

# RIETI BBL Seminar Handout

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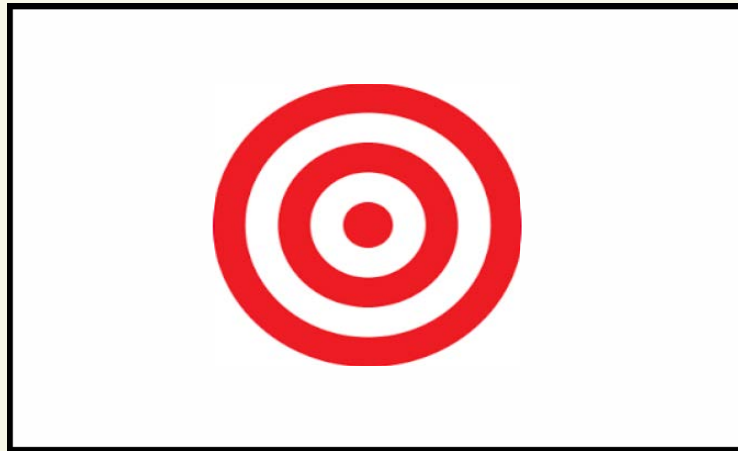
“Japan's Abenomics:  
Reload, Reset or Relaunch?”

September 27, 2016

Speaker: Luc EVERAERT

<http://www.rieti.go.jp/jp/index.html>

# Reload, Reset, or Relaunch? Japan's Policy Options



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# Outline

- ❑ What has Abenomics achieved so far?
- ❑ Why has Abenomics not made more progress?
- ❑ What are the policy options?
- ❑ What are the authorities doing?

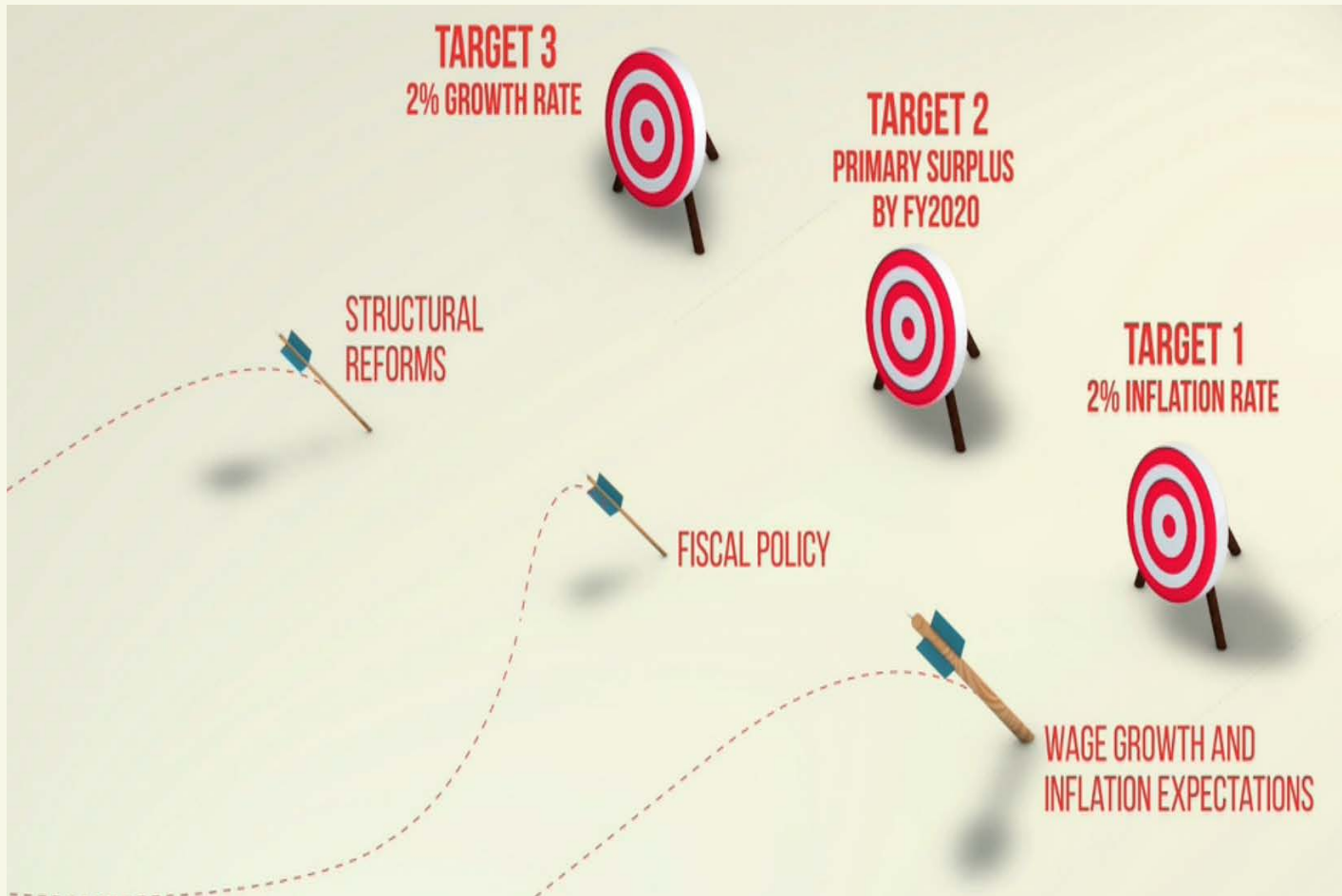


# Abenomics met with some success

- ❑ Reversed undue appreciation of the yen and boosted corporate profits
- ❑ Lifted actual and expected inflation
- ❑ Created modest wage gains and reached full employment
- ❑ Made progress on fiscal consolidation
- ❑ Raised labor force participation and improved corporate governance



# But the targets have not been achieved



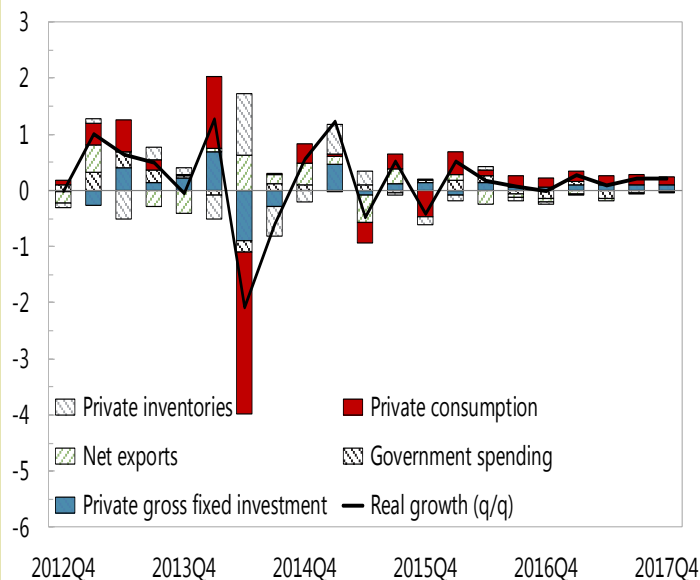
1. What has Abenomics achieved so far?

# Current policies will deliver mediocre growth and low inflation

Weak growth will persist due to subdued private demand ....

Contributions to QoQ Growth (SA)

(In percent)

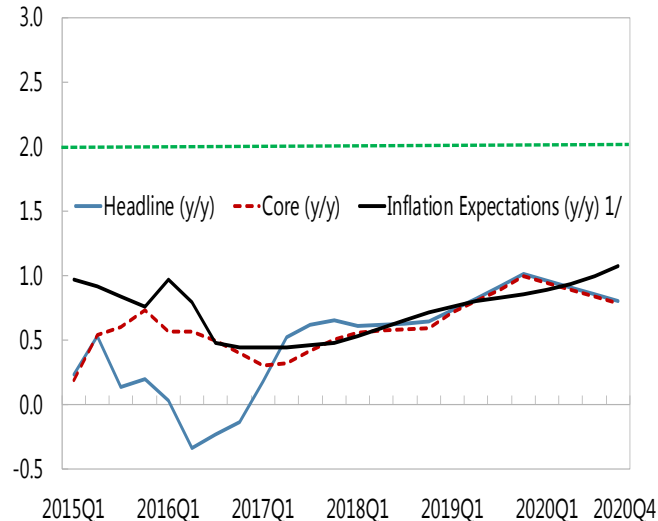


Source: Haver Analytics.

