

ABENOMICS: JAPAN'S LAST CHALLENGE AND THE OPPORTUNITIES FOR ASIA

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OUTLINES

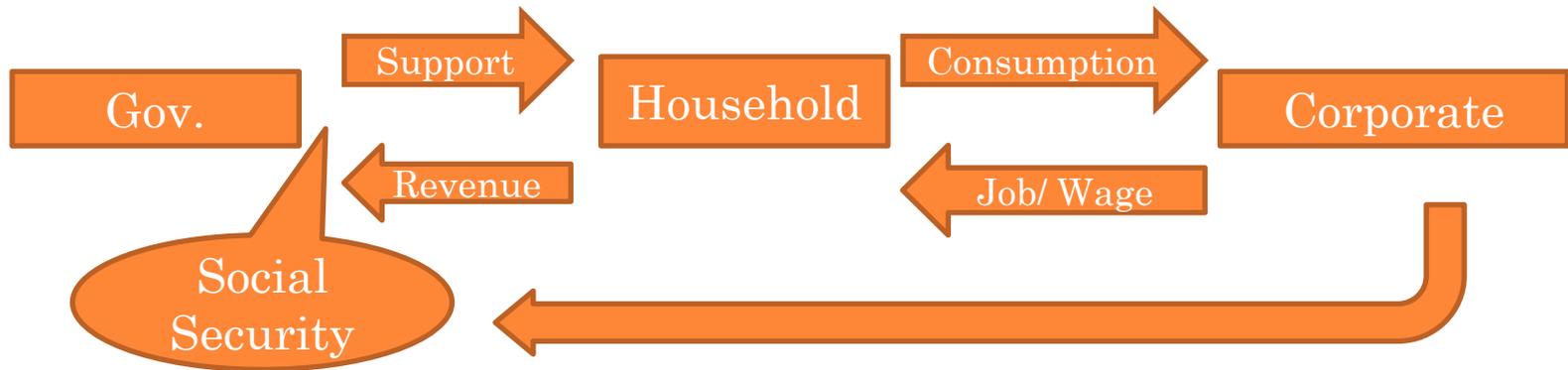
- Political Change and “Abenomics”
- Abenomics as the standardized policy
- Impact of “Abenomics”: Short term
- Structural reform in focus
- Impact on Korean economy
- Opportunities rather than threats
- Temporary conclusion

POLITICAL CHANGE AND “ABENOMICS”

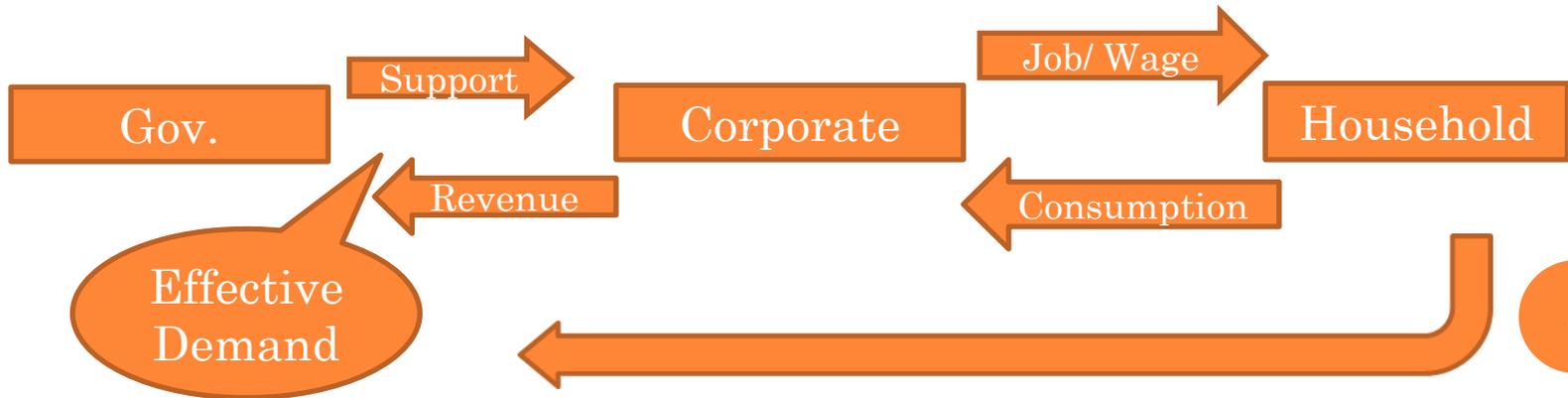
- Regime back to LDP from DPJ (Dec. 2012)
 - ➡ Changed agenda: Political reform to Growth
 - ➡ Crisis in global economy (1): Supply Chains
 - ➡ Crisis in global economy (2): Fiscal pressures
 - ➡ Challenges/ Opportunities: Emerging markets
 - Wake-up call by Korea and China
 - ➡ Incapacity by DPJ (The Earthquake, Fukushima)
 - ➡ Security threats
- Commitments/ Consensus (1): Stop deflation
- Commitments/ Consensus (2): Enhance growth
- Commitments/ Consensus? (3): Accept globalization

POLITICAL LOGIC OF “ABENOMICS”

- DPJ’s Logic against LDP



- New LDP’s Logic against DPJ



UNTIL “ABENOMICS”

- BOJ’s financial policies

1999 : Zero interest rate, “Liquidity trap”

2001: “Quantitative Easing”

2010: “Comprehensive Easing”

(Quasi Inflation targeting (around 1%))

☞ Too little, too slow?

- Political myopia, Patched policies, No consensus: “Koizumi Reform” (2001~2006) and DPJ backlash (2009~2012)

“ABENOMICS” WITH “3 ARROWS”

- (1) Right Macro policies: Government-BOJ coordination, 2% of Inflation target, 7 trillion Yen of assets purchasing per month
⇒ Yen depreciation
- (2) Effective Fiscal spending: Emergency Plan in FY 2012/13
- (3) Growth Strategies: Disaster recovery/protection, Energy Innovation, Labor market flexibilities, Globalization Programs (TPP, Business enhancement, Deregulations...)

COMBATTING DEFLATION: FOLLOWING THE NEWLY STANDARDIZED THEORIES

Central Bank	Program	Asset Purchasing	Peak Scale(Billion)	%/GDP
Fed	QE1	GSE Agency Bond	\$175	1.2
		MBS	\$1,250	8.7
		TB	\$300	2.1
	QE2	TB	\$600	4.2
		Roll-over	TB	\$667
	QE3	MBS	\$160	4.7
	Total			\$3,152
BOE	APF	Guilt Bond	\$590	26
		CP	\$3.10	0.1
		Corporate Bond	\$2.52	0.1
	Total			\$596
EC	CB Program	Covered Bond	\$81	0.7
	SMP Program	National Bonds	\$297	2.4
	CBP2	Covered Bond	\$54	0.4
Total			\$432	3.5
BOJ	Operation	JGBs	\$1,253	21.3
		CP	\$35	0.6
		Corporate Bond	\$12	0.4
	AP Program	JGBs	\$516	8.8
		SB	\$287	4.9
		CP	\$26	0.4
		Corporate Bond	\$38	0.6
		ETF	\$25	0.4
		J-REITs	\$2	0
	Total			\$2,193

