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Reassessing Abenomics by Brad Glosserman

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"Abenomics has failed. Its three arrows – quantitative easing, fiscal stimulus, and economic reform – have missed their mark and Japan's economy continues to stagnate." That is the conclusion that many reached after hearing that Japan last month entered its second recession in three years. Recession notwithstanding, the reality of Japan's economy is more complex. In important ways, the economy is recovering. In perhaps the most important way, however, it is not and that has profound implications for Japan, the region, and the world. Japan cannot assume the more assertive and energetic international role that Prime Minister Abe Shinzo, his supporters, and friends of the country want it to play without a durable and sustained recovery.

Official data showed Japan experienced a "technical recession" – two consecutive quarters of negative growth – in the third quarter of 2015, shrinking -0.8 percent from July to September after contracting -0.7 percent in the previous quarter. This marks the fourth technical recession in five years, and the second under Prime Minister Abe Shinzo's watch. (The first followed last year's increase in the consumption tax rate from 5 to 8 percent.)

The problems go beyond the most recent recession. GDP has fallen four of the 11 quarters that Abe has been in office. Real wages have not picked up. Inflation remains stubbornly low – less than 1 percent – and the Bank of Japan's goal of 2 percent inflation remains well beyond reach. Sovereign debt tops 240 percent of GDP (the highest among all developed countries), and the continuing resort to fiscal stimulus measures – the most recent recession is expected to produce a supplemental budget in January of around ¥3.5 trillion – means that total government debt will top ¥1,167 trillion ($9.469 trillion) in FY 2015. Similarly, the third arrow has also missed the mark. In its most recent assessment of Abenomics, the IMF concluded that "further high-impact structural reforms are urgently needed to lift growth."

Abe is cognizant of the problem. At the end of September, he announced that he was "rebooting" his signature economic program. The new goal is to raise Japan's GDP to ¥600 trillion by 2020 and the country has a new rallying cry – "a society fostering active participation of Japan's 100 million people" – and Abenomics has "three new arrows": a strong economy, support for child raising, and enhanced social security.

Moving the goalposts is typically a way of disguising defeat, and in this case there is some truth to that charge. Still, Abenomics – or at least the economy during Abe's tenure – has produced some positive results. Japan's annual *nominal GDP growth* is the highest it's been in more than two decades. The yen has devalued by about 30 percent since Abe took office, and that has boosted Japanese exports: Toyota earned a record $6.7 billion in the third quarter, more than GM and Ford combined. Japanese companies are estimated to have cash reserves of $2.9 trillion. Not surprisingly, Japan's *stock market* has been one of the best performers in 2015: since September, the Nikkei 225 is fourth among the 93 exchanges tracked by Bloomberg, returning over 13 percent. Company earnings are projected to rise by more than 10 percent over the next 12 months and around 8 percent per year after that. A number of companies are breaking with the tradition of holding onto those funds and are now returning some to shareholders. *Unemployment* has hit two-decade lows, reaching 3.1 percent at the end of November, actually dropping from 3.4 percent in September. *Housing prices* have increased 16 percent since 2013, and small- and medium-size businesses are showing record high confidence levels.

Deconstructing the numbers presents a more mixed assessment. Take the employment figures. All jobs are not equal: Japan's labor market is tightening but many of the new jobs are contract positions that offer neither the security nor the training that comes with permanent posts. On the other side of the ledger, the fact that the economy is in recession is less significant when the average growth rate is just 0.5 percent. That means that the typical corrections of initial economic reports are (relatively speaking) large enough to lift the economy out of recession – and indeed that happened last week when revised figures showed the Japanese economy expanded in the last quarter, rather than contracted. In addition, small, random (and regular) external shocks can knock the economy off-course.

Ultimately, however, there is a critical economic issue that the original Abenomics program addressed only indirectly: Japan's demographic trajectory. Simply put, the population is shrinking in size and unless that trend is reversed there in no way for Japan to recapture the economic dynamism of its go-go years. Absent that economic energy, it will be difficult if not impossible for Japan to assume the regional and global duties that are demanded of a "first-tier nation" and which Prime Minister Abe and many others believe is Japan's rightful role.

To be fair, the LDP government has acknowledged the significance of demographics and has made the promotion of women in the workplace (and in society more generally) a priority as a means of addressing the demographic shortfall. Its logic is based on the fact that women are underutilized within the Japanese economy and the quickest way to boost productivity is to tap their unused talents. (Also, if women have more meaningful choices in life, they are more likely to have more children.) Unfortunately, government efforts have been largely limited to rhetoric and exhortation and haven't proven sufficient. The demographic trajectory remains unchanged and the growth rate remains low.

Abenomics 2.0 takes a more direct approach to the demographic challenge with its call for “a society fostering active participation of Japan’s 100 million people” and one of those “three new arrows” – support for child rearing. Those ambitions are to be applauded but they won’t address the most fundamental problem: Abe’s goal of a ¥600 trillion economy by 2020 requires a 20 percent increase (¥110 trillion) in GDP, which necessitates growth of 3 percent per year, a rate that Japan hasn’t experienced since 1991.

Most economists believe that growth rate is well beyond Japan’s potential. A genuine boost in women’s participation in the work force would help, but it is a partial solution at best. It won’t plug the 500,000 worker shortfall in the construction industry, or the similarly sized hole in the social welfare workforce (created by a perception that the job is poorly paid given the back-breaking labor involved). Immigration is the only real solution to those shortages and Japan has proven unwilling to open its doors to the number of foreign workers required.

The conclusion that Abe’s economic policy has “failed” is hard to square with the experience of anyone who visits Tokyo. The city hums with energy and it seems like every few blocks there is some massive new building complex. A record influx of tourists – Japan is projected to hit its 2020 goal of attracting 20 million visitors five years early – contributes to the image of a country that is hitting its stride (and provides a much needed economic boost).

But the long-term sustainable growth that will provide the foundation for the national resurgence that Abe and his team seek remains stubbornly beyond reach. Difficult choices – guns or butter, the SDF or health care, structural reform or protecting sacred political cows – are inevitable and will demand resolution sooner than many expect.

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