....and inflation will remain below target

Baseline Inflation Outlook

(YoY; in percent)



Source: IMF staff estimates.

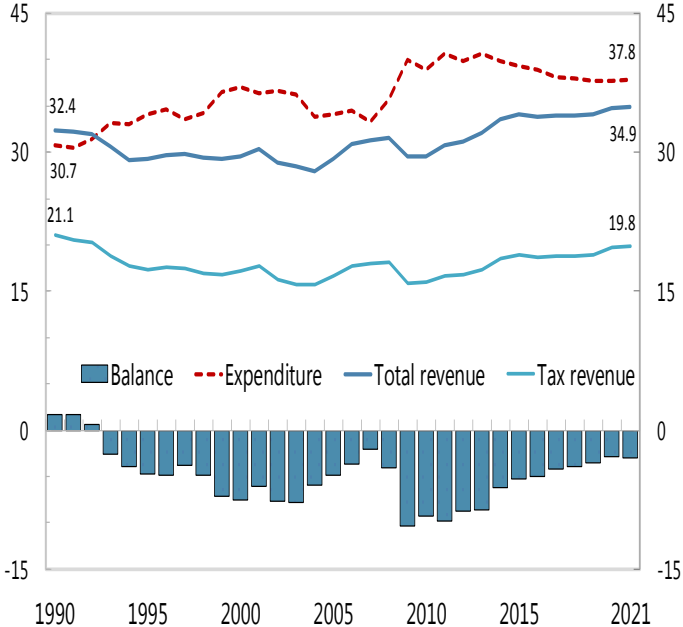
1/ Average of one-year ahead expectations from Consensus, market based measures and Tankan Survey of firms until 2016Q2. Projections assume inflation expectations are based on a weighted average of past and future rates of inflation. Jump in 2016Q1-Q2 reflect the effects of the expected consumption tax rate hike in 2017.

# Public deficits and debt remain high

## Fiscal deficits are large

### General Government Fiscal Balance

(In percent of GDP)

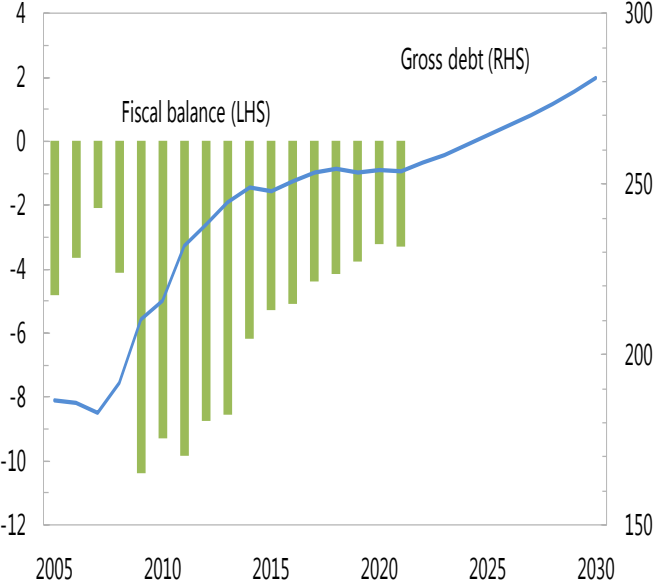


Sources: IMF WEO database; and IMF staff estimates.

## Putting public debt on an unsustainable trajectory

### Japan: Gross Public Debt<sup>1/</sup> and Fiscal Balance

(In percent of GDP)



Sources: Cabinet Office; and staff estimates and projections.

<sup>1/</sup> Gross debt of the general government including the social security fund.

Withdrawal of fiscal stimulus and consumption tax increases to 10 percent in October 2019 are assumed.

# Headwinds, structural obstacles and limits to policy effectiveness

2. Why has Abenomics not made more progress?



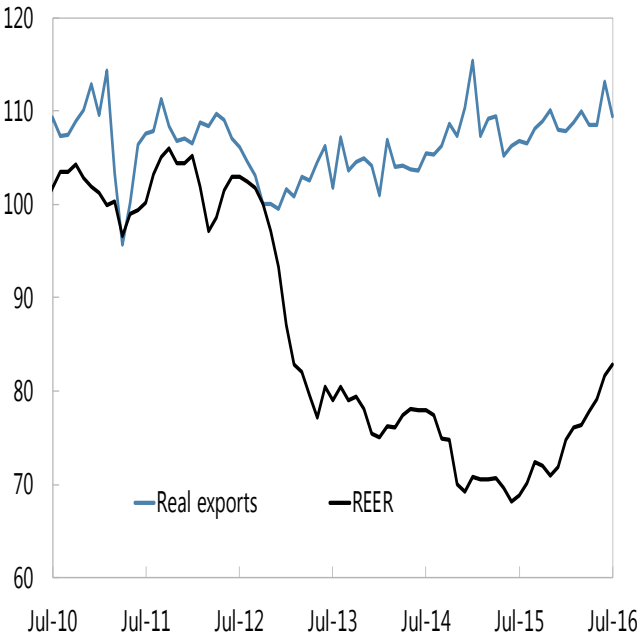


# Global weakness depressed exports and lowered inflation

Global trade slowdown has offset benefits from currency depreciation while....

### Real Exports and REER

(2012 Oct=100)

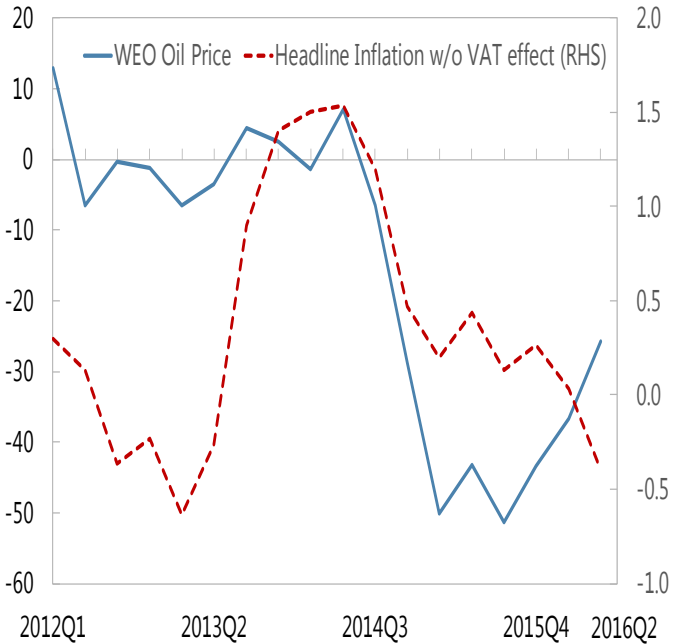


Source: Haver Analytics.

..falling commodity prices have failed to boost activity and put downward pressure on inflation

### World Oil Price and Japan Inflation

(In percent; YoY)

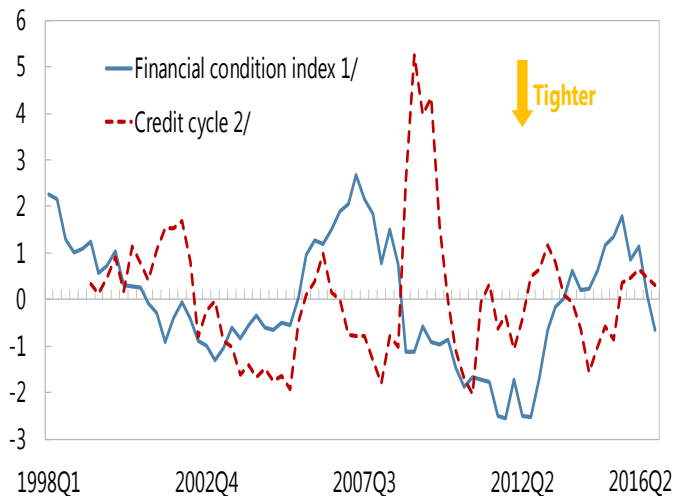


Sources: World Economic Outlook; and IMF Staff Calculations.

