

Mizuho Economic Outlook & Analysis

Policy Issues facing the Abe Administration in the final stage of Abenomics

- Looking beyond to “post-Abenomics” -

October 10, 2018

Mizuho Research Institute

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Summary

- ❑ The Liberal Democratic Party leadership election held in September 2018 saw LDP President (Prime Minister) Shinzo Abe capture his third consecutive victory and party leadership for the next three years. During his last three-year term under the LDP constitution, the Abe administration needs to complete the final stage of Abenomics and draw up a roadmap for the post-Abenomics era.
- ❑ Over the past nearly six years, the Abe administration has promoted its economic policy featuring “three arrows” and “three new arrows,” and the policy has demonstrated certain achievements, for example, substantial progress made in overcoming deflation. But Japan’s full-fledged economic recovery is only halfway down the road. In the coming years, the government needs to advance its policy agenda below and address important medium- and long-term issues.
- ❑ This report examines (1) consumption tax increase, (2) fiscal consolidation, (3) monetary policy, (4) growth strategy, (5) social security, (6) employment, and (7) regional revitalization as the government’s key policy issues.
- ❑ Japan is facing numerous domestic and foreign affairs challenges, including changing the current Japanese era name, the Upper House election, chairing the G20 summit in 2019, and hosting the Tokyo 2020 Olympic and Paralympic Games. With Prime Minister Abe expected to become the longest-serving leader in the modern history of Japan, his administration’s achievements over the next three years will have a significant impact on the country’s future.

1. Policy Issues of the Abe Administration [Overview]: Prime Minister Abe’s “Five Resolutions” presented in the LDP leadership election

- During the LDP leadership election, Prime Minister Abe emphasized the government’s growth strategy, social security system reforms, regional revitalization, diplomacy, and constitutional amendment as the key policy issues.
 - In addition to the “Fourth Industrial Revolution” and “Dynamic Engagement of All Citizens,” he coined new keywords such as the “Corridor for Vitalizing Local Economies” and “Summing-up Postwar Diplomacy.”
 - He also declared his first-year goal of reforming the employment system and the goal of overhauling the social security systems - including healthcare and pensions - in the subsequent two year period.

[Prime Minister Abe’s “Five Resolutions” presented in the LDP leadership election]

Economic growth that rewards hard-working people

- Completely overcoming deflation with “three arrows.” Achieving the highest GDP of 600 trillion yen during the postwar period. Realizing the Fourth Industrial Revolution.

Social security reforms that make all generations feel secure

- Providing free education. Realizing a social security system oriented to all generations. Promoting active participation by women through a virtuous cycle of growth and distribution. Creating a society where all citizens are dynamically engaged.

Preserving beautiful and traditional hometowns for future generations

- Restructuring the agriculture, forestry and fishery industries. Promoting supply system innovation for SMEs and small-scale entrepreneurs. Achieving the target of 40 million visitors to Japan. Implementing emergency measures for disaster prevention/reduction and national resilience.

Laying the foundation for peace and prosperity of the Asia-Pacific in a new age

- Summing-up postwar diplomacy. Laying the foundation for peace and prosperity in Northeast Asia. Promoting a free and open Indo-Pacific strategy based on the US-Japan alliance.

Amending the Constitution to mark a new era

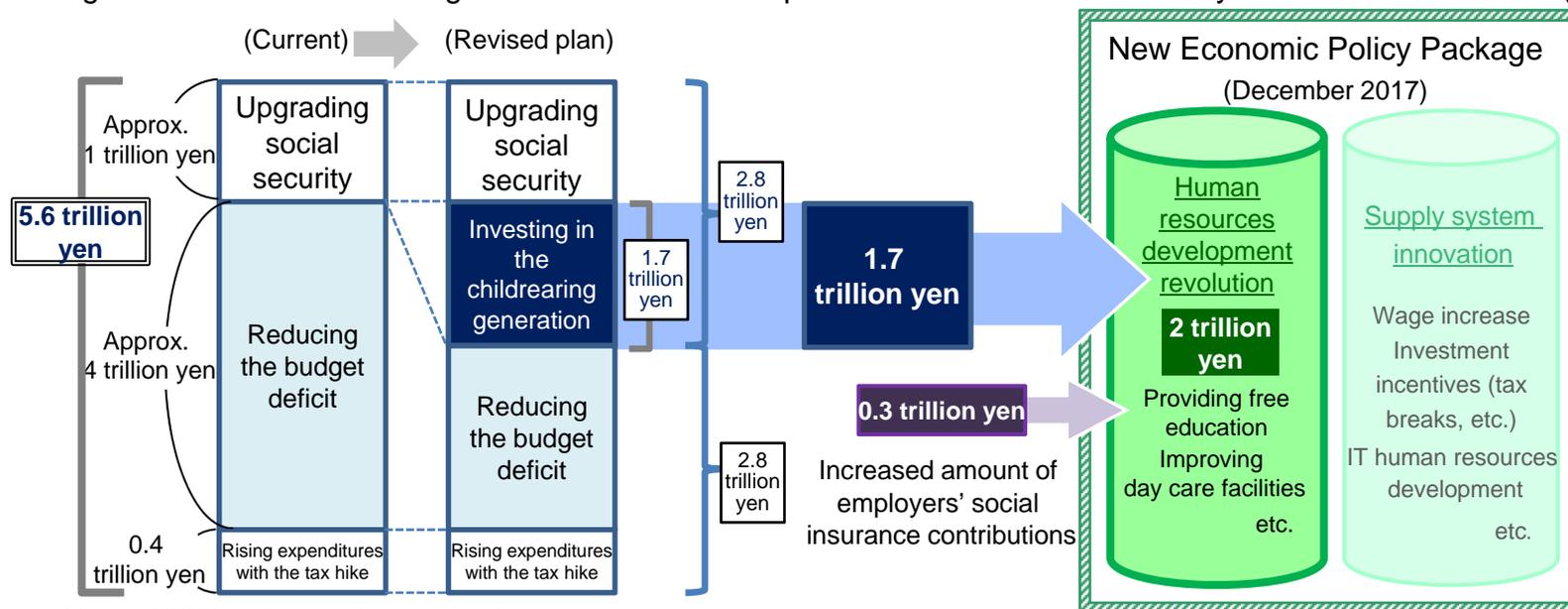
- All LDP members working together to amend the constitution at an early stage by presenting the LDP draft during the next Diet session, thereby fulfilling the four-item campaign pledge for the Lower House election.

