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Abenomics and Policy Implications for Korea

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Sung Chun Jung Director, Department of International Economy (jung@kiep.go.kr)
Hyong-kun Lee Senior Researcher, Japan Team, Department of International Economy (hklee@kiep.go.kr)
Young Kyoung Suh Researcher, Japan Team, Department of International Economy (yksuh@kiep.go.kr)

With the Liberal Democratic Party(LDP) and its coalition partner, New Komeito, securing a two-thirds "supermajority" in the lower house of parliament in the general election on December 16th 2012, the new Japanese Prime Minister Shinzo Abe has been advocating his new economic policy, so-called "Abenomics," a package of economic measures put together to stimulate Japan's floundering economy. Abenomics contains three main aspects; monetary expansion, fiscal stimulus, and the growth strategy, which are aimed primarily at providing a near-term boost to the Japanese economy. That is, Abenomics calls for simultaneously promoting bold monetary easing, timely fiscal spending, and measures to spur private-sector investment to lift Japan from recession and deflation. Since Abe took office, Abenomics has drawn much attention from the international community on its sustainability and ripple effects on the global economy. This report provides a timely review of the details of the policy program, its impacts both on Japan and overseas, and implications for South Korea.

Outline of the Macroeconomic Policy of Abenomics

Policy Background

The new direction for Japan's economy is rooted in three main factors: 1) LDP's policy differentiation strategy in light of the domestic political situation; 2) basic theoretical concept; 3) international trends.

First, the LDP differentiated itself from the DPJ in its basic economic policies to win in the general election. The LDP promised to carry out a bold monetary policy and loose fiscal policy whilst embarking on a capital expenditure program to stimulate the economy. The proposal includes pledges to fix the problem of yen strength, conduct unlimited monetary easing, raise inflation to 2 percent, and strengthen cooperation between the central bank and the government.

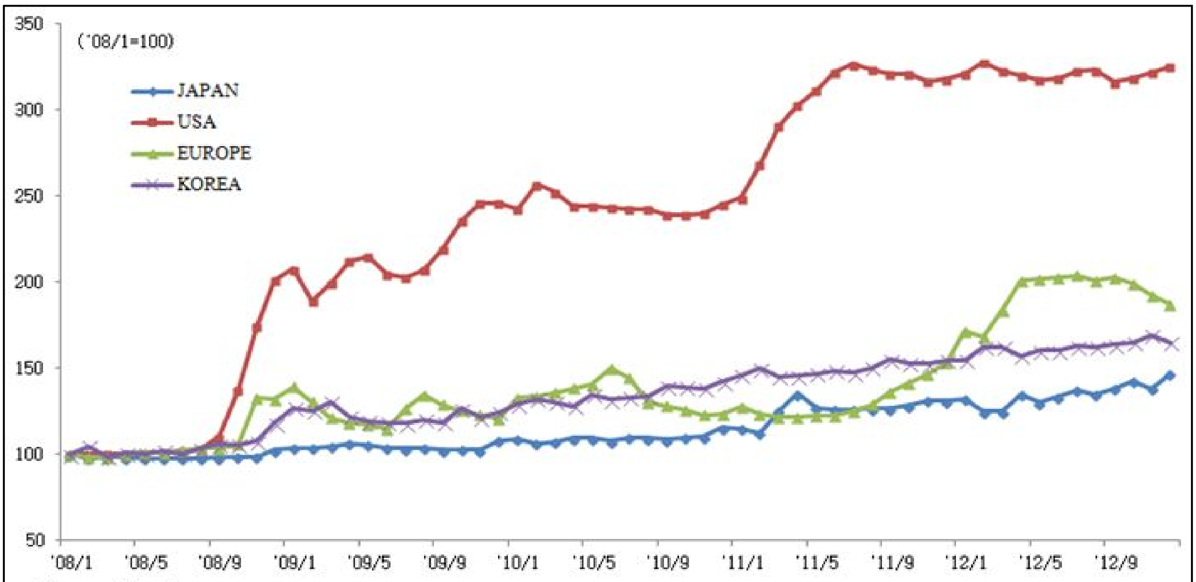
Second, Abenomics is based on a Keynesian demand-stimulus economics. Classic Keynesian economic theory states that economies can go into a long recession when companies stop investing and people stop spending, causing aggregate demand shocks. Unlike the past Japanese government policies aimed at boosting supply side, Abenomics emphasizes the role of aggregate demand in the economy. That is to say, the most urgent need to initiate recovery from recession is to raise aggregate demand rather than to focus on the supply side.

Finally, Abenomics is driven by what the Japanese policymakers see happening in the U.S. and in Europe: bold quantitative easing. Japanese policymakers acknowledge that while the U.S., U.K., and Euro Area are implementing quantitative easing in fairly large proportions, there has not been sufficient action in this regard taken in Japan, which ended up with a strong yen. As shown below in Figure 1, Japan's monetary base rose by about 1.3 times since the financial crisis in 2008, far less than that of other developed countries, indicating that the monetary easing policy in Japan has not been active enough.