# Developments in financial and external conditions complicate the short-term

Financial conditions have tightened recently...

Japan: Financial Condition Index and Credit Cycle



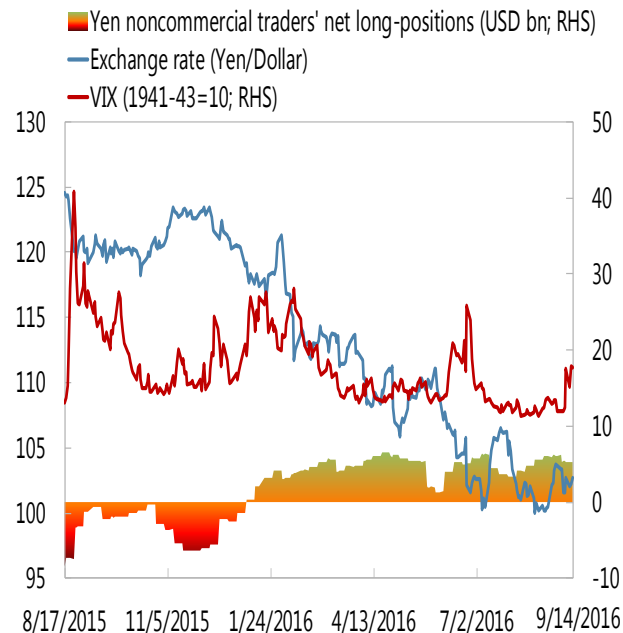
Sources: Bank of Japan; Ministry of Finance; Haver Analytics; and IMF staff estimates.

1/ Estimated as the first principal component of (standardized) 3-month TIBOR, 10-year JGB yield, stock price, and NEER.

2/ Estimated as the average of the HP-filtered real total credit growth (deflated by CPI) and total credit-to-GDP ratio.

....and the yen has appreciated strongly since end of 2015

Japan Exchange Rate Movements



Sources: Bloomberg, L.P.; and IMF staff calculations.

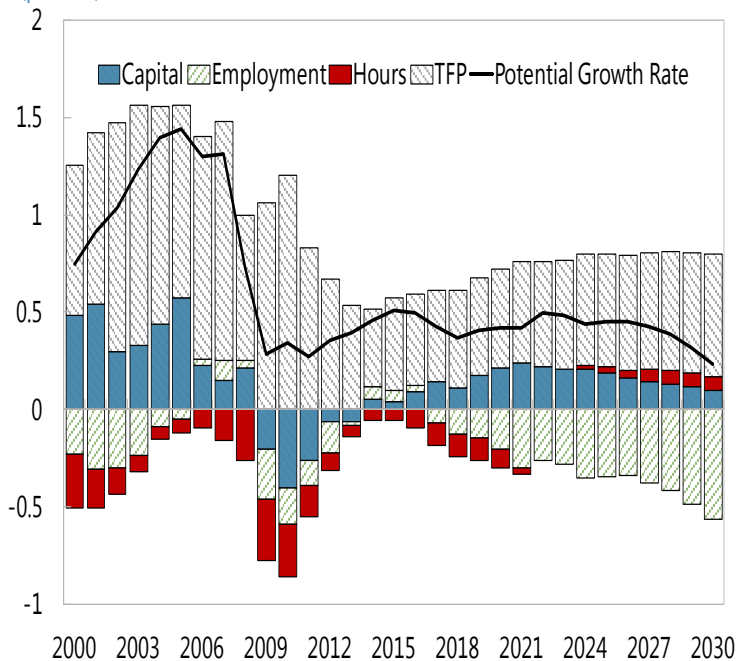
2. Why has Abenomics not made more progress?

# Structural impediments are weighing on growth and wages

Demographic headwinds are lowering potential growth...

## Potential Growth

(percent)

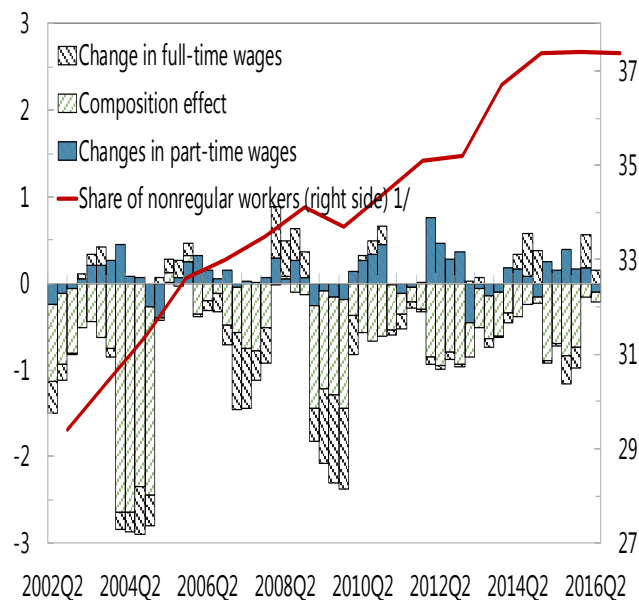


...and labor market duality is preventing wage growth

## Nonregular Workers and Wage Growth

(YoY; in percent)

(In percent of staff)



Sources: Haver Analytics; and IMF staff estimates.

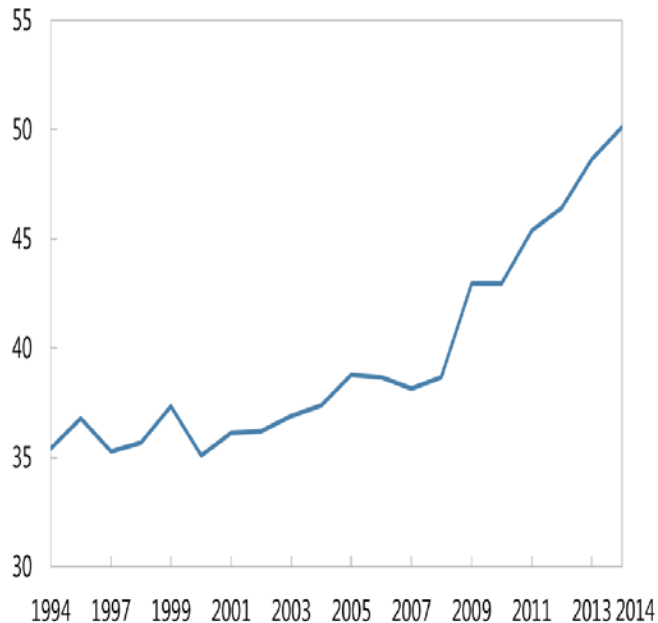
1/ Yearly Average.

# Profits are accumulating and the labor market is increasingly tight

Profits are accumulating in corporate cash holdings

## Non-Financial Firms' Cash Stock

(In percent of GDP)

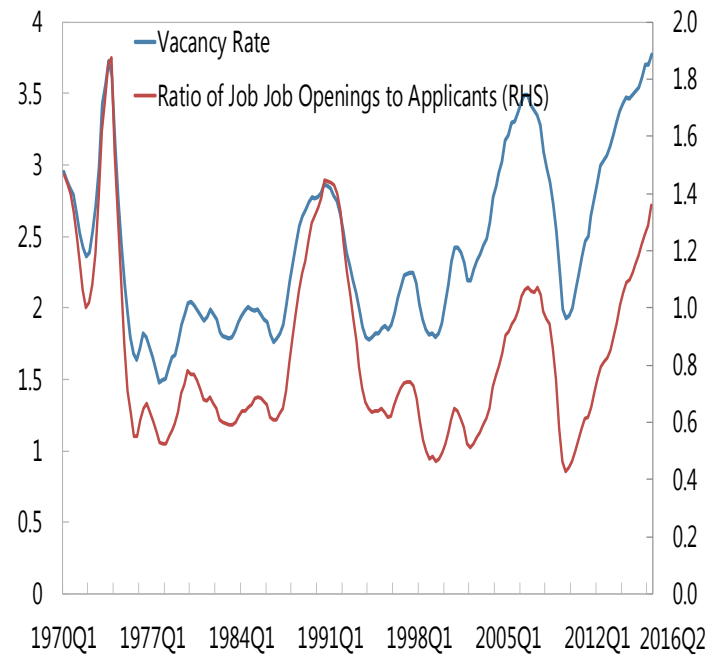


Source: Cabinet Office of Japan/ Haver Analytics.