Source: Made by MHRI based upon the special website of Shinzo Abe LDP Leadership Election and *Views of the candidate Shinzo Abe in the 2018 LDP leadership election.*

2. (1) Consumption tax rate hike: Scheduled for October 2019 with changes in revenue use. Laying the groundwork for the tax hike is a challenge.

- ❑ In the fall of 2017, Prime Minister Abe announced a change in the use of part of the tax revenue growth from the consumption tax rate hike (8%→10%) scheduled in October 2019, from reducing the budget deficit to investing in the childrearing generation, including free education. Laying the groundwork for the tax hike is of vital importance.
- ❑ By the end of 2018, the government will formulate measures to curb demand fluctuations (last-minute surge in demand and reactionary decline) stemming from the consumption tax hike.
 - The government is expected to consider lifting the ban on advertising special sales that offset the consumption tax hike, encouraging total tax-inclusive price displays, and introducing measures to support the purchase of automobiles and houses.
 - The retail industry is opposed to holding special sales to offset the higher tax rate and displaying tax-inclusive price tags due to difficulties in shifting the tax burden. The outcome of these issues is still unclear.
- ❑ The government also faces the challenge of searching for new revenue sources by the yearend to compensate for the reduced tax rate that could lead to a tax revenue loss of roughly one trillion yen.

[Changes in the use of revenue growth from the consumption tax rate hike introduced by the Abe administration (image)]



Source: Made by MHRI based upon various news media reports.

(2) Fiscal consolidation: Steady steps needed for the new goal of achieving a PB surplus by FY2025

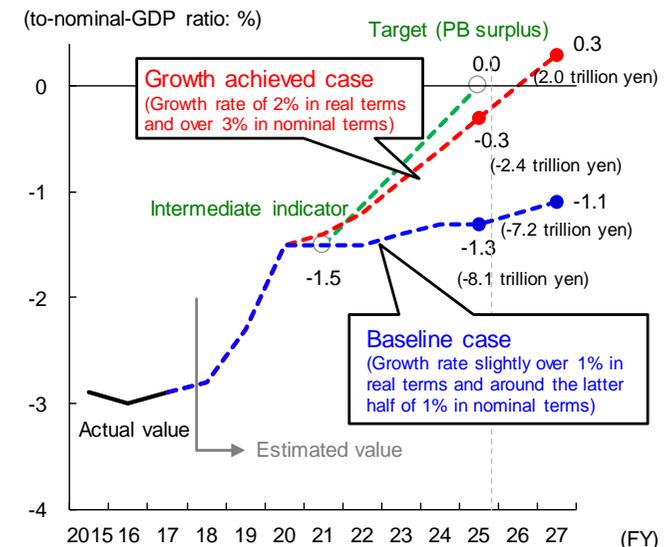
- The government’s new fiscal consolidation plan drafted in June 2018 pushes back the timeframe for achieving a primary balance (PB) surplus by five years to FY2025.
- For the time being it is necessary to steadily implement revenue reforms to meet the FY2021 interim target of -1.5% for the PB-to-GDP ratio.
- Higher expenditures are inevitable for the FY2019 budget, but the government’s efforts to maintain a certain level of fiscal discipline under these circumstances are drawing attention.
 - Measures in response to the consumption tax hike and allocation policies for revenue growth from the consumption tax hike were not included in the budget appropriation requests, but will be added to the FY2019 budget.
 - With the new fiscal consolidation plan failing to set numerical targets for social security expenditures, the government’s fiscal restraint efforts are raising concerns.

[Overview of the New Plan to Advance Economic and Fiscal Revitalization]

Outline	
<ul style="list-style-type: none"> ● Tackle fiscal consolidation flexibly at a steady pace that will not undermine the economic recovery. ● Aim to achieve a PB surplus for central and local governments in FY2025 while steadily reducing the public debt to GDP ratio. ● Position FY2019 to FY2021 as the “foundation-reinforcement period” centered on social security reforms, and formulate a new reform roadmap by the end of 2018. ● Continue the existing policy on social security expenditures by keeping the essential increase within the levels equivalent to the expected increase due to population aging in FY2019 to FY2021. ● Check the progress by setting three intermediate indicators in FY2021. (PB deficit to GDP ratio: about 1.5%; fiscal deficit to GDP ratio: 3% or below; and public debt to GDP ratio: the low 180% range) ● Address policies in a comprehensive and prioritized way for social security in FY2020. 	
Cross-cutting initiatives on expenditure reforms <ul style="list-style-type: none"> • Introduce and expand allocation methods that correspond to reform efforts. • Promote nationwide dissemination of advanced and excellent practices. • Reduce administrative procedural costs by over 20% through digitization. 	Social infrastructure development <ul style="list-style-type: none"> • Improve construction site productivity by 20%. • Reorganize and consolidate public facilities through the Compact Plus Network policy concept.
Social security <ul style="list-style-type: none"> • Adopt prioritized initiatives to prevent lifestyle diseases and dementia. • Develop a public pension system neutral to the job status of the elderly. • Reduction of the regional gap of medical and nursing costs per person. • Improve the productivity of the healthcare and nursing industry through data health reforms. • Examine medical and nursing burdens that correspond to one’s “capacity” including assets holding. 	Local public administration and finance reforms <ul style="list-style-type: none"> • Promote the expansion and communalization of public services. • Review ways to strengthen the allotment of local allocation taxes in response to reform efforts.
	Education, science and technology <ul style="list-style-type: none"> • Increase the ratio of R&D investment to GDP to 4% or over for combined public and private sectors. • Set priorities in financial assistance to universities.