Objectives and Key Principles

The main goals of Abenomics are to devaluate the yen and end Japan's long-term deflation. Although it is not explicitly stated, the Japanese government is willing to free the Japanese economy from the strong yen and promote international competitiveness of its exporters. Also the main policies include, among others, a 2-percent-inflation-target by means of boosting aggregate demand to revive and revitalize the recession-bound Japanese economy.

Figure 1. Changes in the Monetary Base



Source : Bloomberg

To achieve these goals, Abenomics emphasizes its three-pronged policy effort including: 1) bold monetary policies; an inflation target set by the Bank of Japan with additional quantitative easing, 2) flexible fiscal policies; compilation of a big supplementary budget with increases in public spending, and 3) growth strategies; reform program for promoting private sector investment-led growth.

Policy Planning Councils

The Council on Economic and Fiscal Policy (CEFP) and the Industrial Competitiveness Council are the main organizations that function as control towers on policy planning.

The Council on Economic and Fiscal Policy, which the Abe administration has resurrected, after being put on ice when the DPJ took power in 2009, is in charge of compiling Japan's economic policies. The council's 11 members include economic ministers, academics, and business leaders. The governor of the Bank of Japan is also among the members.

The Industrial Competitiveness Council, the new panel under the Headquarters for Japan's Economic Revitalization (a control tower that assumed a central role in comprehensive coordination, planning, and policy making on necessary economic measures and growth strategy), includes selected members of cabinet ministers and business leaders. The council is in charge of growth strategy planning, focusing on industrial policy and regulatory reform.

Implementation of Abenomics: Current Status

Monetary Policy

At the Monetary Policy Committee Meeting held on January 22, the Bank of Japan restated its monetary policy framework, replacing its 1-percent-inflation "goal" with a 2-percent-inflation "target." The 2-percent-target in terms of the year-on-year rate of change in the consumer price index is announced to be achieved at the earliest possible time through monetary stimulus measures and structural reforms designed to boost growth. To achieve the target, the Bank of Japan announced it would commence open-ended asset purchases in January 2014 as a part of the Asset Purchase Program. The Federal Reserve-style program of asset purchases with no predetermined limit at buying securities about 13 trillion yen a month includes 2 trillion yen of JGBs and 10 trillion yen of T-bills. When offset by redemptions, the net increase on the size of its asset purchase program next year will be 10 trillion yen and is expected stay steady thereafter.

After the January board meeting, the Bank of Japan and the government published a joint statement pledging to strengthen their policy coordination. In the "Joint Statement of the Government and the Bank of Japan on Overcoming Deflation and Achieving Sustainable Economic Growth," the government and the Bank of Japan announced that they would work together in order to overcome deflation quickly and achieve sustainable economic growth with price stability. The statement indicated the Bank of Japan's stance of increased cooperation with the government to overcome deflation. The government, for its part, promised to formulate measures for strengthening competitiveness and the growth potential of the Japanese economy.

Although introducing an open-ended asset purchase program is a positive surprise, announcement by the Bank of Japan does not seem to satisfy financial market's expectation to any sufficient degree. The 2-percent-inflation-target has no fixed time limit, the size of the additional purchases looks relatively small compared with the 101 trillion yen of assets it already owns, and the expansion of the asset purchase program does not take effect until next year. These limits in new monetary policy disappointed investors who expected bolder measures.

Table 1. Changes in the Size of the Asset Purchase Program

(Trillion Yen)

	1st round '10.10.5	2nd '11.3.14	3rd '11.8.4	4th '11.10.27	5th '12.2.14	6th '12.4.27	Revision '12.7.12	7th '12.9.19	8th '12.10.30	9th '12.12.20	Total Program Size	10th '13.1.22	Amount Outstanding as of End-December 2012
Japanese Government Bonds (JBGs)	1.5	0.5	2.0	5.0	10.0	10.0	0.0	5.0	5.0	5.0	44.0	2.0/Month	24.1
Treasury Discount Bills (T-Bills)	2.0	1.0	1.5	0.0	0.0	0.0	5.0	5.0	5.0	5.0	24.5	10.0/Month	9.6
CP	0.5	1.5	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.0	2.2		2.1
Corporate Bonds	0.5	1.5	0.9	0.0	0.0	0.0	0.0	0.0	0.3	0.0	3.2	Continue Purchasing	2.9
Exchange-traded Funds (ETFs)	0.45	0.45	0.5	0.0	0.0	0.2	0.0	0.0	0.5	0.0	2.1		1.5
Japan Real Estate Investment Trusts (J-REITs)	0.05	0.05	0.01	0.0	0.0	0.01	0.0	0.0	0.0	0.0	0.13		0.1
Total Asset Purchases	5.0	5.0	5.0	5.0	10.0	10.14	5.0	10.0	11.0	10.0	76.0	86.0	40.2
Fixed-rate Funds-supplying Operation against Pooled Collateral	30.0	0.0	5.0	0.0	0.0	-5.0	-5.0	0.0	0.0	0.0	25.0	25.0	26.9
Total	35.0	5.0	10.0	5.0	10.0	5.14	0.0	10.0	11.0	10.0	101.0	111.0	67.0

Source : Bank of Japan, Sumitomo Mitsui Trust Asset Management Co., Ltd., Dai-ichi Life Research Institute Inc.