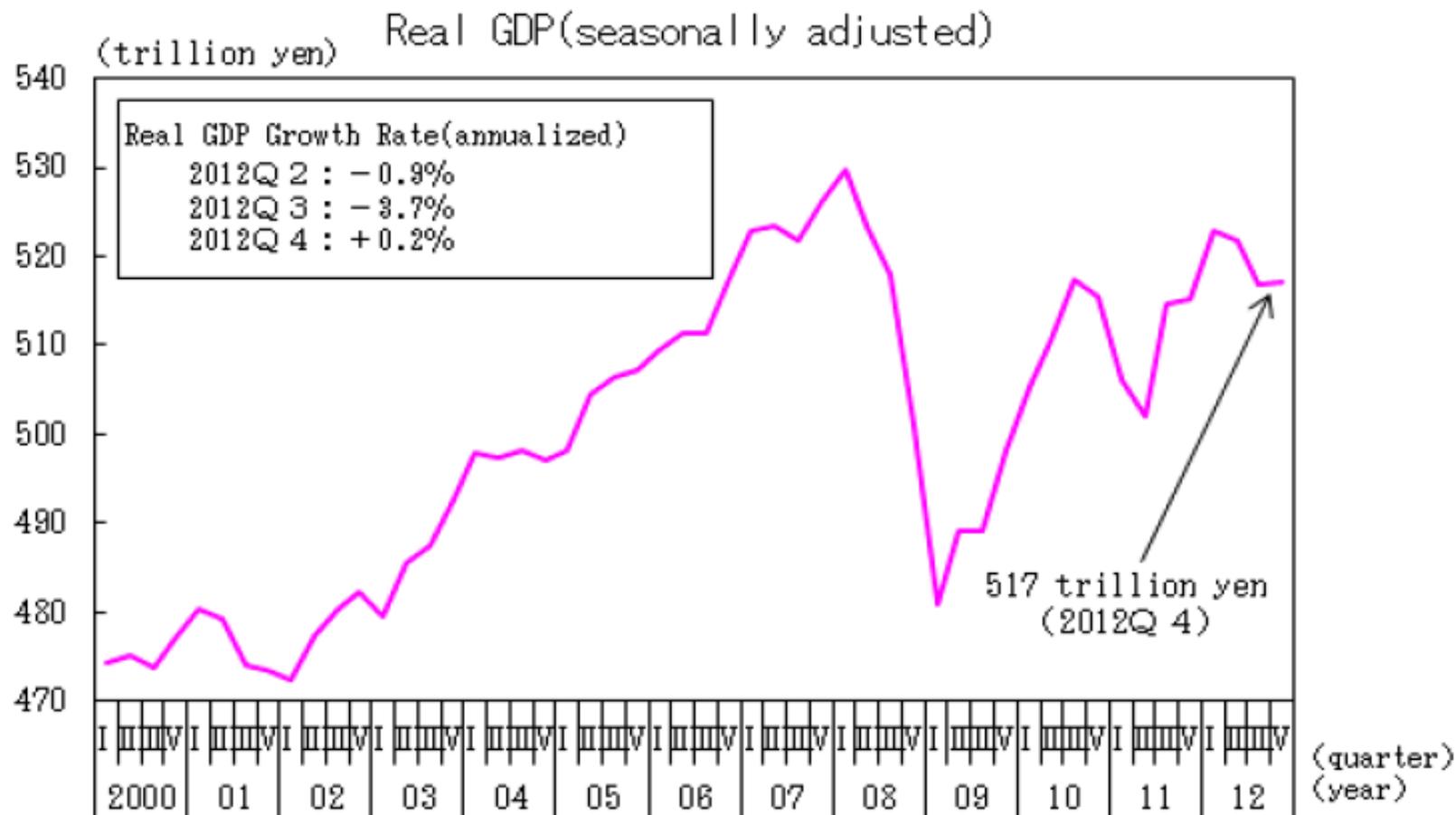
G7 AND G20 (ECONOMIST MAY 18 AND MAY 4)



IMPACT OF “ABENOMICS”

- Stronger growth in FY 2013 with “Full” engines (1Q GDP +3.5% annual basis)
 - ⇨ Equity market and the Asset effects on private consumption
 - ⇨ Property/ Housing investment
 - ⇨ Intensive public spending
 - ⇨ Moderate recovery in export
- Technical backlash and critical turning point of FY 2014, Minus growth again?
 - ⇨ Private consumption shocked by increased VAT
 - ⇨ Public spending cut
 - ⇨ Credit and Market expectation for growth strategy?

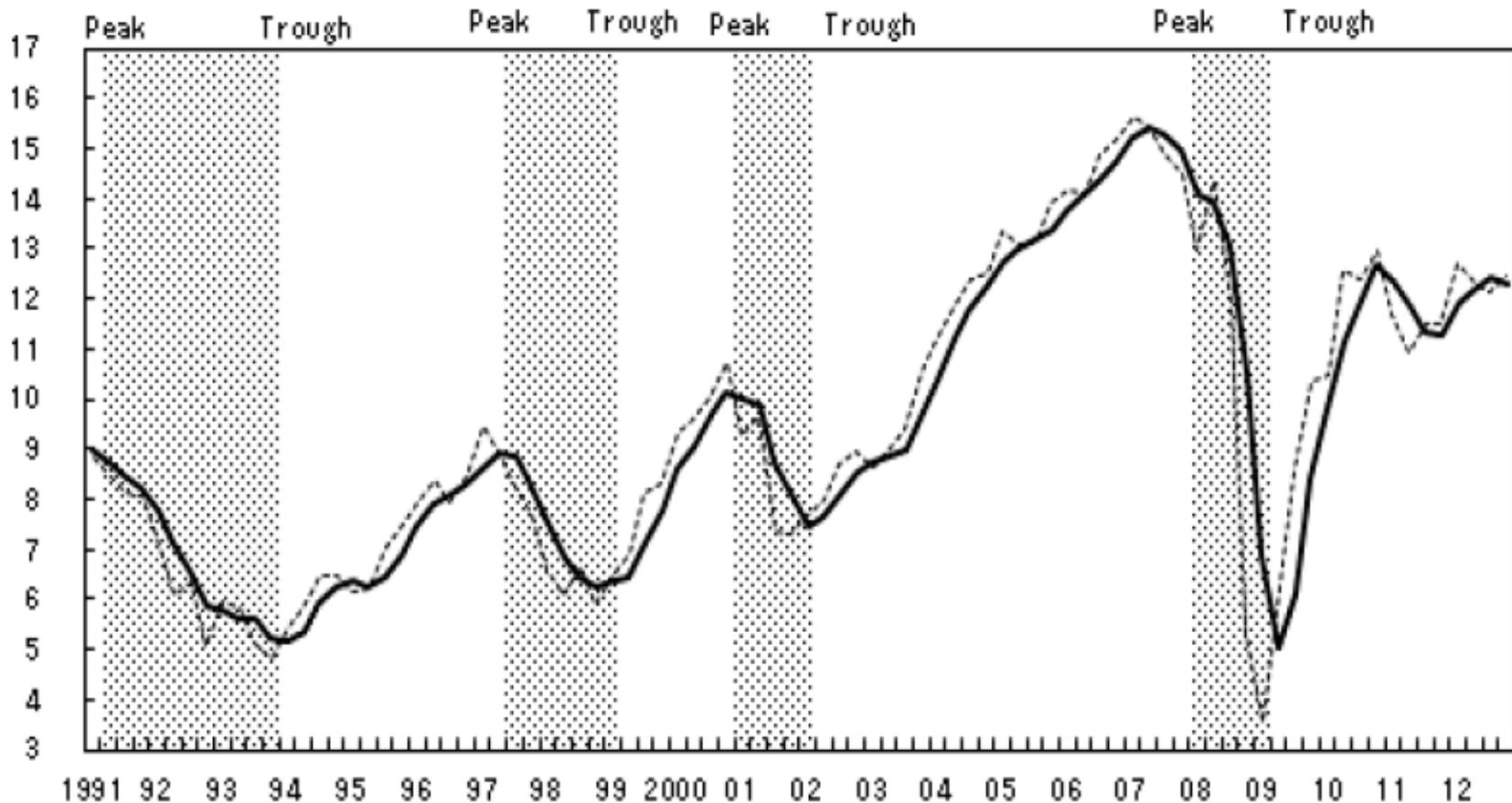
MODERATE RECOVERY UNTIL 2012



CORPORATE PROFIT NOT RECOVERED FULLY

Trend of current profits

(¥1 trillion)