Source: Made by MHRI based upon *Basic Policy on Economic and Fiscal Management and Reform 2018* (approved by the Cabinet on June 15, 2018).

[Outlook for the primary balance (PB)]



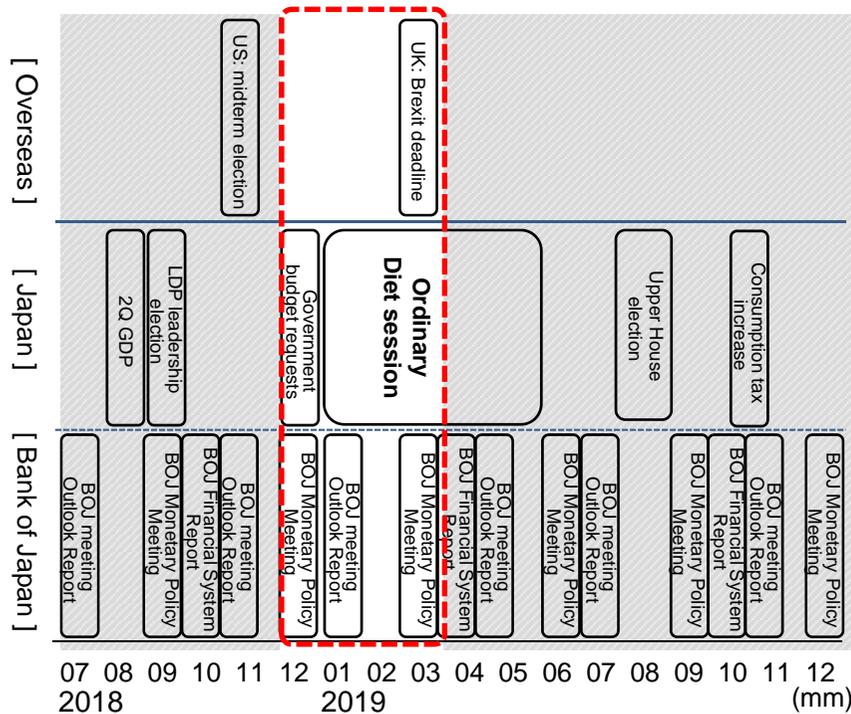
Notes: Based upon revenues and expenditures excluding reconstruction and revitalization measures.

Source: Made by MHRI based upon the Cabinet Office, *Economic and Fiscal Projections for Medium- to Long-Term Analysis* (July 9, 2018, submitted materials for the Council on Economic and Fiscal Policy meeting).

(3) Monetary policy: Challenge of shifting to an exit strategy after the consumption tax increase

- At present, the Bank of Japan is likely to leave its monetary policy unchanged based on the assessment of its policy effects. BOJ Governor Haruhiko Kuroda will stick to his stance of steadily pursuing monetary easing to attain the price stability target of 2%, while maintaining the current low levels of short-and long-term interest rates for the time being. Changing the policy will be difficult next spring and beyond, with the consumption tax hike and Upper House election on standby.
- On the other hand, Prime Minister Abe remarked on the implementation of an exit strategy for BOJ’s monetary easing during his tenure. While the government is not focused on the early achievement of the BOJ’s price target, the BOJ is expected to taper its monetary policy after the consumption tax increase with an eye to potential side effects. The transition for a smooth exit will be crucial.

[Timeframe for the BOJ to revise its monetary policy]



Made by MHRI.

[Comments by the BOJ Governor, Prime Minister, and Finance Minister]

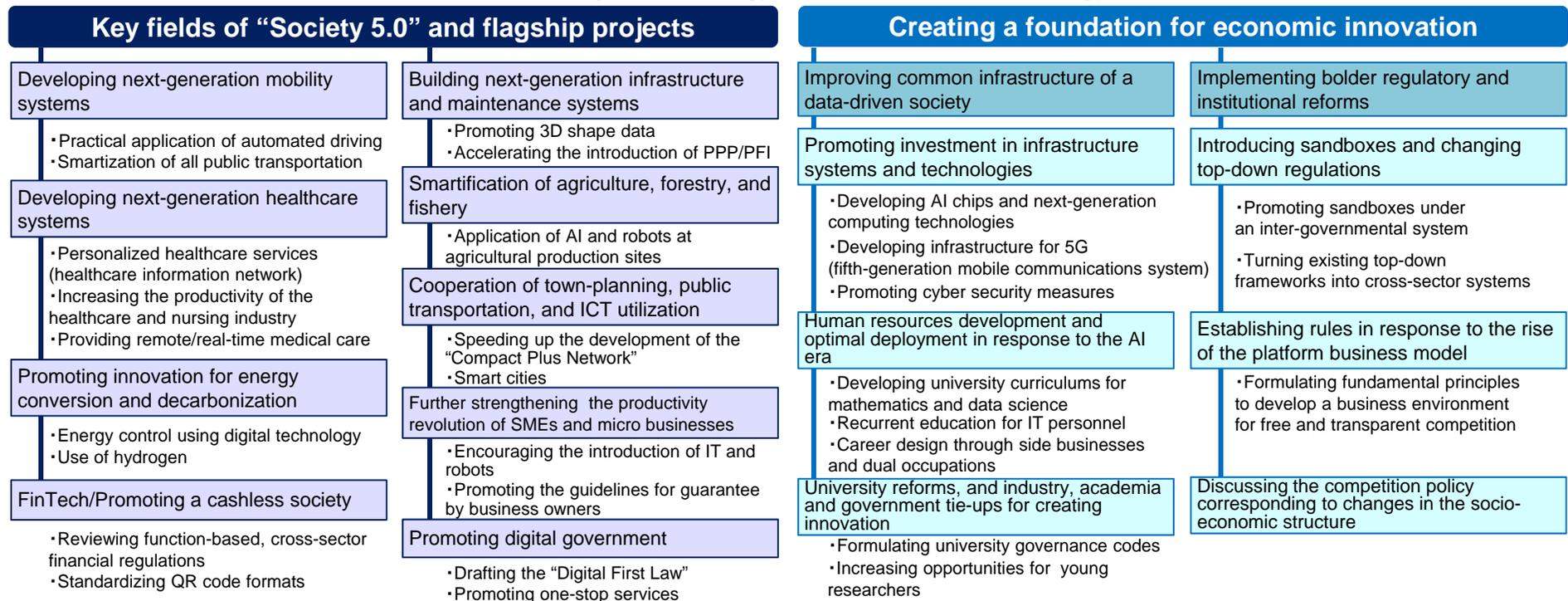
<p>BOJ Governor Kuroda (press conference on September 19)</p>	<ul style="list-style-type: none"> It is true that it's taking time (to achieve the price stability target). <u>We will continue the current monetary easing to achieve this target at the earliest possible time.</u> More work needs to be done on promoting the government's structural reforms and enhancing fiscal sustainability in the medium to long term. <u>The BOJ also needs to do more to achieve its price stability target, and the BOJ and government's joint statement remains effective and necessary.</u>
<p>Prime Minister Abe (public debate on September 14)</p>	<ul style="list-style-type: none"> I don't think the BOJ should continue (quantitative and qualitative monetary easing) indefinitely. With the economy growing at its best, <u>I want to accomplish (an exit strategy) during my term.</u> Deciding when and how is left to BOJ Governor Kuroda. Any comments I make will provoke an immediate market response.
<p>Finance Minister Aso (press conference after the Cabinet meeting on September 18)</p>	<ul style="list-style-type: none"> It will take a long time to achieve (the price stability target). We (the government and BOJ) mutually recognized that the target will be impossible to achieve in two years. <u>We (the government and BOJ) both agreed that the BOJ should responsibly avoid unnecessary actions in terms of the two-percent target.</u>