Fiscal Policy

On January 11, Japanese government announced a fiscal stimulus package ("Emergency Economic Measures for the Revitalization of the Japanese Economy") of 10.3 trillion yen. When local governments and the private sector funding are taken into account, total size of the package comes in at 20.2 trillion yen. Among the 10.3 trillion yen in central government funds, about 3.8 trillion yen is slated for "post-earthquake reconstruction and disaster prevention," with 3.1 trillion yen directed to "creation of wealth through growth", and another 3.1 trillion yen for "ensuring a sense of security in daily life and revitalizing the regions." About half the stimulus size, 5.5 trillion yen, will be spent for financing anti-disaster and reconstruction projects. In order to finance the projects, the Ministry of Finance plans to issue 5.5 trillion yen in construction bonds. The Japanese government estimates that the new stimulus package will boost Japan's real GDP by 2 percent in fiscal 2013, which starts April 1, and create around 600,000 new jobs.

However, it is highly likely that additional bond issuance will raise new concerns regarding Japan's debt burden. Japan's government debt currently exceeds 200 percent of Japan's GDP, which is the worst among major economies.

Table 2. Financial Size of the Package

(Trillion Yen)

		Central Government Expenditure	Total Size
1. Measures for post-quake reconstruction and disaster prevention (3.8 trillion yen)	Acceleration of the efforts for reconstruction of the areas damaged by the Great East Japan Earthquake	1.6	1.7
	Disaster prevention and mitigation	2.2	3.8
2. Creation of wealth through growth (3.1 trillion yen)	Stimulating private investment for stronger growth	1.8	3.2
	Measures for small and medium-sized enterprises, small-scale businesses, and measures for agriculture, forestry and fishery	0.9	8.5
	Facilitating the expansion of Japanese businesses in overseas markets	0.1	0.3
	Measures for human capital development and employment	0.3	0.3
3. Ensuring a sense of security in daily life and revitalizing the regions (3.1 trillion yen)	Ensuring a sense of security in daily life	0.8	0.9
	Revitalizing the regions	0.9	1.2
	Supporting local governments' funding and ensuring the swift implementation of the emergency economic measures	1.4	
· Obligatory assurance of national subsidization for a multiyear construction project		0.3	0.3
Related to economic measures		10.3	20.2
· Government's financial contribution to state pensions at 50%		2.8	-
Total amount of supplementary budget		13.1	-

Source: Cabinet Office, Government of Japan

Growth Strategy

The Industrial Competitiveness Council operates under the Headquarters for Japan's Economic Revitalization, with the aim of giving shape to the growth strategy for the strengthening of the competitiveness of industries in Japan. The council plans to deliver high-level policy proposals by the end of June that will become the substance of the economic revitalization program. The new growth strategy includes a strategic market creation plan, industrial resuscitation, and companies' overseas expansion.

Prospects and Implications for Korea

Prospects

First, the Japanese currency is expected to continue to depreciate against the U.S. dollar under Abenomics as Japanese Prime Minister Shinzo Abe advocates more quantitative easing in the country. His advocacy of a weaker yen to help support Japanese export manufacturers received enthusiastic support. Also, the Bank of Japan's independence is currently under threat from political pressure. All things considered, the recent trend of the weakening Japanese yen will continue for some time.

Second, the new administration of Prime Minister Shinzo Abe pledged to stimulate the economy through 200 trillion yen in public works spending over the next ten years. However, how much economic impact it would have is unclear, and mass spending would certainly exacerbate Japan's national debt.

Third, Abe administration has scheduled the unveiling of a new growth strategy to stimulate private-sector investment in June 2013. However, many of the specific programs reported so far are basically extensions of the former DPJ administration policies. As is known from past experiences, there would be a very low chance of success for such an industrial policy.

Implications for Korea

As a result of aggressive economic policy announcements by the Abe administration, the yen has weakened and the Japanese stock market has soared. If Abenomics leads to therecovery of the Japanese economy, it will be a good benchmark for the future economic policy in South Korea. Once the Abenomics experiment fails, however, Japan will face unimaginable consequences such as an impending financial crisis. Abe seems to be taking a dangerous gamble.

As Abenomics would negatively affect Korea's economy, we need to carefully evaluate the impact of Abenomics and come up with comprehensive plans to protect our economy. The yen-dollar rate in the mid-90 range is often regarded as a return of the reasonable exchange rate band. However, we expect a strong response from the international community if the yen continues to fall dramatically beyond the mid-90 point. KIEP