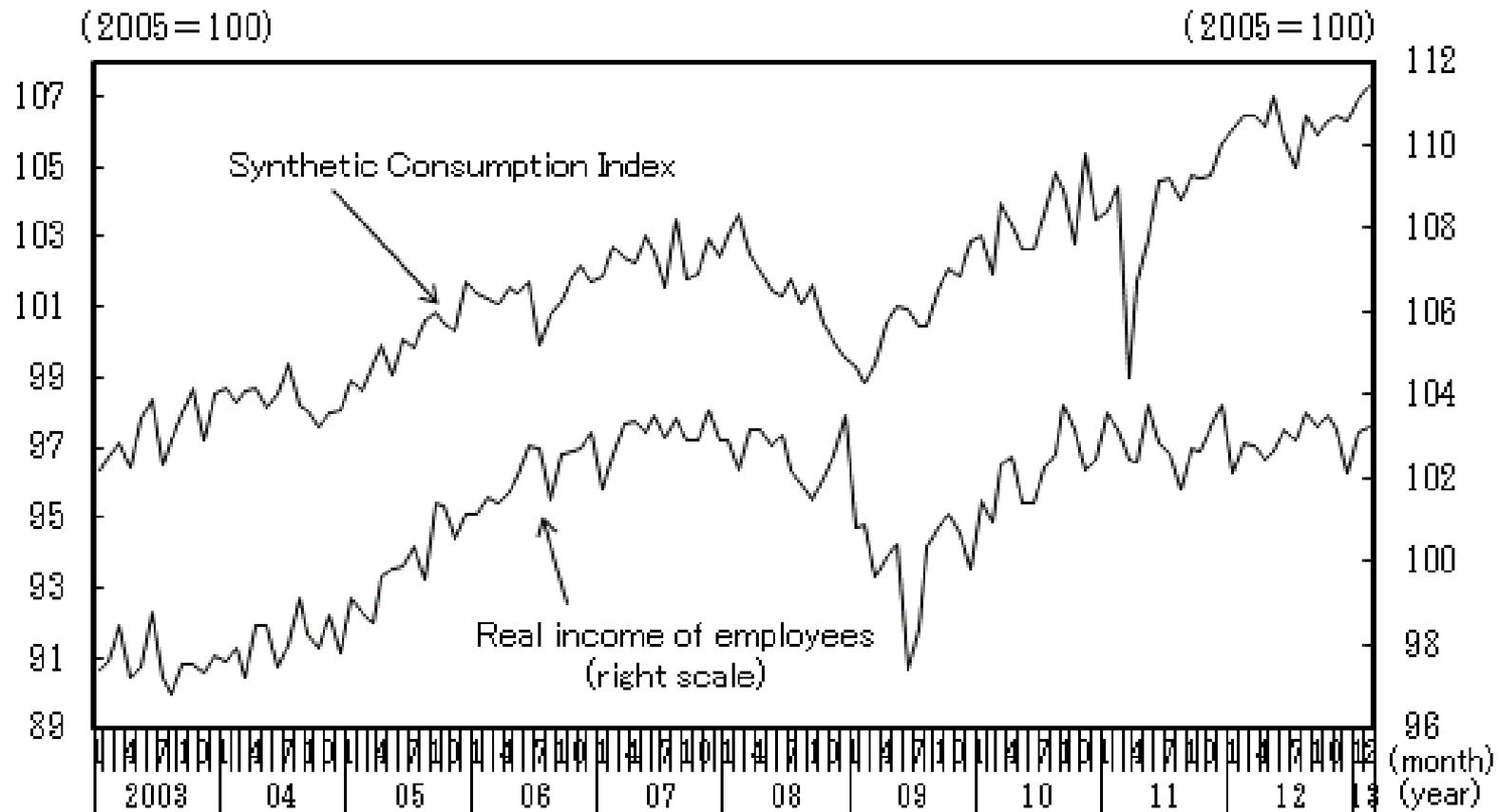
SOARING TOPIX

JP:KSI5U1000 2012/11/14 - 2013/05/17

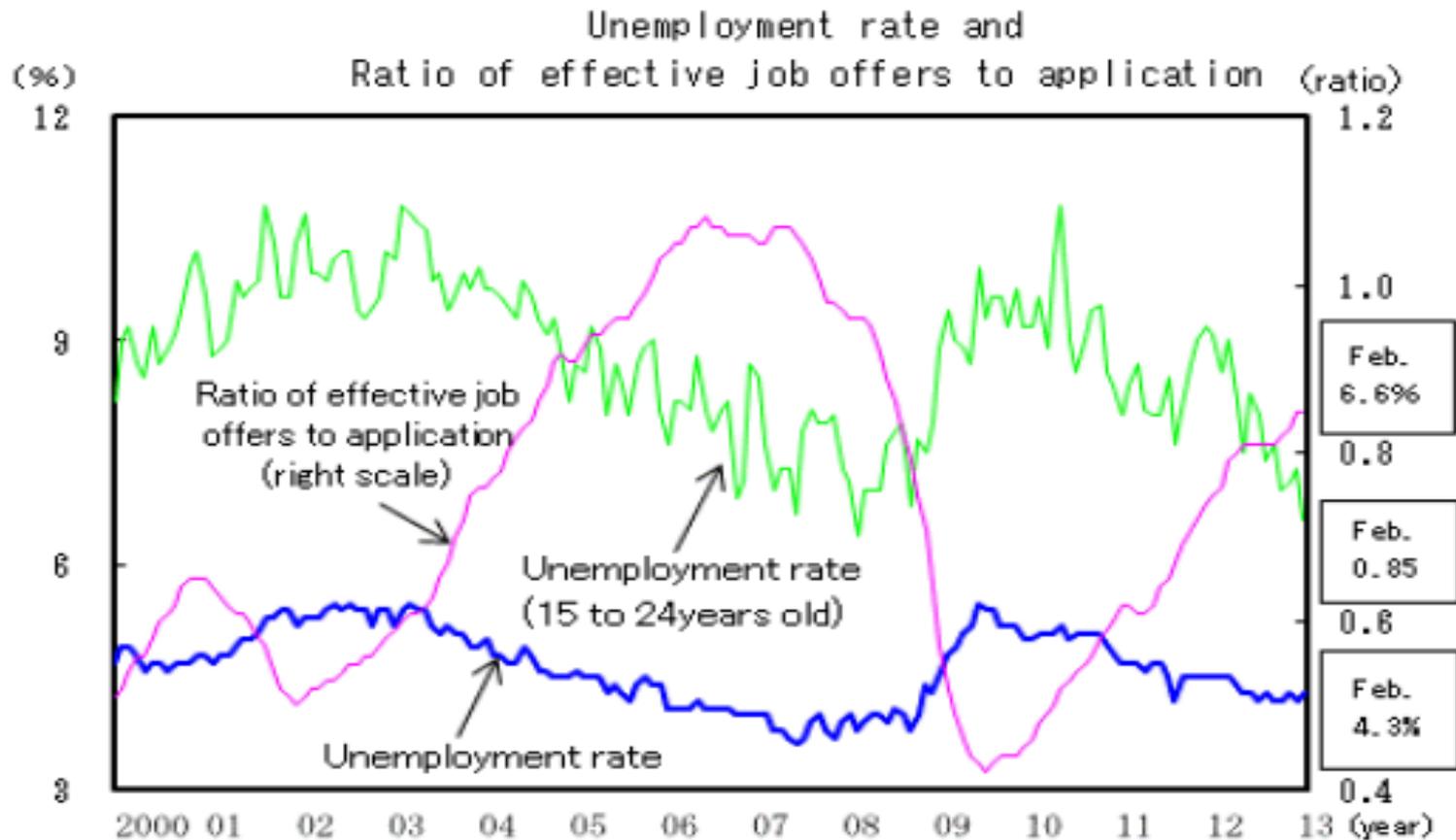