Source: Made by MHRI based upon the Bank of Japan and various news media reports.

(4) Growth strategy: Is it possible to boost growth by implementing the Future Investment Strategy?

- ❑ The Abe administration positions its growth strategy as one of the “three arrows” of Abenomics and has released a total of six strategic initiatives so far.
 - “Future Investment Strategy 2018” announced in June 2018 prioritizes the promotion of a cashless society, digital government, and regulatory sandboxes.
- ❑ Boosting productivity and promoting employment continue to be important for maintaining and enhancing the potential growth rate with the nation’s declining population.
 - Recent strategic growth initiatives have been pointed out as small in scale. Promoting innovation by utilizing data and improving the efficiency of projects are challenges.

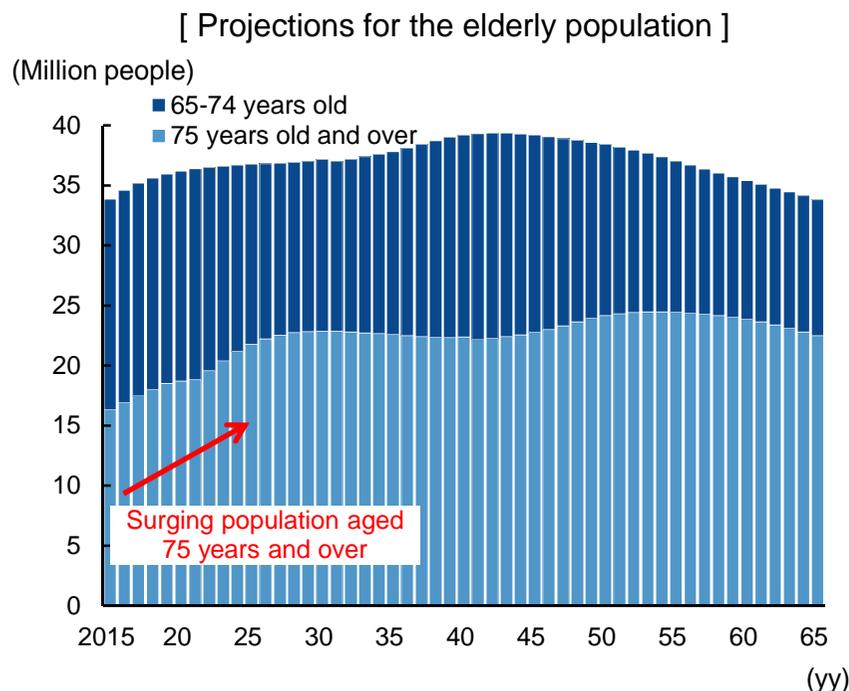
[Overview of the growth strategy “Future Investment Strategy 2018”]



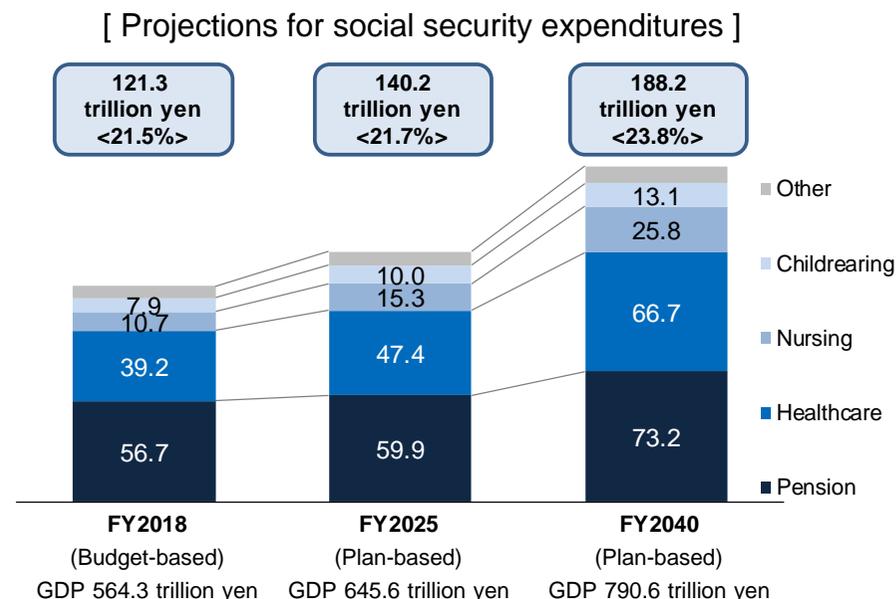
Source: Made by MHRI based upon Future Investment Strategy 2018 (approved by the Cabinet on June 15, 2018).