And there are more vacancies than job applicants

## Vacancy Rate and Ratio of Job Openings to Applicants

(In percent, ratio)



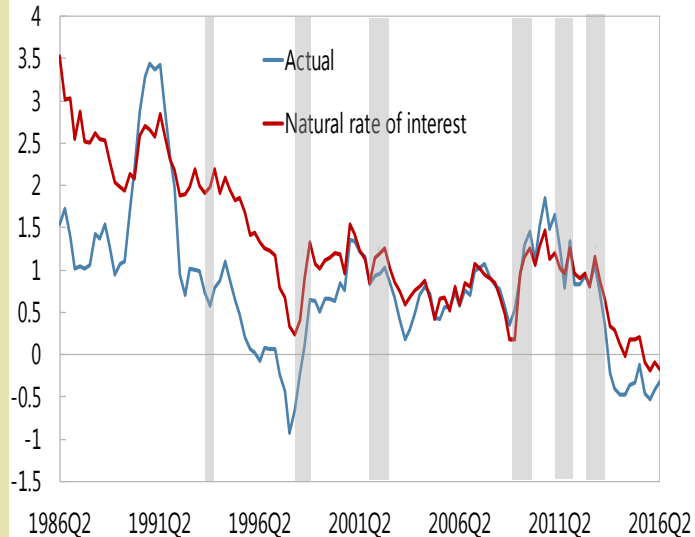
Source: Haver Analytics.

# Aging is dampening inflation and growth

## Declining neutral rate reduces monetary policy effectiveness

### Japan: Natural Rate of Interest

(In percent)



Sources: Bank of Japan; Haver Analytics; and Fund staff estimates.

Note: The blue line is the actual real discount rate deflated by the inflation expectations estimated from an MA(4) model, and the red line marks the mean posterior estimates of the natural rate of interest from a Bayesian time-varying parameter vector autoregression (TVP-VAR) model following Lubik and Matthes (2015). The shadow areas highlight the recession periods (defined as when the SAAR real GDP growth falls below zero for at least two consecutive quarters).

## Aging reduces productivity growth

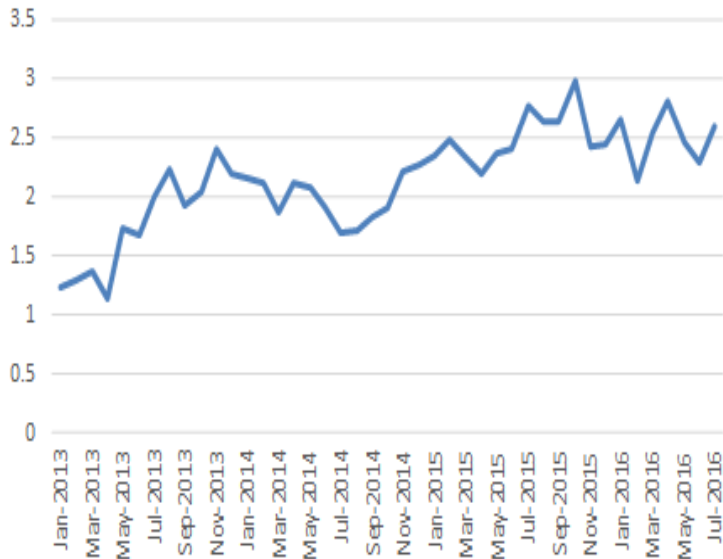
	Labor productivity	Total factor productivity
Old age Dependency	-0.851** (0.338)	-1.157** (0.664)
Net migration	0.724* (0.361)	2.491*** (0.691)
Lagged Population growth	-0.00632 (0.0199)	0.0883** (0.0407)
Control variables	Yes	Yes
Lagged dependent	Yes	Yes
Time dummy	Yes	Yes
Observations	1380	1380
R squared	0.643	0.585

Robust standard errors in parenthesis  
 \*\*\* p<0.01; \*\* p<0.05; \* p<0.10

# Monetary policy has been losing traction

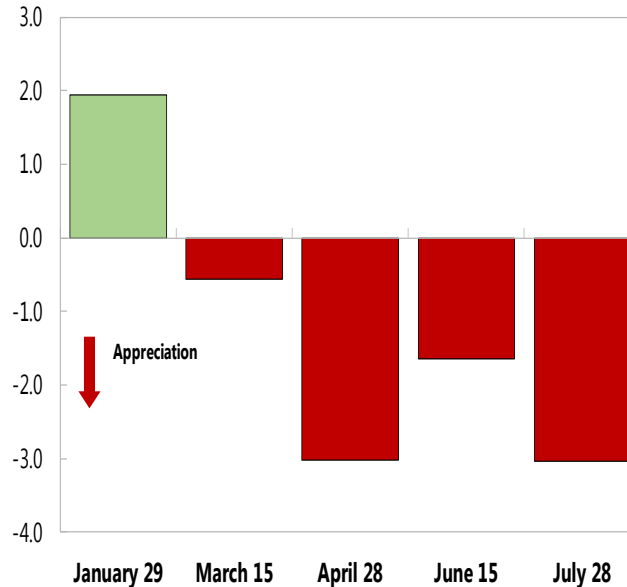
Loan growth has stalled, getting little help from NIRP

Japan: Loans to Private Sector  
(Year-on-year percent change)



...and markets are no longer impressed

FX market reaction on the day of BoJ meetings  
(Yen/U.S. Dollar exchange rate, percent change)



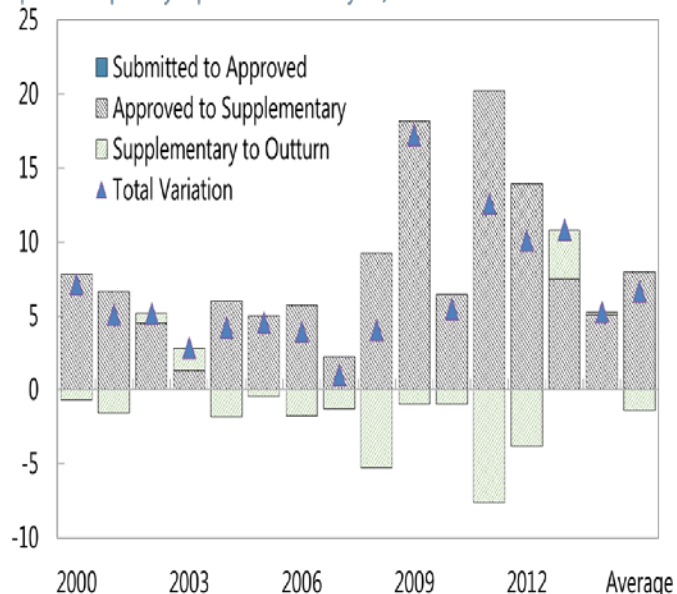
Source: Haver

# Fiscal policy is contributing to uncertainty

## Stop-go nature of fiscal policy contributes to policy uncertainty

Variations in Primary Expenditure from Budget Submission to Outturns

(In percent of primary expenditure in fiscal year)