CONSUMPTION STARTED TO PICK UP

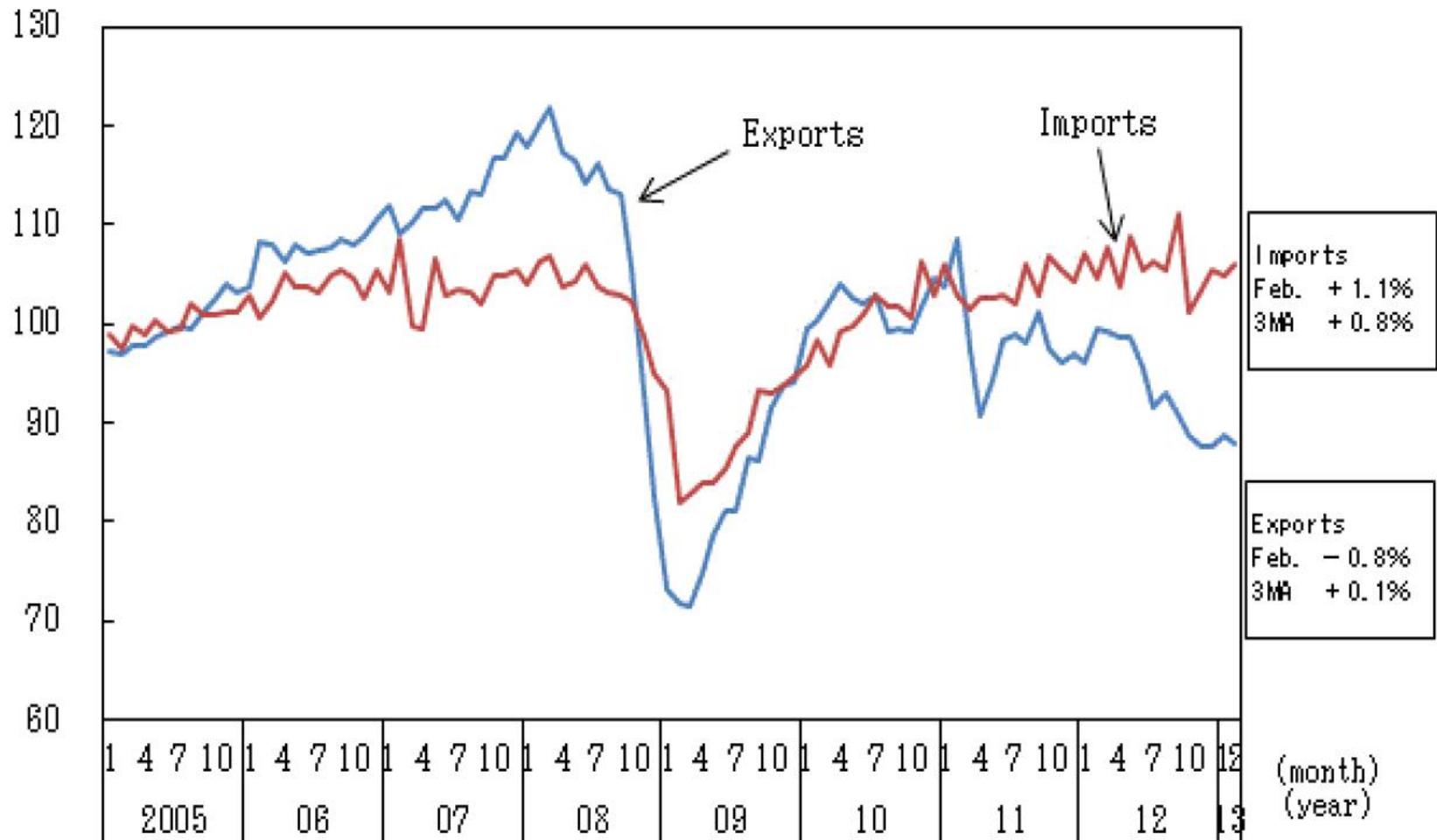
Synthetic Consumption Index and Real income of employees



UNEMPLOYMENT STARTED TO DECLINE...

