

Japan: Abe's gamble

Japan's PM Abe has gambled that a snap election will return him as PM, and give him the mandate to push through his policy agenda



Source: shutterstock

Why did PM Abe call the snap election?

Prompting the snap election was a sense that PM Abe had benefited from a recovery in public opinion, following North Korea's recent display of belligerence. He is also no doubt aware that the opposition party, the Democratic Party of Japan (DPJ), is in deep disarray.

Recent Japanese data has also been strong. Abe will claim credit for this, though Japan's strength is mirrored elsewhere in the region, and Japan seems to be riding on the crest of global demand for Asian goods, including its own. Japan's GDP is strong (for Japan) and unemployment is very low. Even the inflation rate seems to be slowly heading higher, it remains well below what we see as the BoJ's utterly non-credible 2.0% target.

A controversial policy move

If he wins the election, Abe has pledged to raise the consumption tax rate by 2ppt to 10% (not an obvious vote winner) in 2019. Instead of using the proceeds of the tax hike to work down Japan's deficits, as previously promised, Abe has promised to spend the money on enhancing education,

especially pre-school care for would-be returning mothers.

Japan's weak potential growth is a function of a shrinking labour force.

As a policy move, this makes some sense. Japan's weak potential growth is a function of a shrinking labour force. Japan's female participation rates are lower than they could be, though on an international context, Japan compares favourably with some of the bigger European countries on this metric.

From a macro perspective, such policies will provide a boost to potential output, but probably a very small one. The construction of facilities to provide these services will, however, deliver a bigger short-term bounce.

Even so, it is difficult to see a rise in the consumption tax being neutral with respect to the economy, and at best, we envisage the re-distributed revenues and ensuing activity dampening the hit to demand.

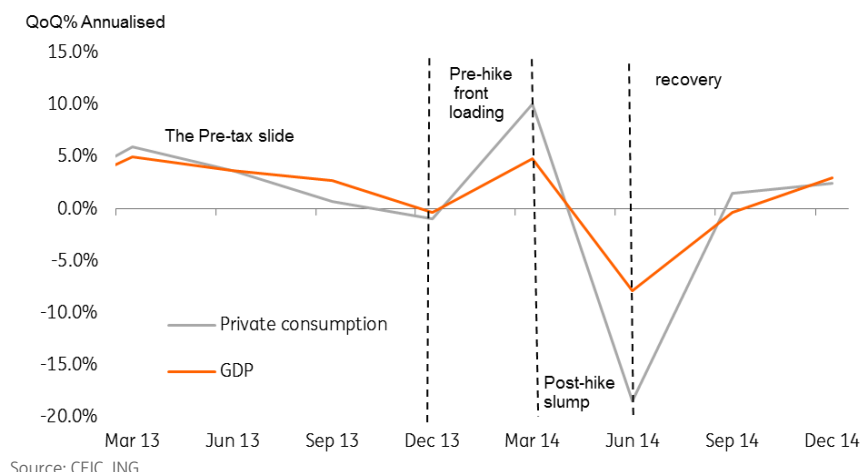
10% Pledged consumption tax
up by 2pp

Will it actually happen and what could the consequences be?

Having been through these tax hikes before, there is a well-worn path for forecasting the outcome, which entails a pre-April 2019 spike in consumer spending and construction to front-run the tax hike (anything from new homes to toilet rolls will be pre-stocked), followed by a slump, and a slow grind back to previous growth rates.

Abe has pulled back from implementing tax hikes before, and it is possible he does so again. He has built in an opt-out into his pledge, saying that the tax hike will go ahead unless it is likely to weaken the economy. And there remains considerable scepticism in the region about a 2019 tax hike. But with growth currently strong, we are now formally incorporating the consumption tax hike and spending pledges into our growth and inflation numbers.

The 2014 consumption tax hike



A win for Abe?

Despite no coherent opposition, this election is still a gamble for Abe. As we wrote two months ago, a new political order is shaping up in Japan, resulting in the sweeping Tokyo election victory for Mayor Juriko Koike. Her Tokyo movement is now trying to join forces with the disbanded DPJ to form a national “Party of Hope”, to challenge Abe.

In four years' time, the Party of Hope will likely give the LDP a run for its money.

With the election on 22 October, we think her chances are slim, even though there are some parallels between what she is trying to do, and Emmanuel Macron’s “En Marche” victory, and also between Abe’s gamble, and the failed gamble of UK PM May earlier this year. Moreover, in terms of policies, there is very little to separate Koike from Abe on policy grounds. This is more about personalities, and so far, Koike is about the only personality in her fledgling party. In four years’ time, the Party of Hope will likely give the LDP a run for its money. But they face a very difficult task at this election.

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 www.ing.com.