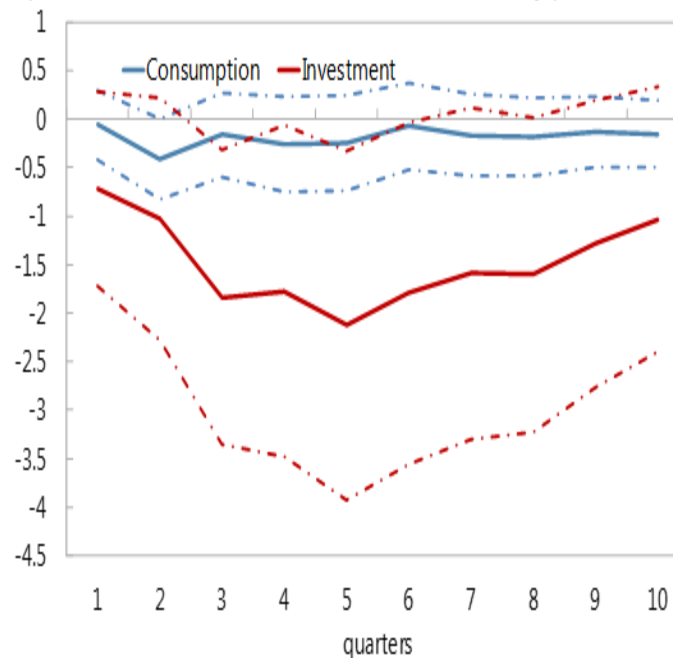
Note: Figures reflect the change in primary expenditure relative to the initial (2000-2014) budget during different stages (budget proposal to approved budget, to supplementary budgets and final outturn) all expressed as percent of final primary expenditure.

Sources: Cabinet Office, Japan; and IMF staff calculations.

## With adverse effects on investment and consumption

Response of Consumption and Investment to Economic Uncertainty

(response to 2-standard deviation shock to economic uncertainty, percent)



Note: Estimated using a quarterly VAR (1986Q2-2013Q4) with VIX, Japan economic uncertainty, equity prices, interest rate, investment and consumption.

Sources: IMF Staff estimates

# Japan is at a Fork in the Road

3. What are the policy options?





# Three alternative policy packages

Under current policies all targets remain out of reach within the timeframe set by the authorities

- ❑ Comprehensive policy **reload** to reach targets under current time-frames
- ❑ **Reset** of targets and policies to prepare for the long haul
- ❑ **Relaunch** policies with further unorthodox measures?

3. What are the policy options?



# Option 1: Reload package

- ❑ Higher incomes and wages with labor contract reform
- ❑ Fiscal and monetary policies for demand support
- ❑ Improved medium-term fiscal and monetary policy frameworks
- ❑ Accelerated structural reforms

3. What are the policy options?

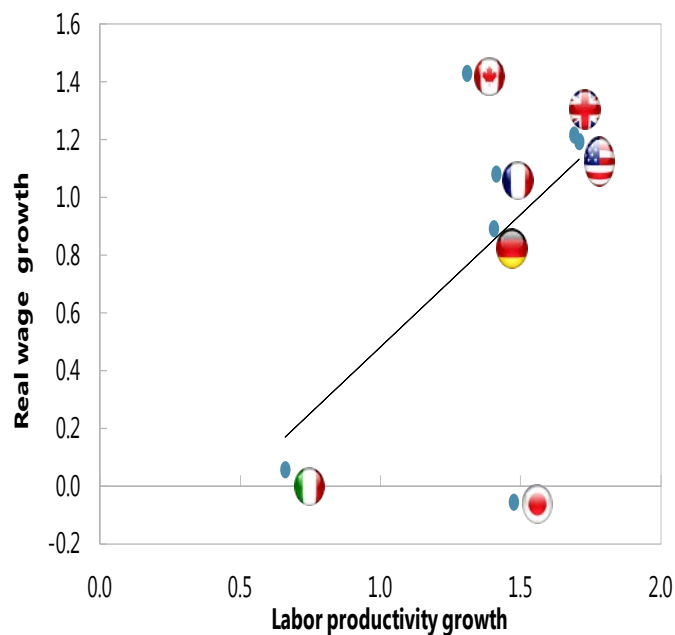


# Income policies to spur and coordinate wage-price dynamics

Wage growth has lagged productivity growth

## Real wage and productivity growth

(In percent, 1992-2014)

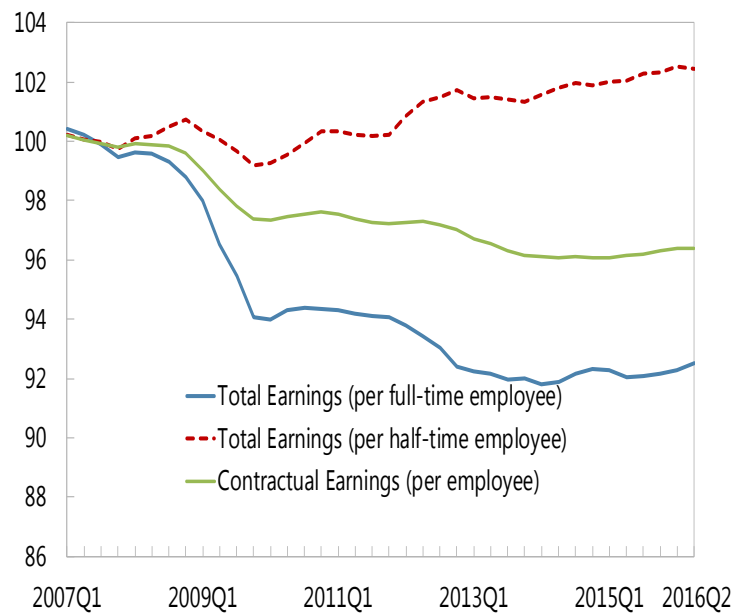


Sources: OECD, and IMF staff calculations.

“Comply or explain” mechanism would help spur private wage growth

## Different Measures of Earnings

(4 quarter MA of total earnings, 2007=100)



Sources: Haver and IMF staff calculations

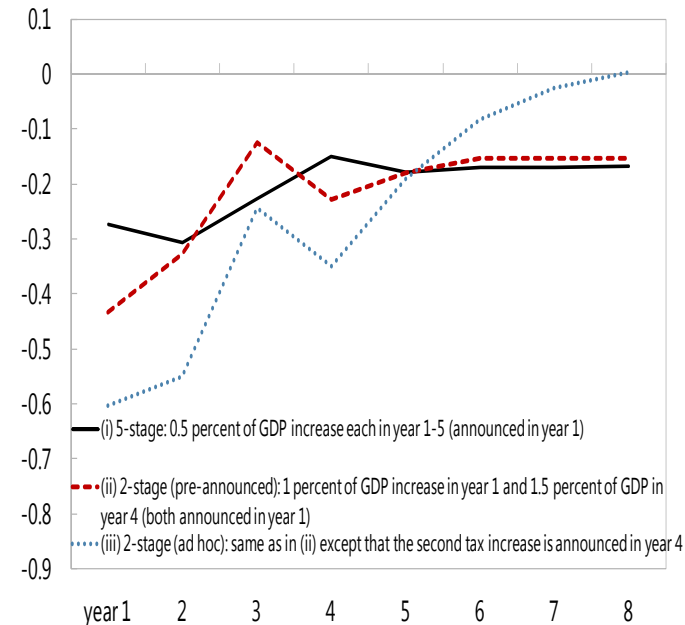
3. What are the policy options?