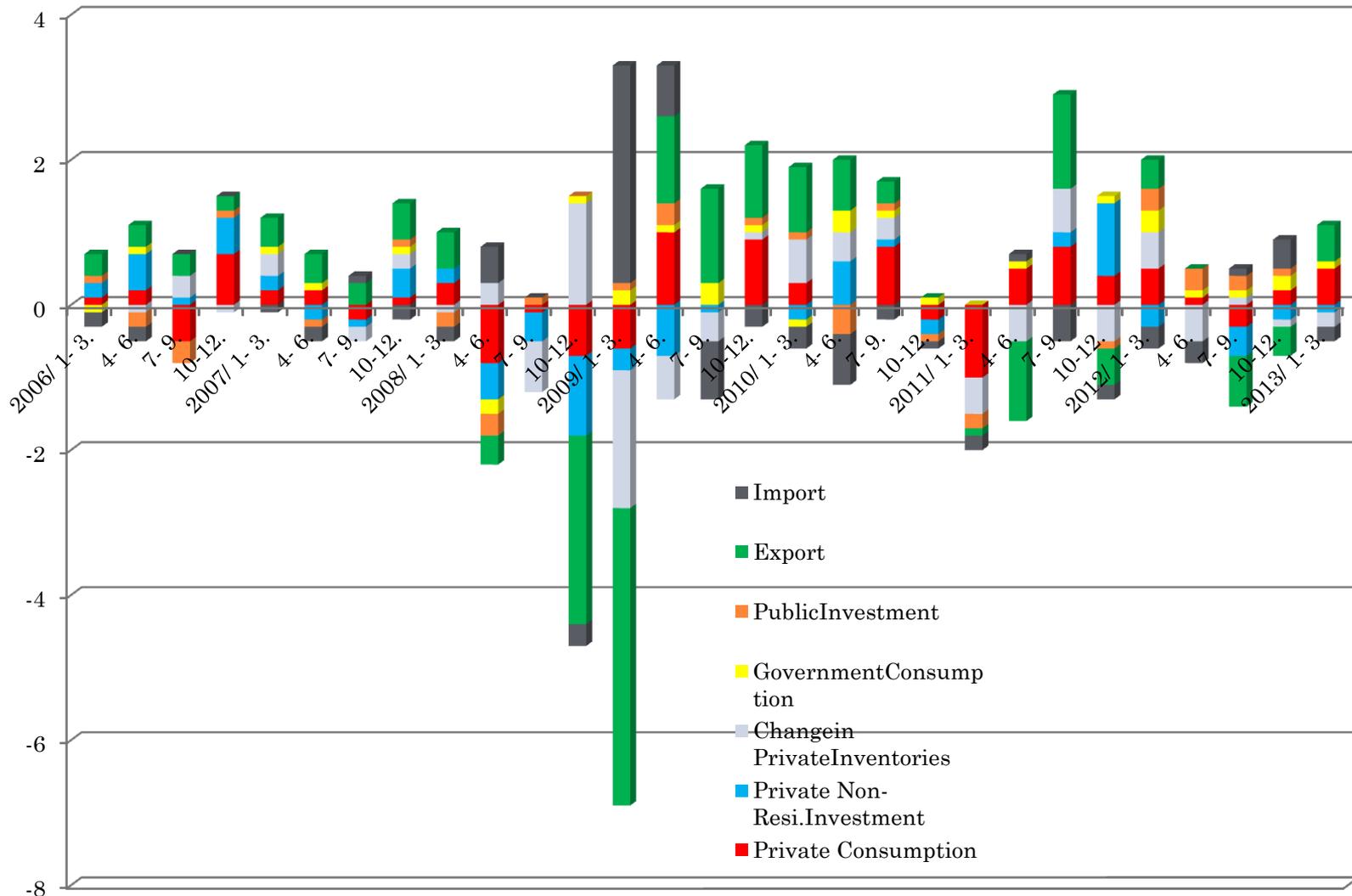


EXPORT IS STILL WEAK IN VOLUME (INDEX: 2005=100)



(Note) "Trade Statistics" and "Balance of Payments" of Ministry of Finance.

GOING BACK TO THE BALANCED GROWTH PATTERN



POINTS OF “ABENOMICS”

- Timing of long-term interest rate hikes
 - ☞ Inflation target achieved, finding exit, Expected interest rates hikes
 - ☞ Finding no exit, Risk Premium, Financial catastrophe
- Direction of BOP: Current account surplus sustained?
- Growth strategy (○): Innovation, Facility investment, Job and Wage hikes, Current account surplus
- Growth strategy (×): Stagnant investment, Low interest rate maintained, Further depreciation of Yen, Asset bubbles, if bubble bursts again.....??

GROWTH STRATEGIES BY “ABENOMICS”: GOING BACK TO HOMEWORK (1)

- Pushing comprehensive reform
 - (1) *Labor market reform*: Mobility, Flexibility, Female participation
 - (2) *Corporate governance reform*
 - (3) *Innovation system reform*: Strategic support, IPR and Standardization, Big data
 - (4) *Location strategies*: Reviewing special zones, Privatization
 - (5) *Education reform for globalization*

GROWTH STRATEGIES BY “ABENOMICS”: GOING BACK TO HOMEWORK (2)

- Innovation based on the domestic market
 - (1) Health and Medicare services: Establishing NIH, Regenerative medicine, Health promotion, Deregulations on drugs
 - (2) Energy Innovation: Comprehensive energy plans (Nuclear Power?, Clean Coal Power? Clean Power? New energies? (Methane Hydrate Deposits, Shale-gas?))
 - (3) Infrastructure Renovation: Hardware, Future transportation system, Disaster management
 - (4) Agricultural reform: Land reform, Export promotion, High value added service...
 - (5) Promotion of service/ contents export

IMPACT ON KOREAN ECONOMY (1): END OF ABJ GROWTH HYPOTHESIS

- Anything But Japan (ABJ) Strategies

Japan= *Appreciated Yen* + Heavy Corporate Tax +
Energy constraints + Environment standards +
Labor costs + Slow FTA \Rightarrow R&D with More risk

Korea= *Depreciated Won* + Gov. supports +
Energy Subsidies + Minor Co2 commitment +
Labor costs + FTA hubs \Rightarrow Profit with Less risk

- The success: Converging industrial structures, Soaring global market share, FDI attraction, Technological catch-up

- The contradiction: Cost competition, Deteriorated term of trade, Energy crisis, More impacts from Yen-Won rate, Increased IPR frictions

EXPORT SHARE OF ELECTRONICS/ INTERMEDIATE GOODS BY JAPAN AND KOREA (METI (2012))

