More Abenomics

Within days of being elected for a third term to lead the world’s third largest economy, Japanese Prime Minister Shinzo Abe has declared a war on low wages by urging the private sector to implement a 3% pay rise from next year. This bold intervention could infuse substance to the third arrow (structural reforms) of ‘Abenomics’ as part of the broader strategy to unshackle Japan from two decades of on and off deflation. Monetary easing and fiscal stimulus are the other two elements of the now widely acclaimed three-pronged strategy launched in 2012 to meet a 2% rate of inflation and boost growth. Accordingly, the Bank of Japan’s (BoJ) policy of negative interest rates and quantitative easing — the purchase of sovereign bonds worth trillions of yen — to stoke the current nearly zero rate of inflation has yielded spectacular results. For instance, the country recorded an unbroken six consecutive quarters of growth until June in gross domestic product (GDP), the longest spell in over a decade. The 4% annualised growth in the April to June quarter was remarkable in a predominantly export-driven economy, underpinned as it was by a boost in domestic demand and private consumption.

Similarly, Japan’s current labour market conditions are said to be the strongest since 1974, with unemployment hovering below 3%. But prices have evidently not kept pace with these improvements as inflation has remained close to zero, underscoring the limits to how much ultra-loose monetary policy by itself can do to trigger demand. In fact, the BoJ has repeatedly deferred its decision to achieve the 2% target rate. Another instance is the lack of rise in wages commensurate with the growth in employment, impacting prices and consumption.

Against this backdrop, there is growing perception that the objectives of Abenomics could be thrown into jeopardy unless reforms are given a rigorous push. On the strength of a massive mandate, Mr. Abe has now specified an annual 3% pay rise, unlike his more general pleas in the past for hikes larger than the previous year. Such a direct appeal echoes the International Monetary Fund’s 2016 suggestion to designate pay rise as a fourth arrow of Abenomics, when it argued for an incentive-based annual 3% wage increase. Mr. Abe’s call will further strengthen the bargaining power of trade unions, which, during annual wage negotiations, have sought to counteract the effects of the controversial 2014 hike in consumption tax. Potentially more radical perhaps is the IMF’s recent appeal to the government to push further on reforms to the labour market — in particular, the disparities between the country’s full-time employees and temporary staff. There has been a decline in Japan’s population in the working age, and the country stands 111th in the World Economic Forum’s ranking of gender equality. It needs a transformation of cultural attitudes to maintain its industrial might. Clearly, Japan is moving further and further away from the “lost decade” of the 1990s. The question is only how far and how fast.

The new U.S. Fed Chairman is unlikely to opt for policies that might upset the President’s plan

END