

# ABENOMICS VS THE DEFLATION MONSTER

Bloomberg  
BRIEF

July 2014

A year and a half into Prime Minister **Shinzo Abe's** attempt to lift Japan's economy from its two-decade stagnation, policy makers say Abenomics is on track. Inflation has moved higher, corporate profits are up and businesses are starting to invest again. Not everyone is so optimistic. The Nikkei is the worst performing major market in the world this year as investors worry about slow progress on structural reforms and a looming debt crisis. Who is right? Bloomberg Brief asks leading scholars and economists to weigh in.



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# MONETARY POLICY

TOM ORLIK, BLOOMBERG ECONOMIST

## Bank of Japan Inflation Target in Sight, Believers Will Prevail, Ito Says

More than a year into the Bank of Japan's program of quantitative easing, Takatoshi Ito talks to Bloomberg Economist Tom Orlik about progress so far. Ito is a public policy professor at Tokyo University, an adviser to the government on reform of Japan's giant public pension funds and a long-time advocate of reflation.

**Q: What's your assessment of progress on the BOJ's program?**

**A:** It's been a good year for the BOJ. Their forecasts for inflation have been accurate and they are on track. Mr. Kuroda has been very consistent in his message, he's confident that without changing what he laid out last year he can achieve his target.

**Q: Where do you think the inflation is coming from? Some skeptics say it's mainly imported price pressure from a weak yen.**

**A:** Six months ago yen depreciation was driving inflation. Now yen depreciation has faded but we still see the CPI around 1.3 percent so there is demand side pressure. The output gap has closed. Labor markets are tight and wages are rising — that's demand side inflation.

**Q: Do you think closing the output gap will be enough to push inflation up to the 2 percent target?**

**A:** Critics say that even if the output gap closes, Japan's Phillips curve is very flat so you won't get higher wages and more inflation. I disagree. Higher inflation expectations will tilt the Phillips curve up. That is happening already, though very slightly.

If something happens, the Chinese bubble bursts, the euro zone blows up. Mr. Kuroda will take additional measures. That's what he's said. Without a big external shock, I'm not expecting a second round of easing.

**Q: What does that mean for the yen?**

**A:** It's surprising the yen hasn't depreciated more this year. I attribute that to the U.S. where rates have been coming down despite tapering by the Federal Reserve. There's a limit to that. I think toward the end of this year we'll see U.S. rates rising before Japan's rates. Now the yen is in a 100-105 box. We will go to a 105-110 box around the end of the year.

**Q: How does asset reallocation drive growth?**

**A:** As investors shift out of low-yield government bonds into riskier assets equity prices will rise, household wealth will rise, corporates will invest more. That's the start of a virtuous cycle.

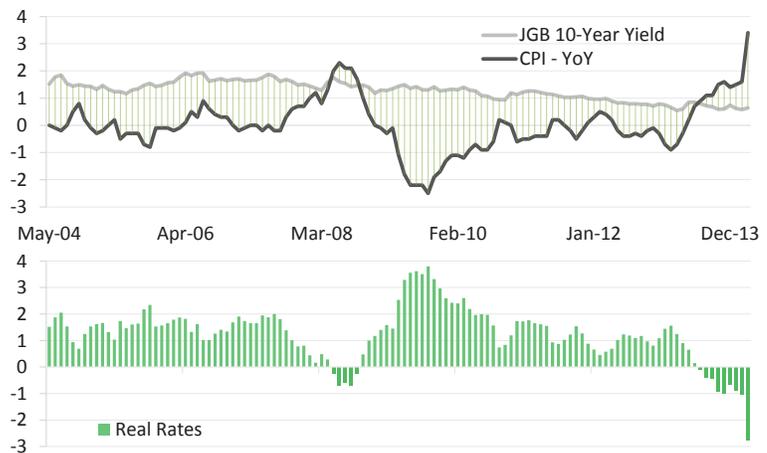
**Q: What should we expect on Government Pension Investment Fund asset reallocation?**

**A:** The next move is revising the GPIF's benchmark portfolio. Currently there is about 55 percent invested in bonds. That should go

down to below 40 percent and the share in equities should increase. If they are smart they will revise the portfolio before they make an announcement. If Bloomberg writes they are revising the portfolio and the markets move that's very bad.