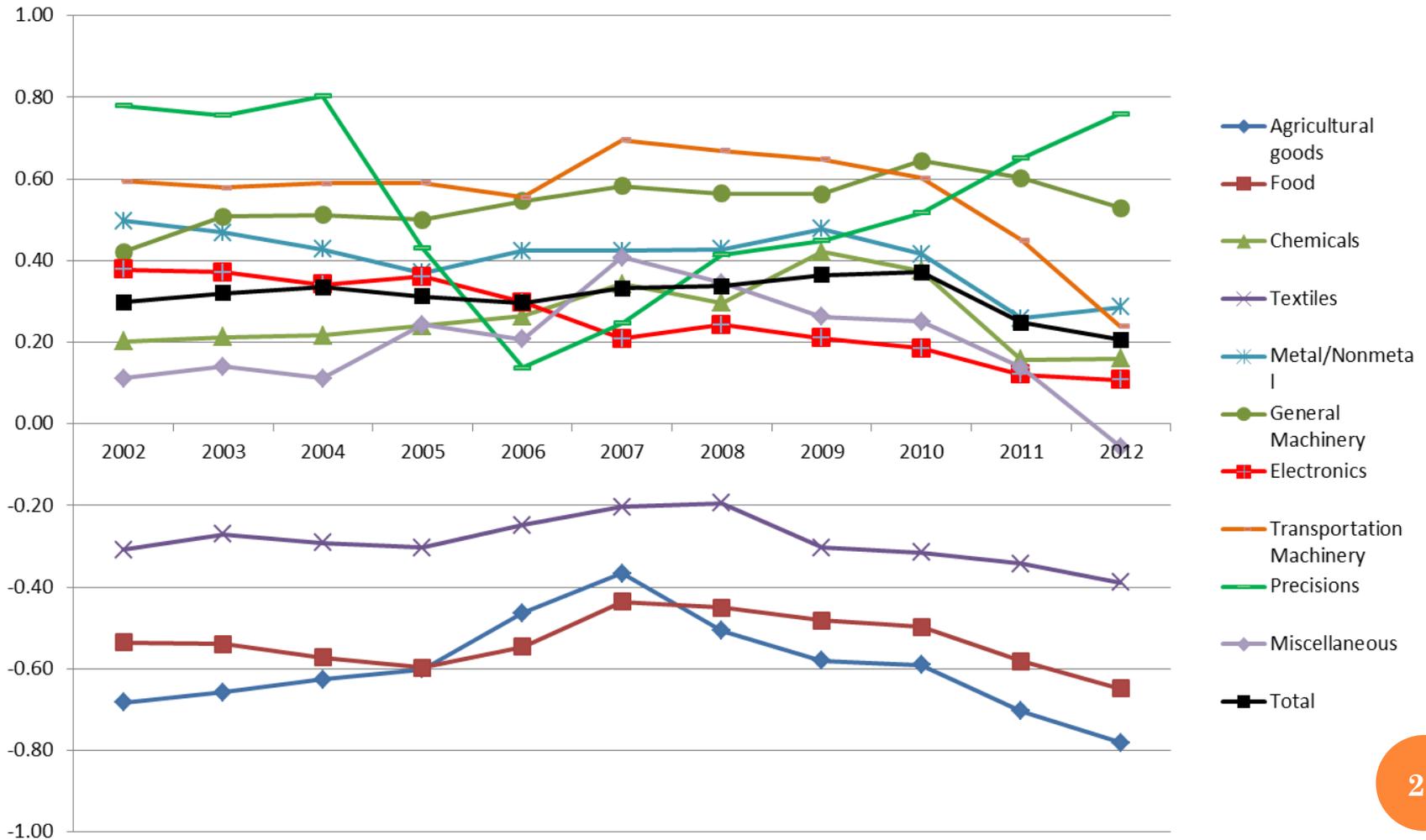
2000

Destination	Market share	Acquired Share	
		Korea	Japan
World	100.0	5.6%	15.2%
EU15	23.8	2.7%	9.3%
USA	16.1	8.8%	18.8%
Singapore	6.7	5.7%	19.4%
Hong Kong	6.4	6.6%	19.6%
Japan	5.4	10.4%	X
Mexico	5.4	3.2%	4.3%
China	5.3	12.9%	30.7%
Malaysia	5.2	5.4%	21.0%
Taiwan	4.9	9.0%	25.2%
Korea	4.4	X	28.9%
Canada	3.4	3.0%	7.9%
Others	3.1	2.7%	5.6%
Thailand	2.0	5.0%	29.3%
Philippines	1.8	8.9%	17.2%
Brazil	1.0	7.6%	15.0%
Hungary	0.7	2.2%	15.0%
Cesko Slovakia	0.7	0.3%	4.2%
Australia	0.6	2.8%	14.5%
Poland	0.4	2.5%	4.4%
Turkey	0.4	2.5%	3.0%
India	0.3	6.3%	10.1%
Argentina	0.2	5.8%	11.0%
Romania	0.2	0.9%	4.8%
Vietnam	0.2	5.4%	58.8%
Indonesia	0.1	4.4%	26.0%
Russia	0.1	2.2%	3.6%
Chile	0.1	2.9%	4.1%

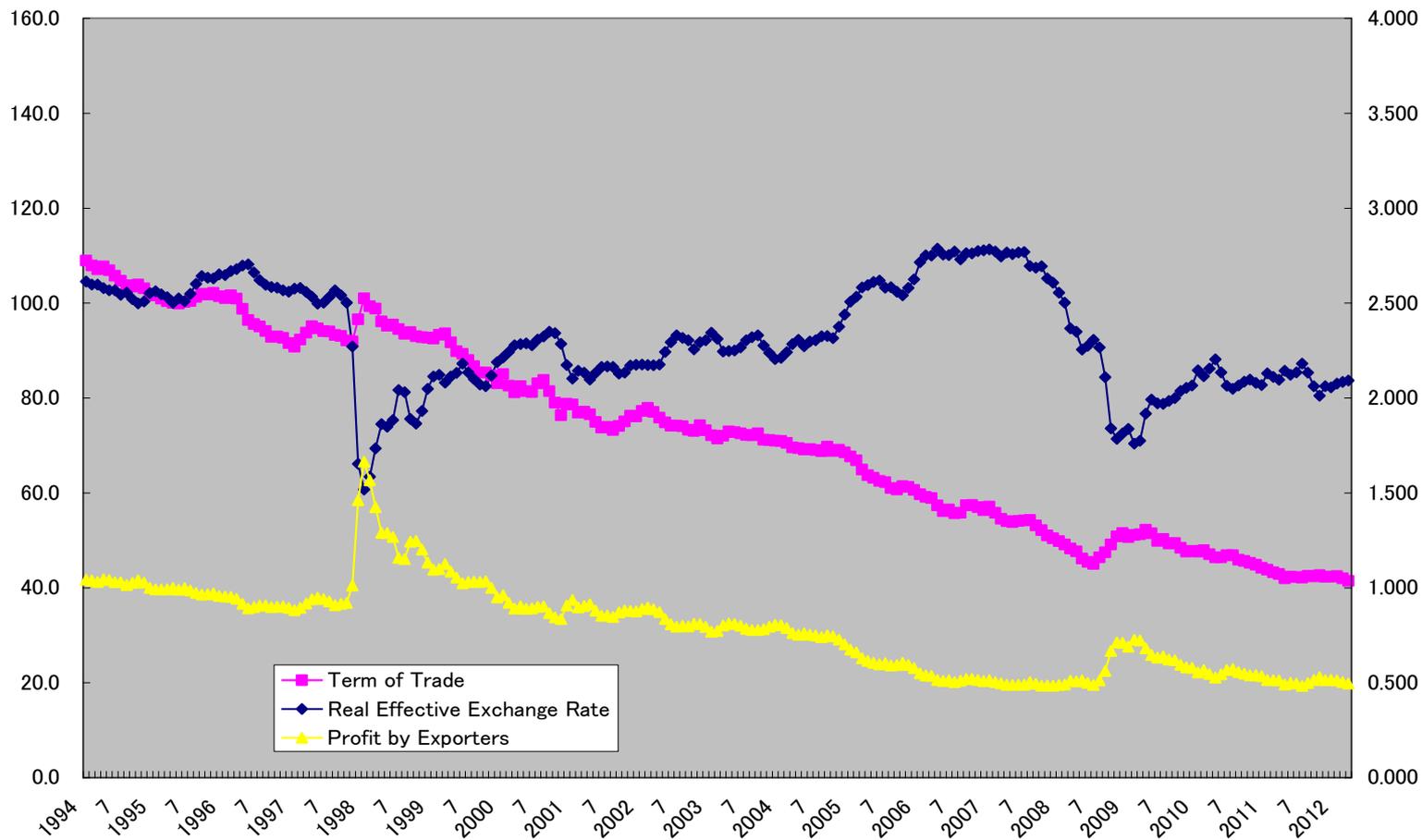
2010

Destination	Market share	Acquired Share		
		Germany	Korea	Japan
World	100.0	6.6%	10.5%	10.8%
EU15	18.1	13.6%	3.5%	4.8%
China	17.1	3.4%	23.8%	19.1%
Hong Kong	11.5	0.8%	7.1%	9.7%
USA	7.5	4.8%	5.4%	11.7%
Singapore	6.4	2.7%	14.8%	8.7%
Taiwan	4.2	1.6%	14.2%	22.9%
Japan	4.2	2.3%	11.0%	X
Malaysia	4.1	6.6%	9.7%	12.9%
Korea	4.0	3.0%	X	16.6%
Others	3.8	14.1%	3.3%	3.1%
Mexico	3.8	2.7%	15.4%	9.4%
Cesko Slovakia	2.1	20.0%	11.8%	5.0%
Thailand	1.9	2.6%	6.8%	32.4%
Philippines	1.5	3.3%	11.4%	12.7%
Canada	1.4	3.1%	5.6%	5.6%
Hungary	1.2	32.6%	13.5%	5.8%
Brazil	1.1	5.9%	15.3%	6.5%
Poland	1.1	13.7%	17.1%	3.8%
Indonesia	0.9	3.7%	7.7%	18.4%
Russia	0.7	12.8%	10.0%	4.0%
India	0.6	10.7%	8.7%	6.8%
Australia	0.5	6.3%	5.0%	8.9%
Romania	0.4	33.2%	0.4%	1.3%
Turkey	0.4	17.1%	2.7%	4.0%
Vietnam	0.3	1.9%	6.5%	28.9%
Argentina	0.2	12.4%	6.8%	2.3%
Chile	0.1	6.3%	4.6%	2.2%

