of rise year-on-year of the hourly amount (the nationwide weighted average). The spring wage hike rate is for major private sector companies.
 Source: Made by MHRI based on Ministry of Internal Affairs and Communications, *Consumer Price Index*, Ministry of Health, Labour and Welfare materials

[Formation of a virtuous cycle in the economy led by wage hikes]



Source: Made by MHRI

Epilogue: take advantage of the administration's stability to focus upon long-term policy issues

- ❑ Even though Japan is no longer technically in a state of deflation as a result of five years of Abenomics, a full-fledged economic revival is yet to be achieved.
- ❑ In the near term, Japan will need to emerge out of deflation and form a virtuous cycle in the economy through the human resources development revolution, productivity revolution, and wage hikes.
- ❑ Furthermore, in order to create a sustainable vision of the economy after the economic revival has been achieved, initiatives taking a long-term perspective should also be strengthened.

[Evaluation of five years of Abenomics and policy issues going forward]

- The administration has continued for five years, which is unusual in Japan
- It has succeeded in ensuring economic stability and improving employment
- It has come close to escaping from deflation but has not achieved the inflation target of 2%
- The growth strategy has produced outcomes to some extent in terms of implementation but its effects have been varied
- Abenomics is still only half done
- Fiscal soundness is insufficient

Evaluation of five years of Abenomics

- Abenomics is continuing. Look forward to further expansion
- Formation of a virtuous cycle in the economy and escaping from deflation are its aims
- The administration's ability to implement the human resources development revolution and productivity revolution is being questioned
- Building the environment for the consumption tax hike in 2019 is important
- It is also focusing on responses to the New Imperial Era, holding G20 Japan, the Tokyo Olympics, etc.

Priority policy areas in which initiatives taking a long-term perspective should be strengthened

- Responses to the population decline (encouragement of employment, productivity improvements, utilization of foreign human resources)
- Responses to the super-aging era (reforms of social security and the tax system)
- Attraction of overseas demand (trade agreements, inbound, agricultural exports)
- Prioritizing the encouragement of innovation, reinforcement of competitiveness, and strengthening of human resources
- Restoring fiscal soundness (steady implementation of reforms of both spending and revenue)
- Explore an effective exit strategy from quantitative and qualitative monetary easing

Directions going forward in the short term

Source: Made by MHRl

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