(5) Social security: Urgent measures required to deal with surging social security expenditures resulting from the growing elderly population

- ❑ Prime Minister Abe newly established the “Minister in charge of Social Security Reform” (Toshimitsu Motegi, concurrently Minister of State for Economic and Fiscal Policy and Minister in charge of TPP and Japan-US Trade Negotiations) to implement social security reforms over the next three years.
- ❑ The elderly population is expected to rise from 33.8 million in 2015 to almost 40 million in the 2040s, resulting in a surge in healthcare and nursing care expenses.
- ❑ It is necessary to secure financial resources from the consumption tax rate hike and carry out reforms that require people to pay premiums according to their financial capacity instead of their age.



Source: Made by MHRI based upon the National Institute of Population and Social Security Research, *Population Projections for Japan* (estimates in April 2017).

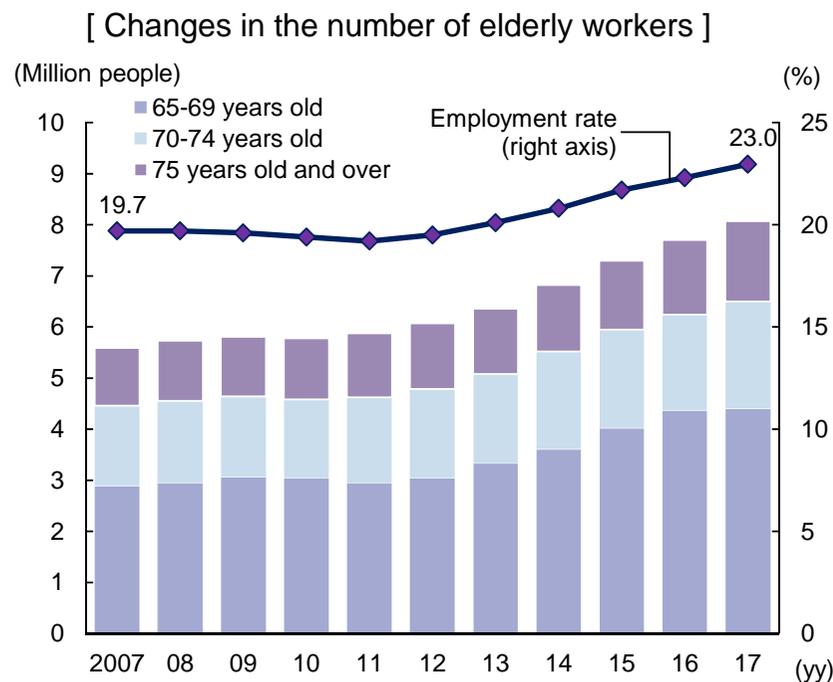


Note: The “< >” parentheses represent ratios to GDP. Healthcare expenditures showed two assumptions for growth rates in unit value, with benefit expenditures indicating two patterns as well, but the smaller rate was used in this report as a current projection case.

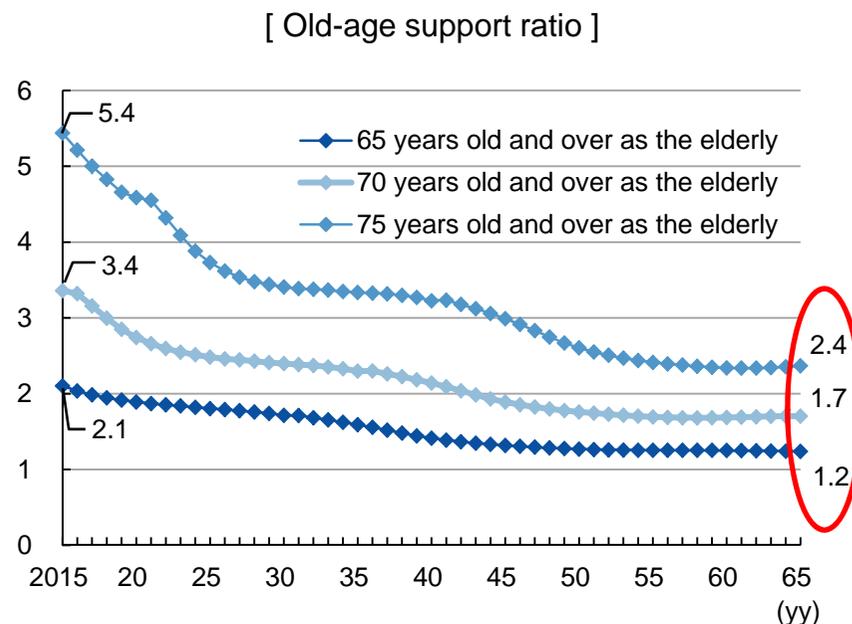
Source: Made by MHRI based upon the Cabinet Secretariat, Cabinet Office, Ministry of Finance, and Ministry of Health, Labour and Welfare, *The Future Outlook for the Social Security System towards 2040 (discussion material) – Overview* (May 21, 2018).

(6) Employment [1]: Promoting employment of people aged 65 and older to create a society where people can remain in the workforce throughout their lifetime

- ❑ Over the next year, Prime Minister Abe will tackle the challenge of establishing a system that allows the elderly to work longer, while asking businesses to secure employment until age 70.
- ❑ Many elderly people show a strong desire to continue working, with about 70% of people aged 60 and older willing to keep working past the age of 70 (2013 survey by the Cabinet Office).
- ❑ The old-age support ratio will decline from 2.1 in 2015 to 1.2 in 2065 if the elderly are defined as 65 years and older, but with the elderly defined as 70 and older, and 75 and older, the ratios would improve to 1.7 and 2.4, respectively.
- ❑ Employment measures for the elderly up to 75 years old are the key to realizing a society where people can remain active throughout their lifetime.