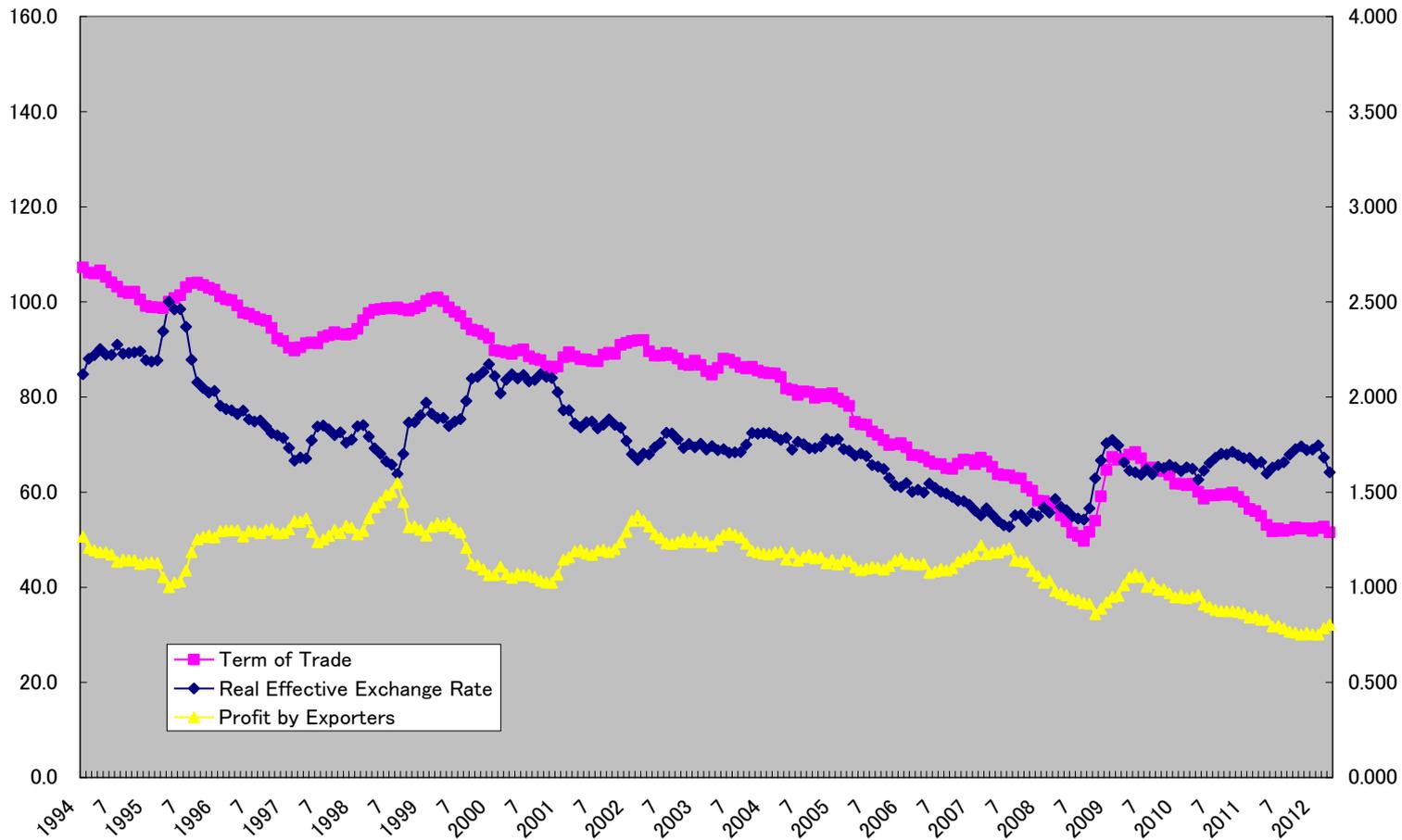
TRADE SPECIALIZATION BY JAPAN AND KOREA



TERM OF TRADE, REER, AND PROFIT BY EXPORTERS, KOREA (1995.4=100, PINK, BLUE, YELLOW)



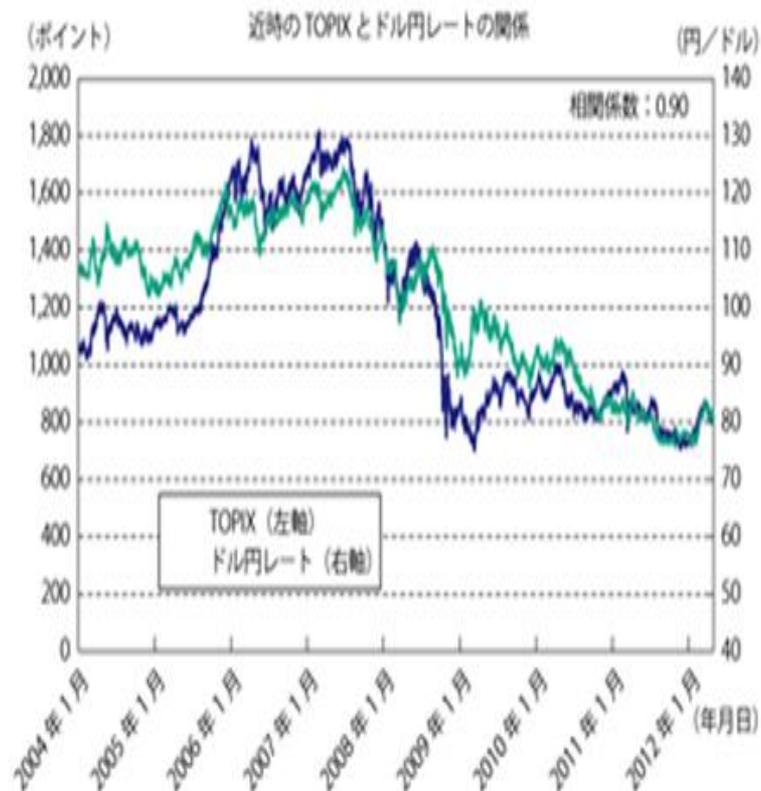
TERM OF TRADE, REER, AND PROFIT BY EXPORTERS, JAPAN (1995.4=100, PINK, BLUE, YELLOW)



TOPIX vs. ¥/W RATE AND \$/¥ RATE (METI(2012))