# Fiscal expansion to close output gap but with preannounced consolidation

Steady and gradual on the consumption tax

**Consumption Tax Hike: Deviation in Growth from Baseline**

(In percentage point)

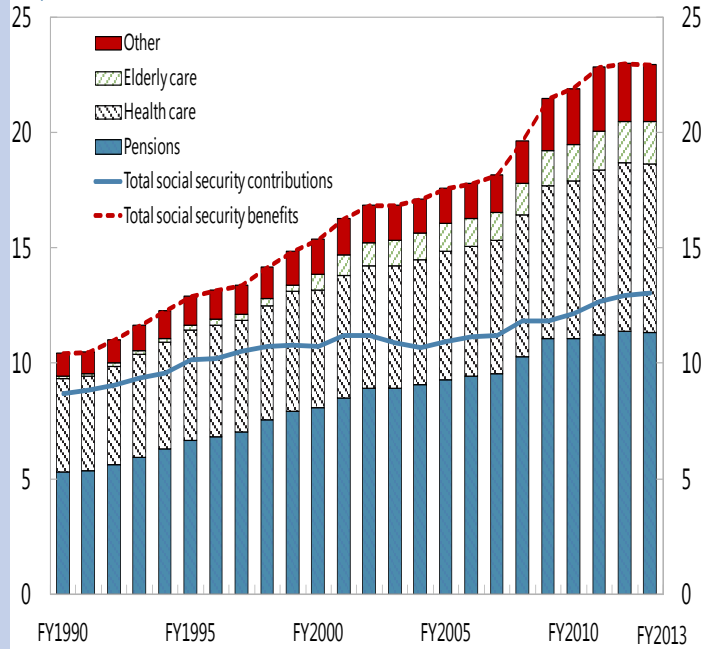


Source: IMF staff estimates.

Mind the rising gap in social security

**Social Security Benefits and Contributions**

(In percent of GDP)

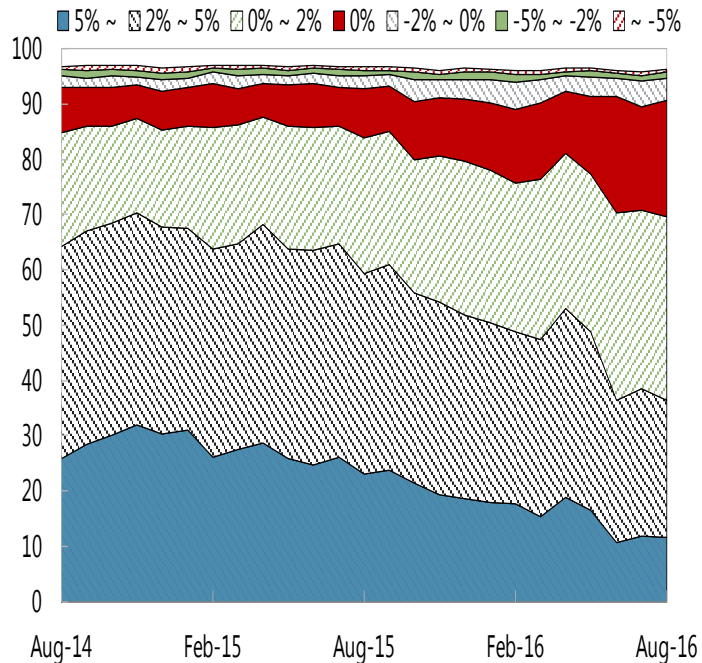


Sources: National Institute of Population and Social Security Research.

# Continued monetary accommodation with improvements to the framework

Reverse downward drift of inflation expectations

Share of households with one year ahead inflation expectation



Source: Cabinet Office.

Strengthen communication and clarify guidance:

- Move away from a pre-specified time horizon for meeting targets
- Clarify which inflation measures drive policy
- Publish a staff baseline forecast together with underlying policy assumptions
- Discuss alternative scenarios

# More structural reforms to boost wage pressure and potential growth

## Restore wage bargaining power

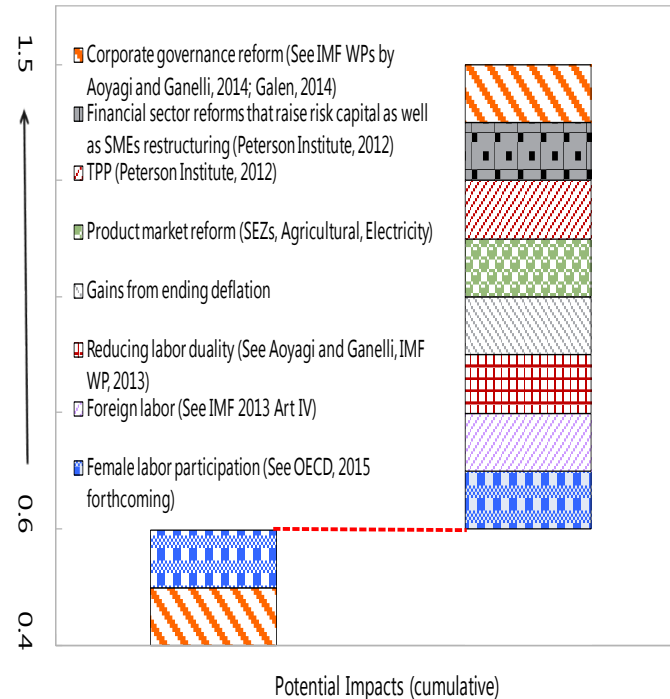


Source: MHLW "Basic Survey on Labour Unions"

## Boost labor supply (female, older, foreign) and deregulate

### Potential Impact of Path-Breaking Structural Reforms

(Potential growth; Illustrative)



# Option 2: Resetting targets and policies

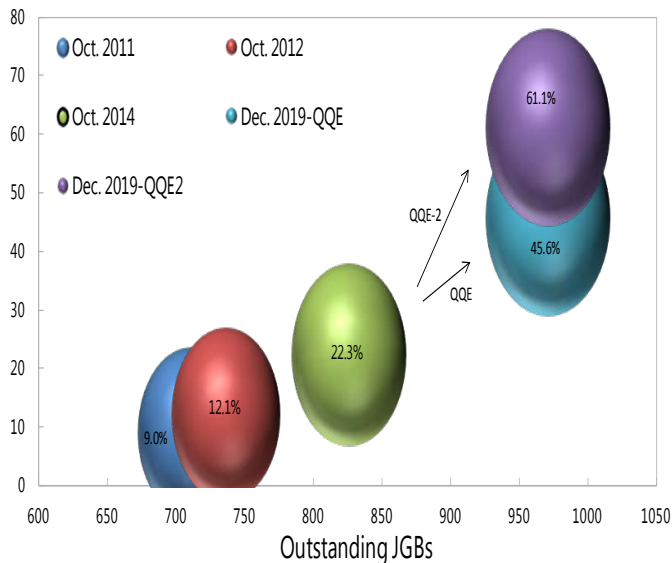
3. What are the policy options?



# Monetary policy: easy for longer while minding stability risks

Limited monetary policy room ...

Share of JGB holdings by the Bank of Japan <sup>1/</sup>  
(In percent)

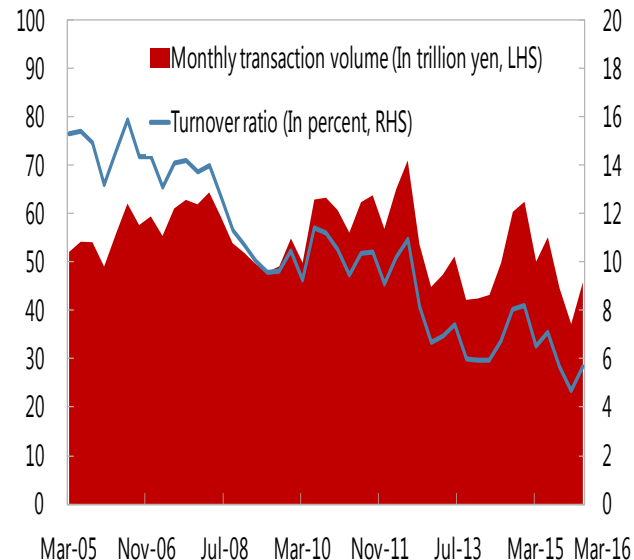


Note: 1/ Uses deficit projections to forecast outstanding amount of JGBs (size of the bubble).

Source: IMF staff calculations.

... with lurking risks to financial stability

Inter-dealer Monthly Transaction Volume <sup>1/2/</sup>



Sources: Japan Securities Dealers Association; Ministry of Finance.

1/ Treasury Discount Bills, etc. are excluded from transaction volume.

