Bond Blog

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A PATH FOR POLICYMAKERS : THE LASTING LESSONS OF ABENOMICS

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Before Covid and even more so during the pandemic, efforts in developed market countries to boost growth and lift inflation to hit targets have turned into a torrent of fiscal and monetary stimulus. Focused efforts on structural economic improvements, such as Europe's recent joint fiscal recovery plan, have been more the exception than the rule. In a best-case scenario, the broad-brush stimulus policies would return the world to the sub-par, unsatisfactory growth and inflation environment that existed pre-Covid. However, there is also the risk that these policies sow the seeds of future instability by creating asset bubbles and enabling, if not encouraging, the extension of debt to what is already a heavily indebted global economy. As policymakers have witnessed in recent decades, in the end, this boom bust cycle, has also contributed to rising inequality.

Against that backdrop, Shinzo Abe's resignation as Japan's Prime Minister provides a moment to reflect on the lessons of Abenomics' successes and, in particular, its targeted approach to solving seemingly intractable challenges, such as yawning government deficits and the headwinds of an aging demographic.

It's worth noting, however, that even before Abenomics, there was plenty to learn from Japan. For example, aging societies don't seem to end up with a shortage of workers that precipitates a wage-price inflationary spiral. Rising debt burdens and running fiscal deficits do not necessarily push long-term interest rates higher, nor do they necessarily lead to currency depreciation or higher inflation. And for those hoping Modern Monetary Theory (expansive fiscal stimulus supported through quantitative easing) will solve the world's problems, Japan showed that extraordinarily easy monetary and fiscal policies, even continued for decades, can't push an economy to a new higher plane of growth. And lastly, QE can go too far: an overly aggressive bond buying program stifles the market and ruins returns for financial institutions and individual investors alike. And so Japan has been backing out of these well intentioned, but ultimately ineffective wholesale policies.

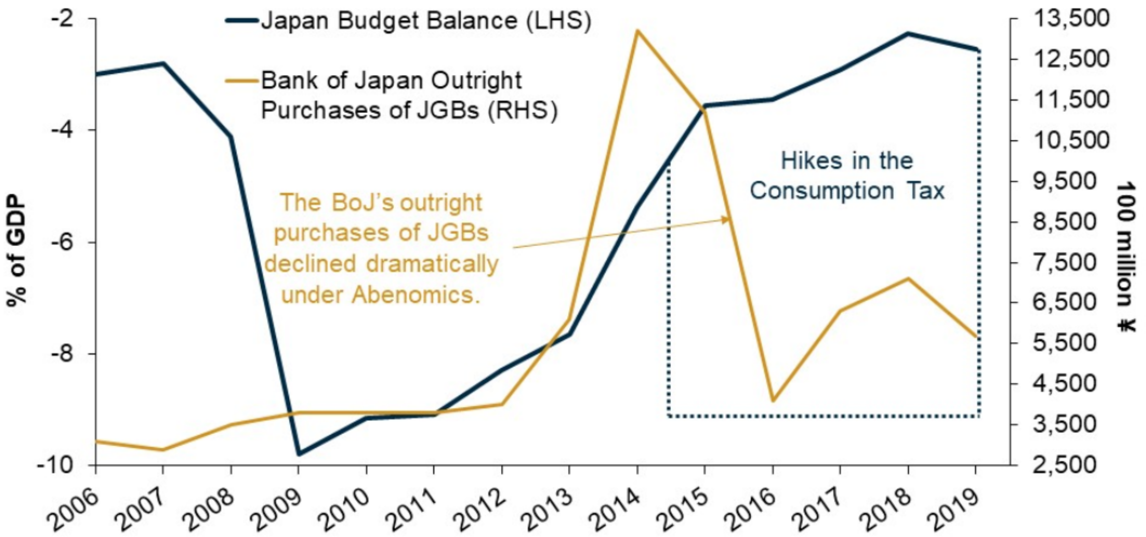
Many countries have overlooked Japan's experience and repeated its unsuccessful fiscal and monetary policies, and pundits continue to fear an inevitable uncontrollable rise in interest rates and / or inflation. But as they are finding out—and as Japan has already amply demonstrated—that's just not how it goes.

