

Japan: Trying times

After all the speculation, Japan's government has imposed the consumption tax hike. The coming months will be heavily distorted by this and it may not be until the New Year before we have clarity on how this plays out



Japanese Prime Minister Shinzo Abe

Source: Shutterstock

10%

New consumption tax rate

Up from 8%

As expected

Fiscal consolidation in Japan

Japan's public finances are the worst in the developed world. Measures of gross debt to GDP top 240% on some measures (OECD), and even netting out the considerable amount owned by the government itself, is far in excess of 120%. At this scale, the exact numbers lose a lot of their meaning. Government debt is huge, and it does not seem unreasonable to try to bring this under

some control.

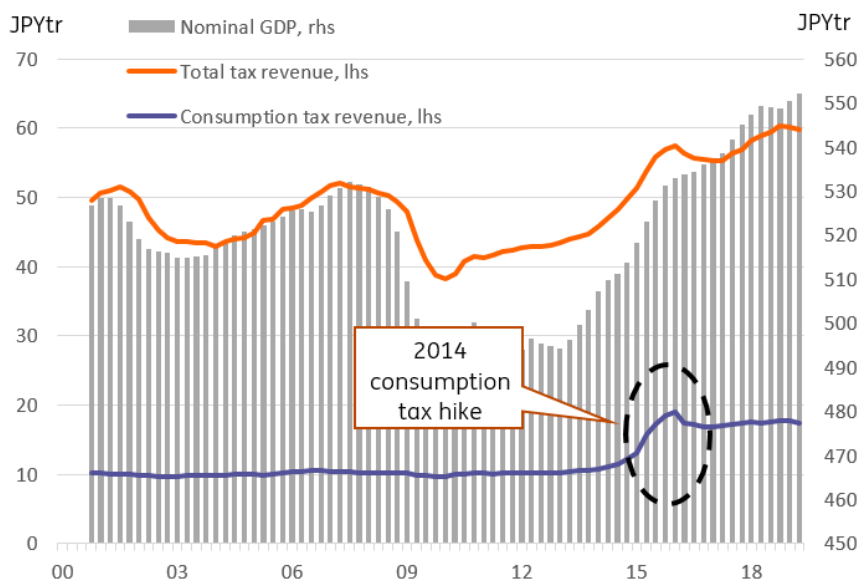
Is this the right thing to be doing?

That said, there may be better ways of Japan going about this than a consumption tax hike. Especially when most of its peer group is belatedly coming to understand that monetary policy has lost most, if not all, of its potency and fiscal policy is the only way to give growth a helping hand.

Consumption tax revenues static

The chart below shows total tax revenues on an annualised basis and nominal GDP. Total tax revenues track nominal GDP more or less. But consumption tax revenues are virtually a constant, with the exception of the bump in revenues following the 2014 April consumption tax hike.

Tax revenues and nominal GDP



Source: CEIC

A lot of distortion for not much fiscal benefit

A two percentage point increase in this tax would add about JPY 5.4 trillion annually to total tax revenues (about 1% of GDP) though the total effect on the budget deficit will be considerably less than this, due to the numerous offsetting measures that have been put in place to mitigate the impact of the tax on activity, and the numerous opt-outs that mean the full 2ppt increase will never be brought to bear.

Some front-running, but not much

In the short-run, the biggest impact of the tax hike will be to distort spending and inflation data. We don't have much to go on, but the front running so far seems fairly muted. August retail sales spiked up 4.8% month-on-month, and we can expect an elevated figure for September, too before the October figures drop sharply back. In 2014, they fell far more than they rose, though they fairly quickly returned to the pre-hike trend.

BoJ to buy more short tenor, fewer long tenor bonds

Japan's bond yields have retreated from the -0.3% level they reached at the end of August and were on the way to returning towards in the latter part of September. The 10-year yield now sits at about -0.164%.

BoJ schedule for outright bond purchases

	August	September	Difference
< 1y	100-1000	100-1000	0
> 1 ≤ 3	2500-5000	3000-5500	500
> 3 ≤ 5	2500-5000	200-4500	-500
> 5 ≤ 10	2500-5500	2000-5000	-500
> 10 ≤ 25	1000-2500	500-2000	-500
> 25	100-1000	0-500	-500
Inflation indexed	250	250	0
Floating rate bonds	1000	1000	0
Max total	21250	19750	-2500

Source: Bank of Japan

Reverse Twist

The central bank has refrained from changing its official policy stance, but the announced bond purchases suggest the Bank is engaging in a sort of reverse twist operation, buying more shorter-dated assets, and fewer longer-dated ones. Along with an announcement by the Government Pension Investment Fund that currency-hedged foreign bonds could be viewed as similar to domestic government bonds, this has added to the yield curve steepening, and given the currency a little upwards push too.

Author

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial

Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.