資料：株式会社東京証券取引所「TOPIX」、The Bank of Korea「円ウォンレート」、CEIC Database から作成。



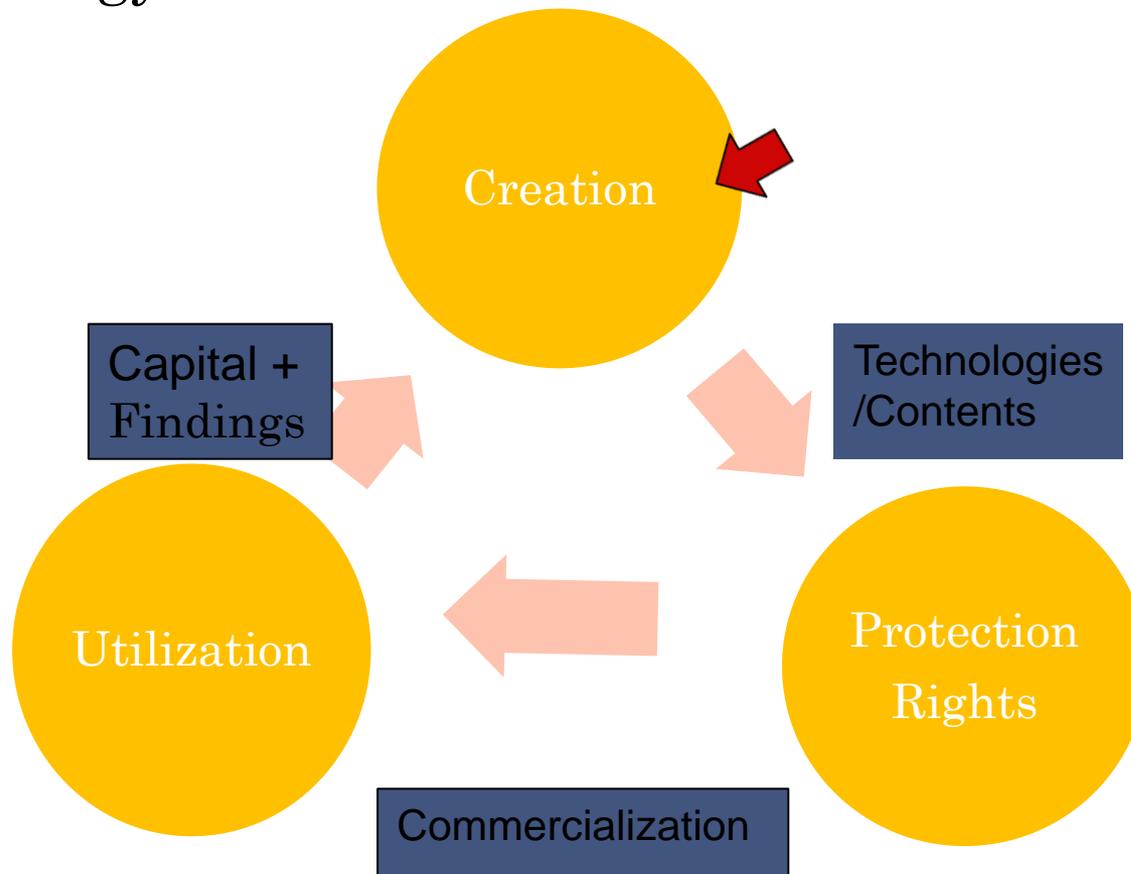
資料：株式会社東京証券取引所「TOPIX」、日本銀行「ドル円レート（スポットレート、17:00時点）」、CEIC Database から作成。

IMPACT ON KOREAN ECONOMY (2): GLOBALIZATION HYPOTHESIS

- Korean market share grew under Won appreciation before 2008
- Financial crisis awoke Korean Business for globalization: Dominant strategies, Concentration, Outside labor market...
- Market-driven technologies, Technology digitalization
- Efficient allocation system, Manageable supply-chains
- Speedy decision making system, IT management, Managerial discipline

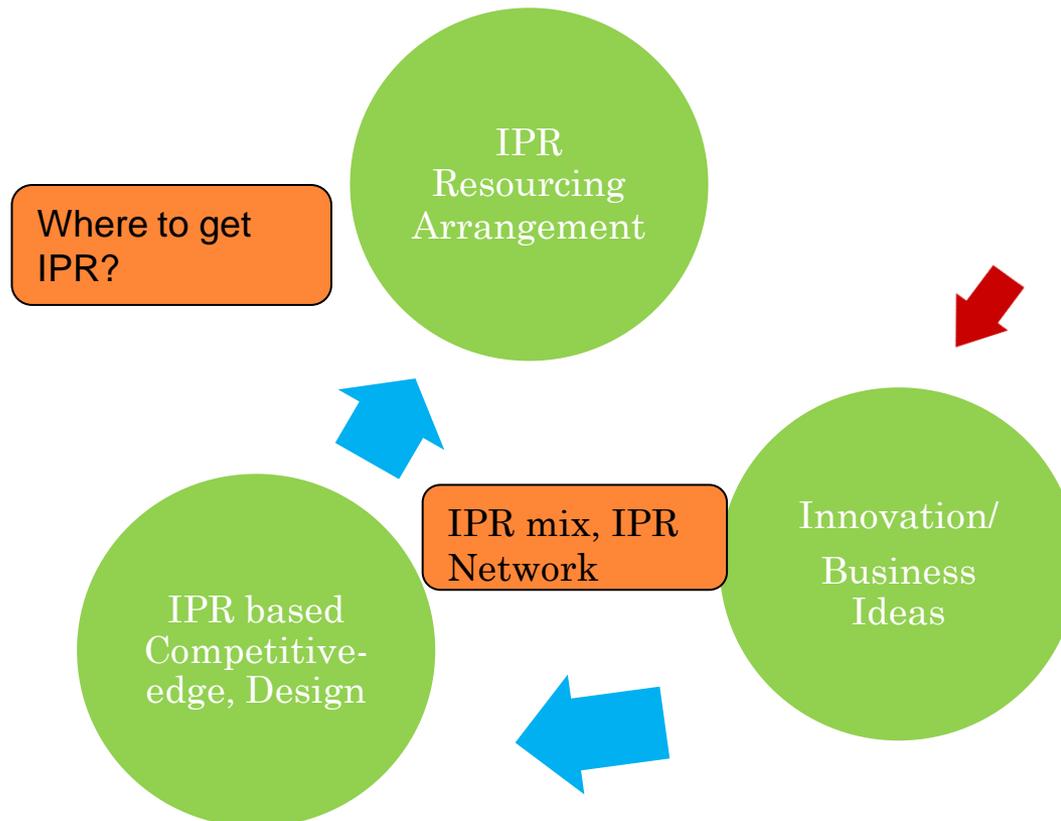
TRADITIONAL MODEL

- Binding “Technology Projection Model”
(Technology → Market)



NEW MODEL UNDER GLOBALIZATION

- Business Reflection Model (Business model → Resources)



IMPACT ON KOREAN ECONOMY (3): DIFFERENT I-O STRUCTURE HYPOTHESIS

- Input-Output Structure is different
 - Japan: Import Input Coefficient is low
 - Korea: High
 - ☞ Korea may be more neutral to REER change
 - ☞ Shock on trade: Japan > Korea
 - ☞ Korea may cancel out the import cost
 - ☞ Relative competitiveness depends on \backslash -W rate, rather than \$-W rate
- Import Input Coefficient grew in Japan and Korea: Globalized allocation? Deterioration of terms of trade?

KOREA'S CONTRADICTIONS AND “ABENOMICS”

- ABJ strategies: Trying to compete with Japan by making another Japan?
 - ☞ Price competition and the impact of “Abenomics”?
- Dominant strategies: Managerial resource concentration into the Giants, but “Economic democratization”?
 - ☞ More competition with Japan by large firms but SMEs?
- Opened input structure resilient for exchange rate fluctuation, Financial Hub?
 - ☞ Import substitution should be promoted?
 - ☞ Impossible trinity??

FINDING OPPORTUNITIES MAY BE CONSTRUCTIVE

(1) Market-led integration as the Reality:

- ☞ Industrial accumulation effect matters!
Especially for ventures and SMEs
- ☞ No Yen-Won transaction market?
- ☞ Strategic value in standardization?

(2) Better survival in Globalization:

- ☞ Pooling talents
- ☞ Complementary relations: Sogo-shosha, Mega Banks

(3) Different in Input-Output Structure:

- ☞ In a mean time, minor bombing?
- ☞ Value of Japanese market for innovation?

TEMPORARY CONCLUSION

- Market is *ALREADY* integrated
- Better separate business from politics
- Impact of “Abenomics” may be inflated, considering Korea’s recent performance:
 - ☞ Division of labor, rather than bench-marking may mitigate the fear (ex. Samsung)
 - ☞ Japan’s recovery may provide opportunities for common strategic business (ex. Medicare)
 - ☞ Market intervention may have deteriorated terms of trade
- Better to be ready for the worst scenario rather than complaining!