But where's the thrill of Abenomics? In recent years Japan's growth has remained unimpressive, and inflation, while generally above zero, does not appear to be on course to its 2% target. So, where's the success? What are the lessons?

A Policy Rethink: Micro, Experimental, and Aggressive

While Japan continued to tweak the traditional levers of monetary and fiscal policies, one unique aspect of Abenomics was an implicit realization that these measures had gone too far and needed to be scaled back. While other central banks have been ramping up bond purchases, in recent years the Bank of Japan has been reducing its bond purchases in order to restore market function and steepen the yield curve. Similarly, on the fiscal side, realizing that the benefits of growing fiscal deficits were over-rated, the government engaged in opportunistic budget consolidation, picking its spots for reducing the deficit when opportunities arose. A measured program, including two hikes in the consumption tax, to move towards a balanced primary budget followed as a result (Figure 1).

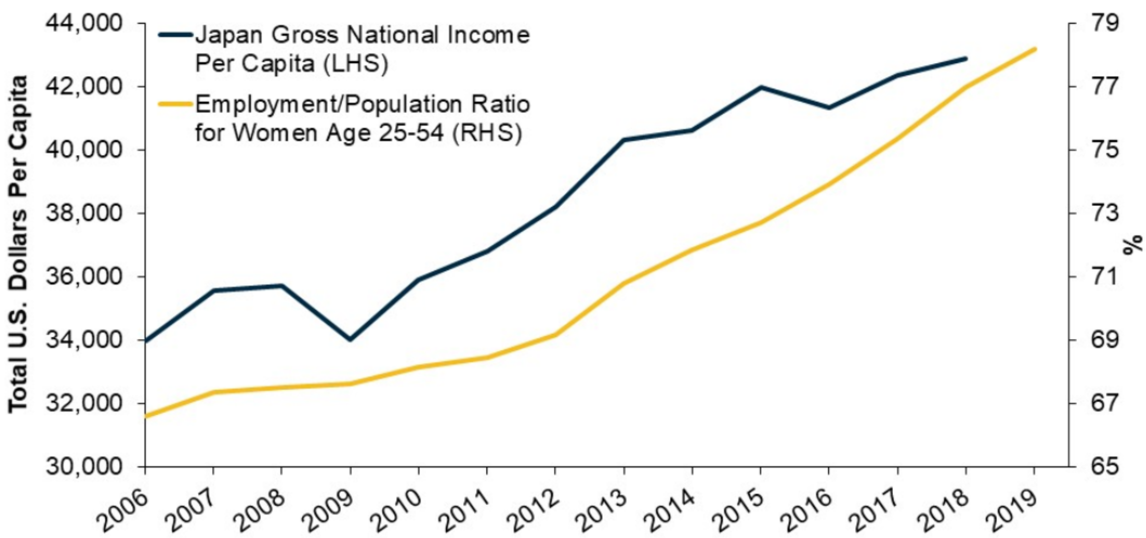
FIGURE 1: JAPAN TOOK TANGIBLE STEPS TO REDUCE ITS BUDGET DEFICIT AND CURTAIL ASSET PURCHASES IN RECENT YEARS



Source: Bloomberg

Japan's structural reforms have perhaps been more important. If falling per capita income is the ultimate threat from an aging economy, then the genius of Abenomics was finding practical solutions to get more people in Japan working. For example, increased availability of childcare and elder care visibly accelerated the rise in the participation rate of women in the labor force and an increase in per capita income (Figure 2).