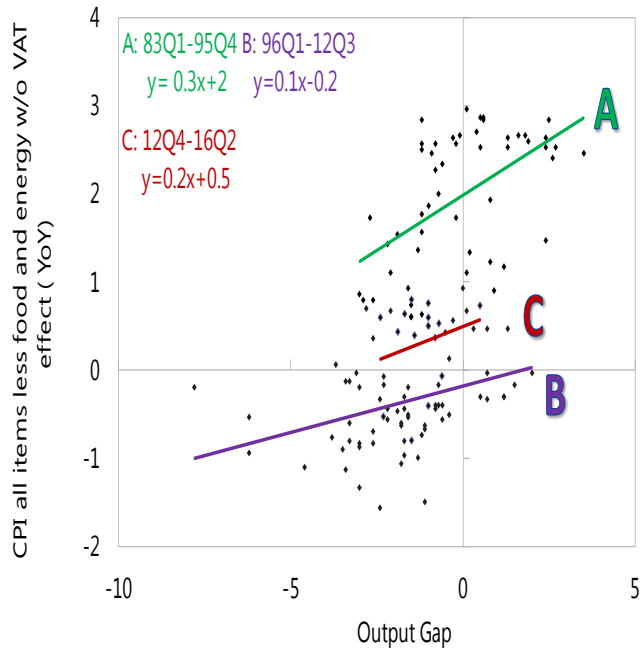
2/"Turnover ratio" is calculated by dividing the transaction volume by the outstanding amount.



# Fiscal: steady and gradual consolidation for longer

Moving the Phillips curve may exhaust fiscal space

## Phillips Curve

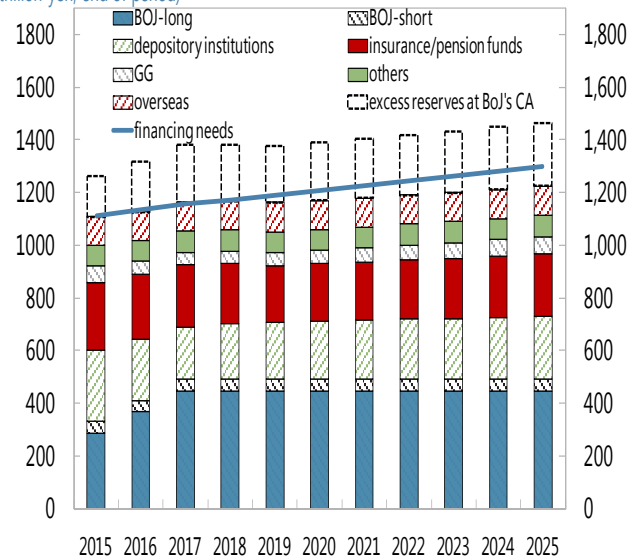


Sources: Cabinet Office; Bank of Japan; and IMF staff estimates.

...and risk fiscal confidence shocks

## Public Debt Financing in the Baseline

(In trillion yen; end of period)



Sources: Flow of Funds (BoJ); and IMF staff estimates.

Note: Includes both central and local governments' debt (including FLIP bonds). The BoJ is assumed to stop increasing its JGB holdings under QQE2 at end-2017.

# Option 3: Re-launch unorthodox policies

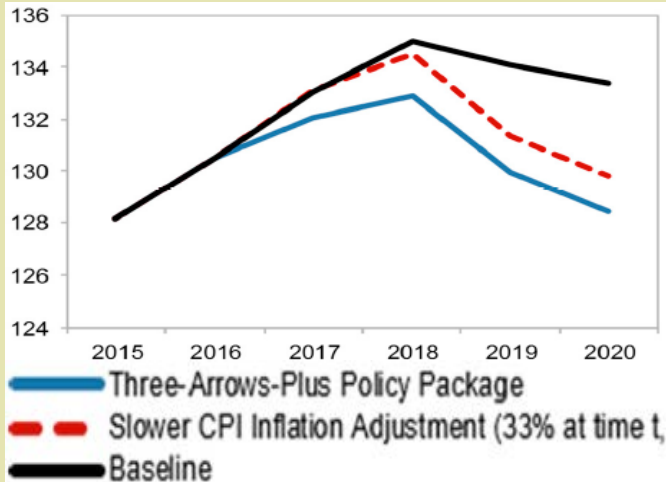
3. What are the policy options?