Source: Made by MHRI based upon the Ministry of Internal Affairs and Communications, *Labour Force Survey* (each year).

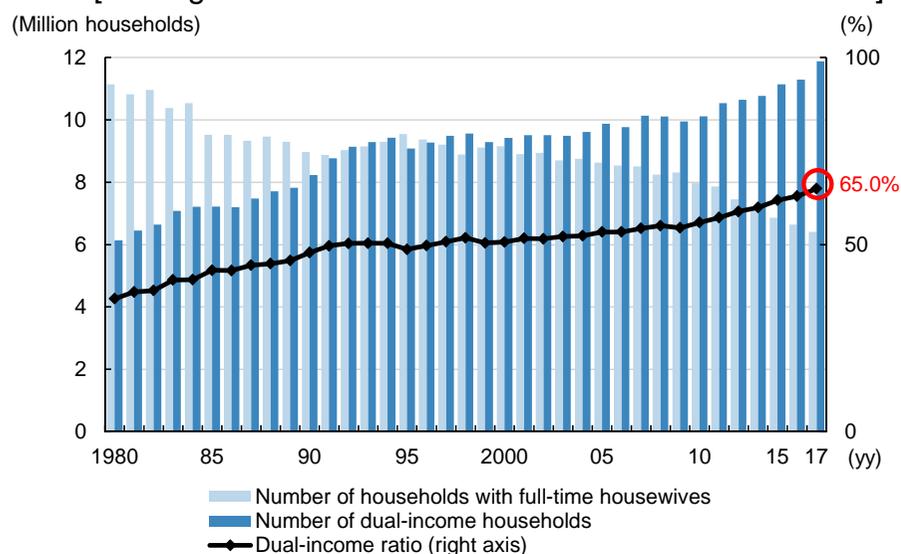


Note: The "old-age support ratio" refers to persons of working age (20 to elderly) per elderly.
 Source: Made by MHRI based upon the National Institute of Population and Social Security Research, *Population Projections for Japan* (estimates in April 2017).

(6) Employment [2]: Overcoming labor shortages by promoting female labor force participation and expanding the acceptance of foreign workers

- ❑ Japan's rate of double-income households expanded to 65%, while the number of women who wish to work and are not currently employed stands at 2.62 million people (2017).
- ❑ If all these women were employed, the country's female labor force participation rate would rise even further.
 - The most frequently cited reason for not seeking employment is "childbirth and childrearing" at 35.6%.
 - Ensuring a work-life balance that promotes various workstyles and men's participation is important to enable women to balance work and childbirth and childrearing.
- ❑ The government is likely to accept more foreign workers with a new residency status. It is essential to improve the working environment and to develop communities where foreigners can live comfortably.

[Changes in the number of double-income households]

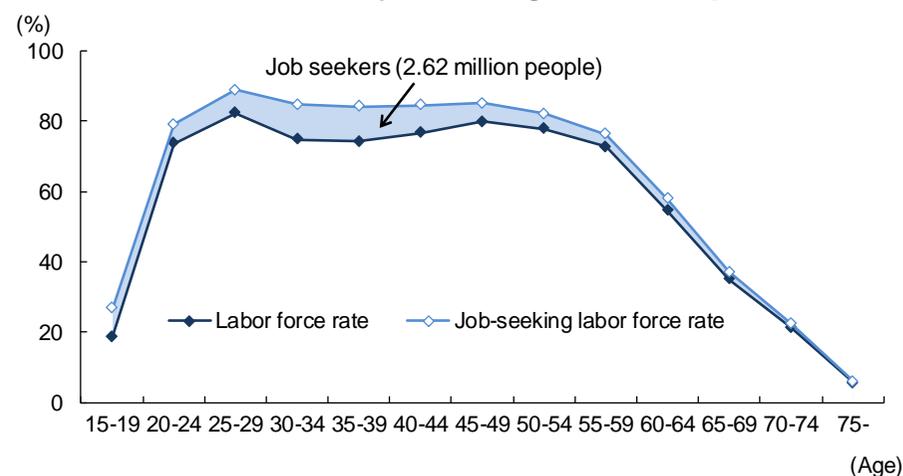


Notes: 1. A household with a full-time housewife refers to a household with a husband as a non-agriculture and forestry employee and a housewife as a non-employed person. A dual-income household consists of both a husband and wife as non-agriculture and forestry employees (including non-regular employees).

2. No data available in 2011 due to the effects of the Great East Japan Earthquake.

Source: Made by MHRI based upon the Ministry of Internal Affairs and Communications, *Labour Force Survey*.

[Comparison of the female labor force participation rate and job-seeking labor force]