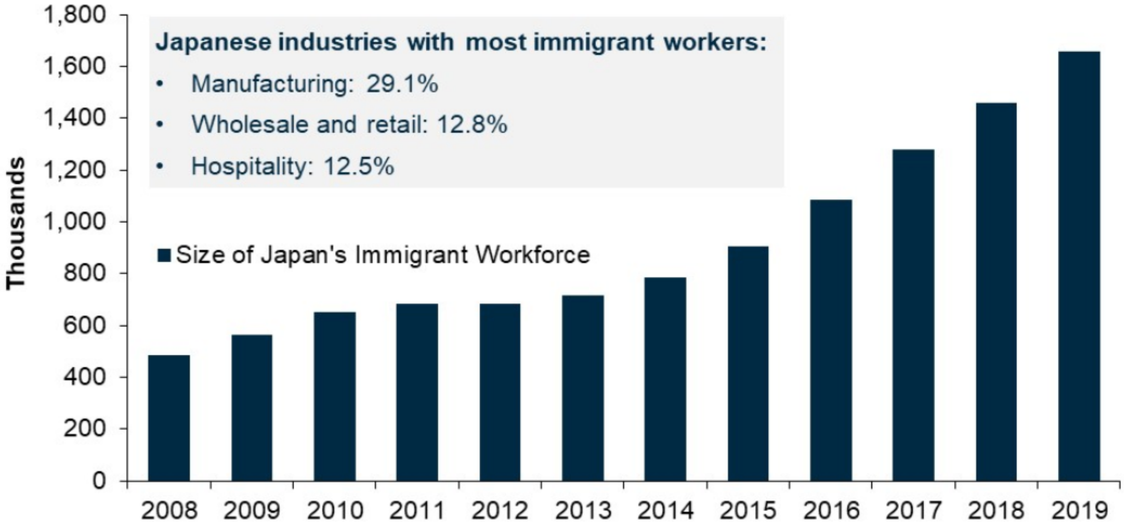
FIGURE 2: INCOME LEVELS ROSE AS MORE WOMEN ENTERED JAPAN'S LABOR FORCE



Source: PGIM Fixed Income, OECD, Bloomberg

Abenomics also stoked immigration into Japan, a heretofore relatively untapped avenue to offset the aging and shrinking population. In contrast to its meagre growth prior to the Abe administration, Japan's immigrant workforce more than doubled between 2013 and 2019 (Figure 3).

FIGURE 3: JAPAN'S IMMIGRANT WORKFORCE CONTINUES TO GROW



Source: PGIM Fixed Income, Ministry of Health, Labour and Welfare Japan, and statista.

Another focus of Abenomics was increasing the efficiency of the corporate sector to the benefit of Japanese society. These measures have ranged from improving management's accountability and focus on profitability to measures that encourage hiring and higher wages. The improved accountability was accompanied by an increase in outside directors: just 22% of the firms in the benchmark TOPIX index had two or more outside directors in 2014, and that share rose to 95% as of 2019.[1] Following Abe's resignation, the Suga administration may try to build on Abenomics' success with large companies by attempting to improve productivity in small and medium sized enterprises through consolidations.

In addition to pushing for improved corporate performance, Abenomics' impact on Japan's massive public pensions provided another powerful measure. It redirected their investments away from supporting the government through domestic government bonds and instead directed them towards higher returning domestic and international equities as well as international bonds.

Japan's focus on solving problems in determined, flexible, and experimental ways appears to have yielded measurable benefits. The increases in labor force participation and immigration, the improvement in corporate performance, and a shift to more sustainable monetary and fiscal policies may hold lessons for other governments seeking a path forward. In particular, once the Covid pressure points have passed, they should consider turning away from unfocused wholesale monetary and fiscal stimulus and the hope for achieving unrealistic levels of growth and inflation. Instead, they might be better served to focus on regaining policy balance and solving actual structural economic impediments while taking a creative, flexible, experimental, and aggressive approach to implementation. These lessons of Abenomics may provide a path for other governments and central banks to follow in the years to come.

[1] https://www.japantimes.co.jp/news/2020/09/14/business/corporate-governance-abenomics-japan/

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