25

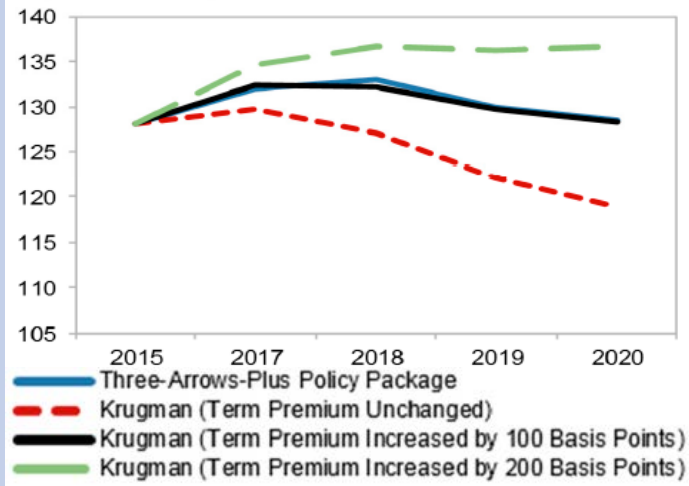


# Risky business: net government debt in different scenarios (percent of GDP)

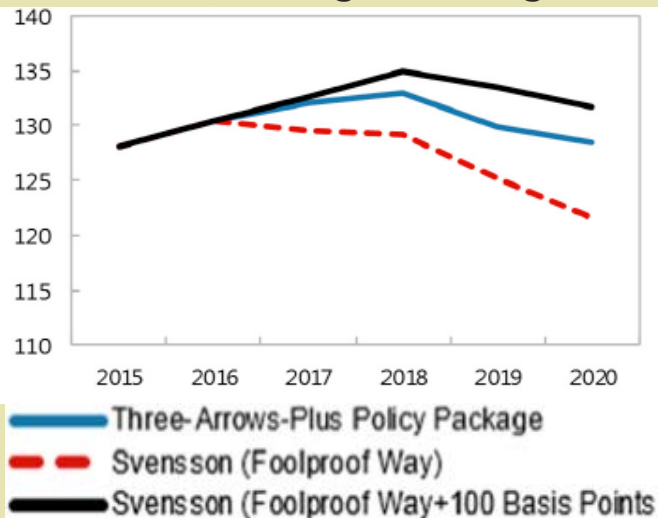
## Reload package



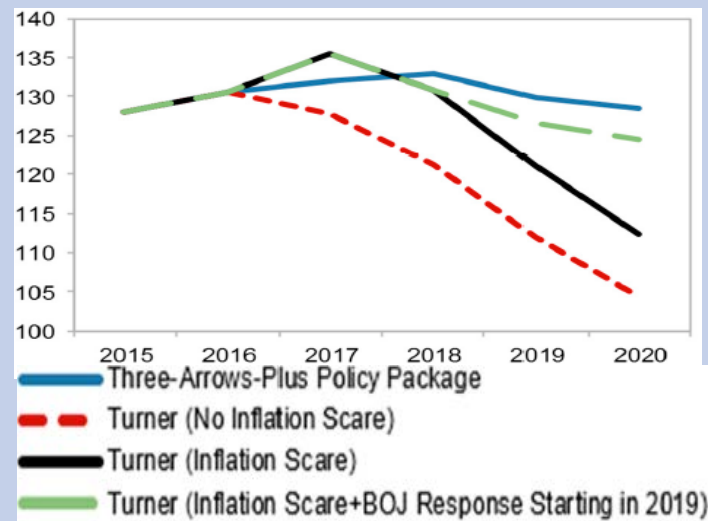
## Krugman fiscal expansion



## Svensson exchange rate target



## Turner monetization

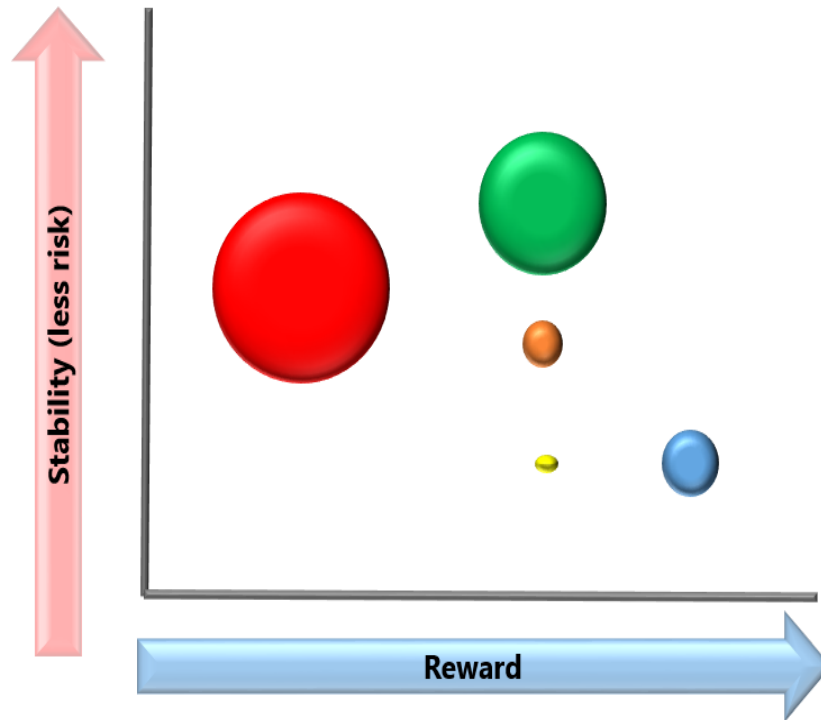


3. What are the policy options?



# Risk-return trade-off remains so far in favor of a comprehensive, balanced package

## Trade-offs between Policy Packages



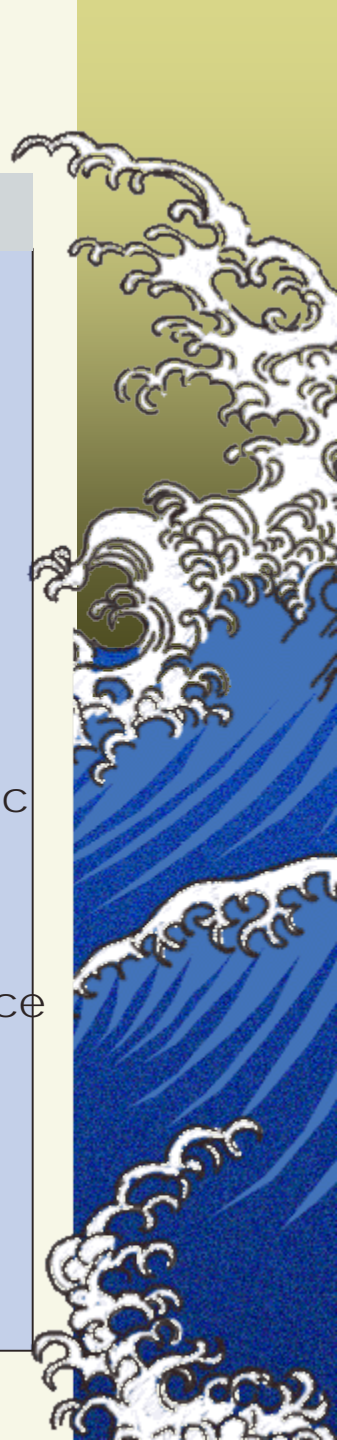
- = Reloading Abenomics
- = Resetting Targets and Policies
- = Monetized fiscal deficit
- = Fiscal deficit spending
- = Price/exchange rate path targeting

- High political feasibility
- Low political feasibility

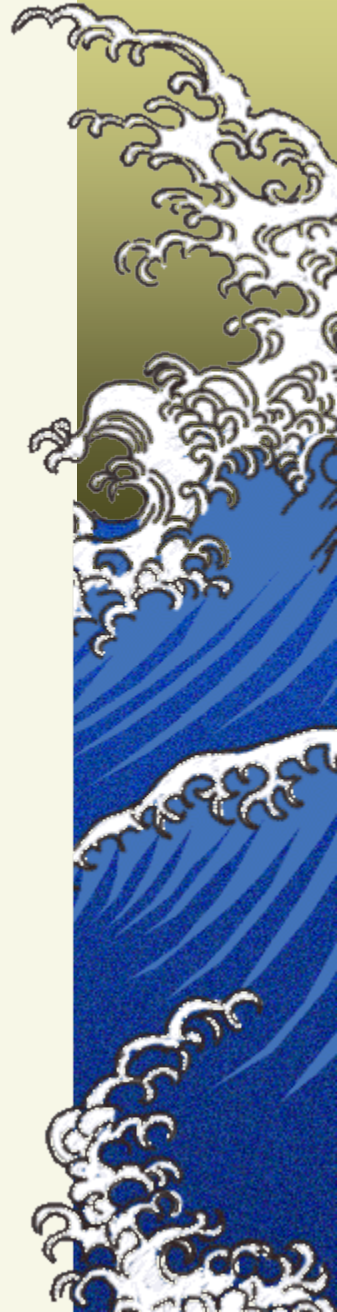
Source: IMF staff.

# Where do policies stand?

	Done	To do
<b>Incomes policy and contract reform</b>	<ul style="list-style-type: none"> <li>-Minimum wage increases</li> <li>-Tax incentives for private wage increases</li> </ul>	<ul style="list-style-type: none"> <li>-Private sector wage hikes through comply/explain</li> <li>-Larger tax incentives (and penalties if needed)</li> <li>-Public sector wage increases</li> <li>-Contract reform</li> </ul>
<b>Fiscal Policy</b>	Near term stimulus	<ul style="list-style-type: none"> <li>-Credible medium-term framework with gradual consumption tax hikes</li> <li>-Independent macroeconomic and budget projections</li> </ul>
<b>Monetary Policy</b>	<ul style="list-style-type: none"> <li>-Accommodative stance</li> <li>-More sustainable framework</li> </ul>	Strengthen communication framework and clarify guidance
<b>Structural reforms</b>	<ul style="list-style-type: none"> <li>-Child and nursing care reform</li> <li>-Corporate governance reform</li> </ul>	<ul style="list-style-type: none"> <li>-Labor supply measures for women, older, and foreigners</li> <li>-Productivity enhancing deregulation</li> <li>-Capital deepening</li> </ul>



**Thank You!**



# References

- IMF Staff Report for the 2016 Article IV Consultation with Japan:  
<http://www.imf.org/external/pubs/ft/scr/2016/cr16267.pdf>
- Selected Issues (analytical work by the IMF Japan team):  
<http://www.imf.org/external/pubs/cat/longres.aspx?sk=44159.0>
- “How to Reload Abenomics” , IMF News Article:  
<http://www.imf.org/en/News/Articles/2016/08/02/13/00/NA080216-How-to-Reload-Abenomics>
- IMF blog on “Japan: Time to Load a Fourth Arrow-Wage Increases”:  
<https://blog-imfdirect.imf.org/2016/03/13/japan-time-to-load-a-fourth-arrow-wage-increases/>
- Davide Porcellachia “Wage-price dynamics and structural reforms in Japan” WP16/20  
<http://www.imf.org/external/pubs/cat/longres.aspx?sk=43693.0>
- George Kopits “The Case for an Independent Fiscal Institution in Japan” WP16/156  
<http://www.imf.org/external/pubs/cat/longres.aspx?sk=44161.0>
- Arbatli, Botman et. al. “Reflating Japan: Time to Get Unconventional?” WP16/157  
<http://www.imf.org/external/pubs/cat/longres.aspx?sk=44162.0>
- Ikuo Saito “Fading Ricardian Equivalence in Ageing Japan” WP forthcoming