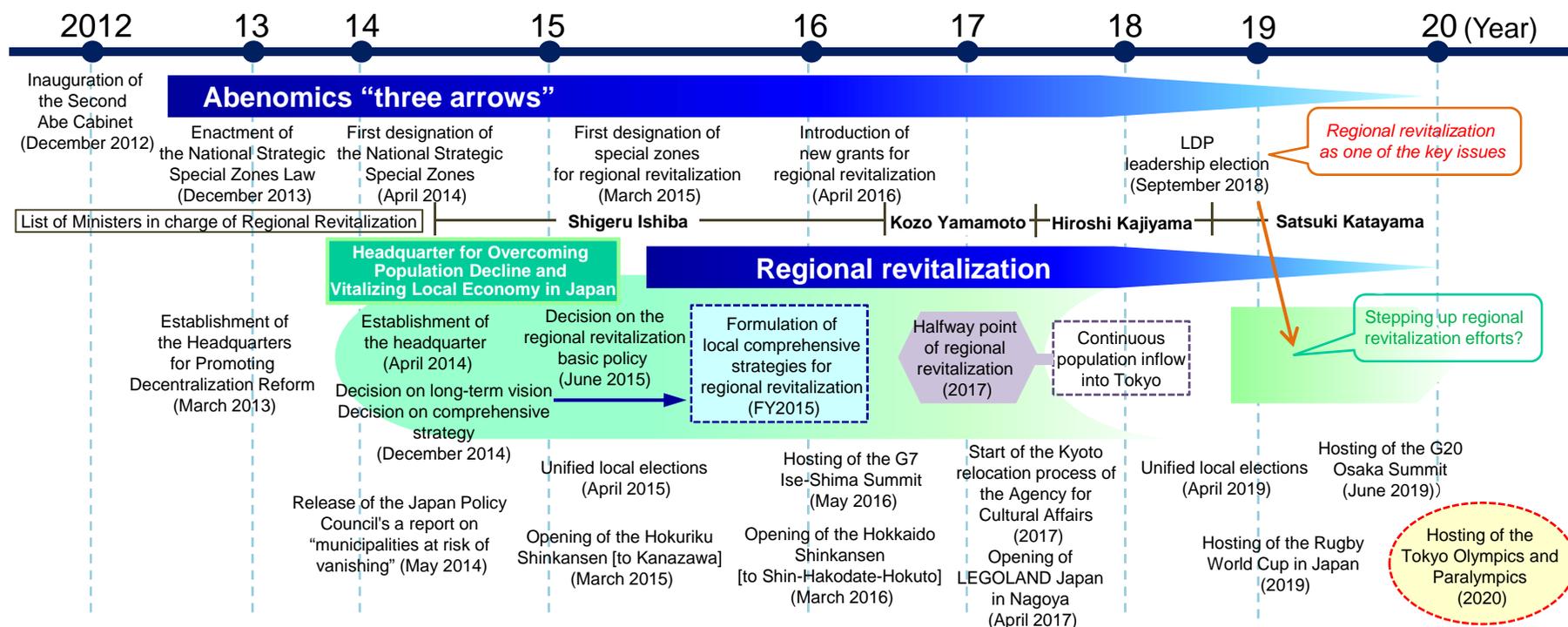
Note: Data is based upon the Ministry of Internal Affairs and Communications' "Population in Labor Force" (2017). The job-seeking labor force rate is the ratio of the labor force population + job seekers to the population by age group.

Source: Made by MHRI based upon the Cabinet Office, *White Paper on Gender Equality* (2018).

(7) Regional revitalization: Featured as a major issue in the LDP leadership election and expected to attract attention again in the upcoming unified local elections and Upper House election

- Regional revitalization has become a major issue since addressed by Shigeru Ishiba, who served as the first Minister in charge of Regional Revitalization, in his campaign for the LDP leadership election held in September.
 - Local authorities invariably criticize the impact of Abenomics on regional economies as weak.
- With the unified local elections scheduled for next spring and the Upper House election next summer, the Abe administration's ongoing regional revitalization policy will be brought up again.
 - Stepping up efforts to revitalize regional economies will be the focus of attention under the new regional revitalization minister, Satsuki Katayama.

[Past initiatives and future prospects of regional revitalization]

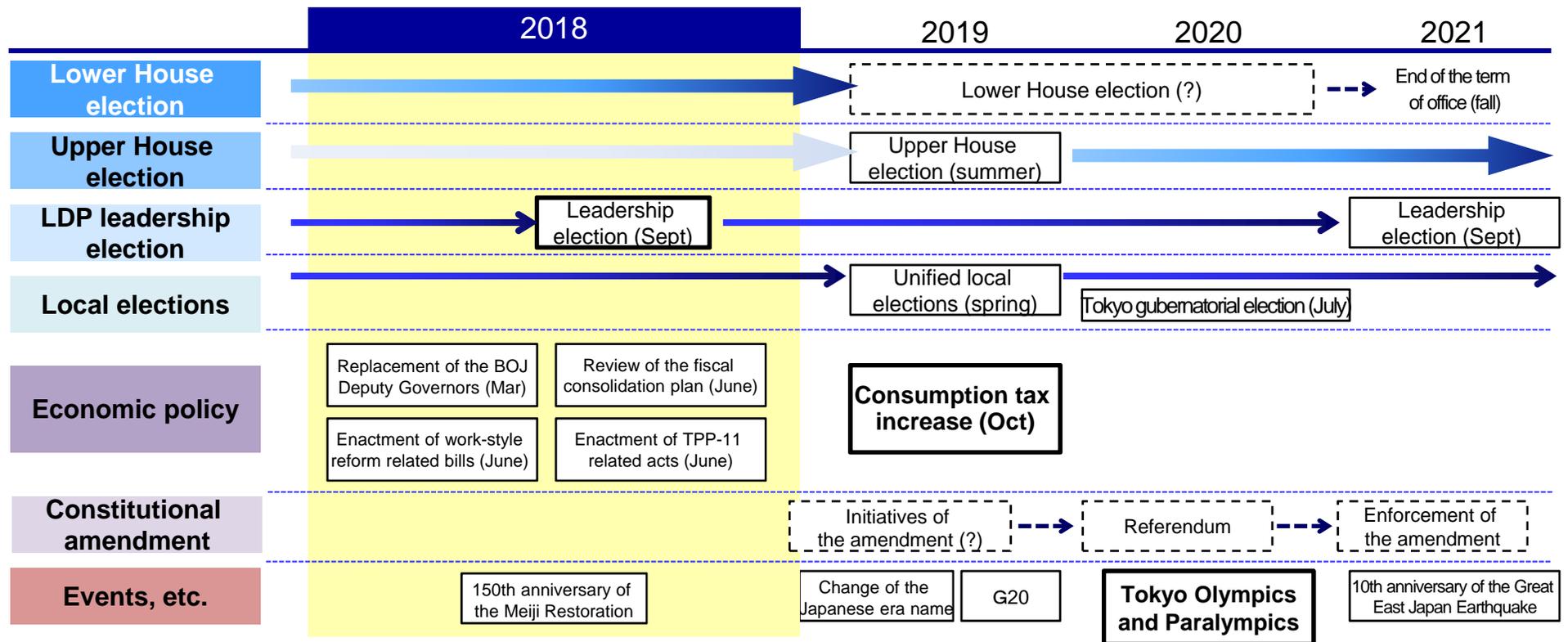


Made by MHRI.

3. Future Points of Focus: National elections playing a key role

- ❑ Unified local elections and the Upper House election are scheduled in 2019.
 - The Upper House election results are likely to affect the government's administration and constitutional amendment plans in subsequent years.
- ❑ The term of the incumbent House of Representatives ends in 2021. Whether Prime Minister Abe will call a snap election during his term is also the focus of attention affecting the outlook for post-Abenomics.

[Medium-term schedule of major political events and policy issues]

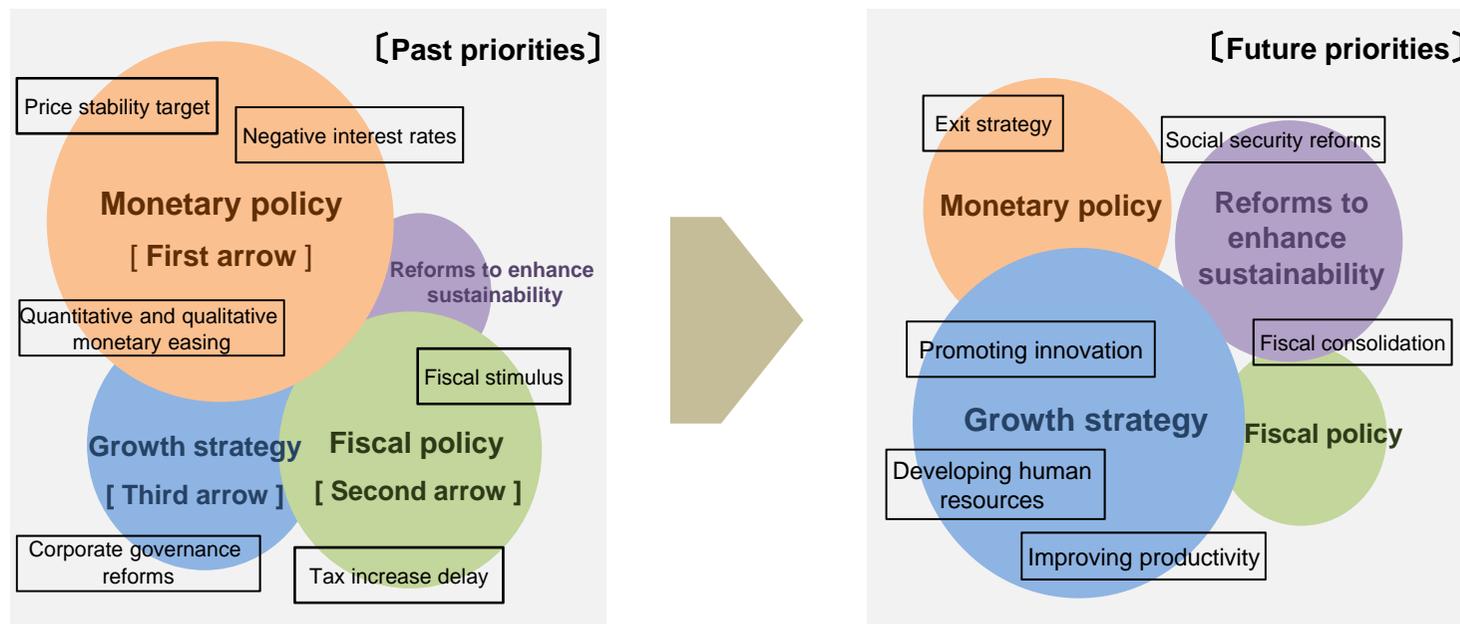


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4. Shift in Priorities of Abenomics: Promoting policies with growth and sustainability as the key pillars

- ❑ Growth strategy and structural reforms will play leading roles in Abenomics.
 - Abenomics' first arrow of monetary policy and second arrow of fiscal policy have partly contributed to lifting the economy out of its slump.
 - With little room left for further monetary easing, fiscal policy should place more emphasis on consolidation.
 - In the coming years, Abenomics' third arrow of growth strategy should play a more critical role. It is important to strengthen structural reforms aimed at improving productivity and boosting the nation's underlying economic strength.
- ❑ Looking ahead to the future, Abenomics is entering the phase of responding to the growing need for initiatives that enhance economic and social sustainability.
 - By taking advantage of its long-established political foundation, the Abe administration is expected to actively push through fiscal and social security reforms and other policy measures paving the long road ahead after Abenomics.

[Past and future of Abenomics: ideal shift in priorities]



Made by MHRI.

Conclusion – Towards the 2020s

- ❑ As Japan braces for an even more rapidly aging and shrinking population in the future, it is becoming increasingly important to implement measures to maintain and improve the country's socioeconomic vitality. The next three years, or the beginning of the 2020s, when postwar baby boomers will join the “latter-stage elderly” group aged 75 years and older, will be a crucial time for the government to put its policy measures on the path to progress, thereby enhancing the sustainability and stability of various programs designed to lift economic growth and support people's lives.
- ❑ The 2010s are witnessing political and social instability rising in many countries, and political powers with radical views are emerging. The growing trend of nations to pursue their own national interests and inward policies is also seriously affecting international cooperation and free trade systems. While maintaining a stable political base among the leaders of major countries, Prime Minister Abe will take on the important role and responsibility as chair of the G20 summit in 2019.
- ❑ With the business environment rapidly changing in Japan and abroad, and challenges continuing to mount, the approaches to reform of the newly reshuffled Abe Cabinet will be the key to setting the landing points for an array of Abenomics initiatives. How the administration handles these issues will also affect the Upper House election in 2019.
- ❑ Amid global competition for AI applications and digitization, dealing with a data-driven society incorporating technology is becoming an imminent challenge. The current administration's leadership will be tested in the process of accelerating public and private endeavors.
- ❑ What should the Abe administration leave behind and pass on to future leaders? While taking the reins of a long-established administration, operating the government with an eye to the future is also important.

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