At the moment most household assets are in deposits. When prices were falling that made sense. Now inflation of 2 percent is in sight, it's not rational to have funds in zero-return cash. This is a battle between the BOJ and those who doubt its commitment to the 2 percent inflation target. Those who believe will prosper. Those who doubt will not.

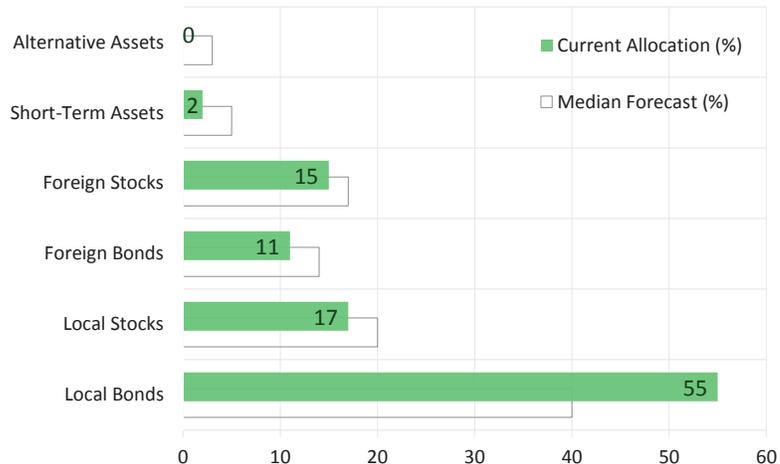
### Rising Prices Push Real Rates Down



Source: Bloomberg

[BloombergBriefs.com](http://BloombergBriefs.com)

### GPIF Set to Shift Out of Low-Return Bonds Into Equities



Source: Bloomberg

[BloombergBriefs.com](http://BloombergBriefs.com)

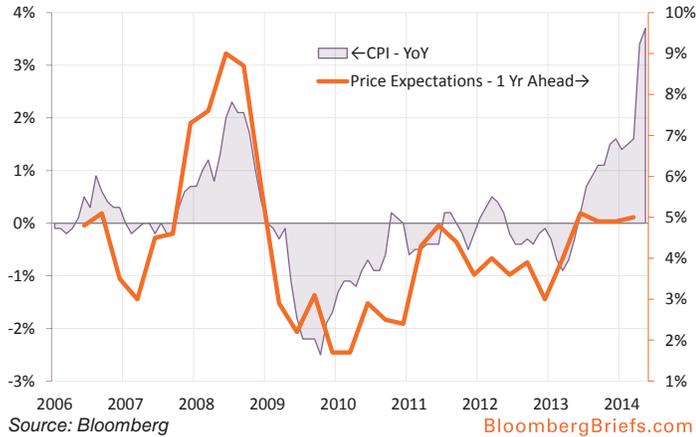
# ABENOMICS CHARTBOOK

TOM ORLIK, BLOOMBERG ECONOMIST

## April's Tax Rise Hasn't Derailed the Recovery, Higher Potential Growth Remains Elusive

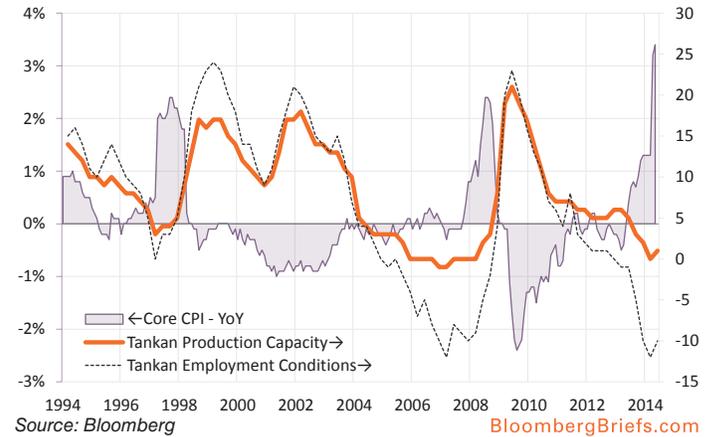
Eighteen months into efforts to revive the economy the record is mixed. Inflation is up, though import prices rather than wages account for the bulk of the increase. A skeptical public remains unconvinced that long-term prospects are brighter.

### Stimulus Shifts Japan From Deflation to Inflation



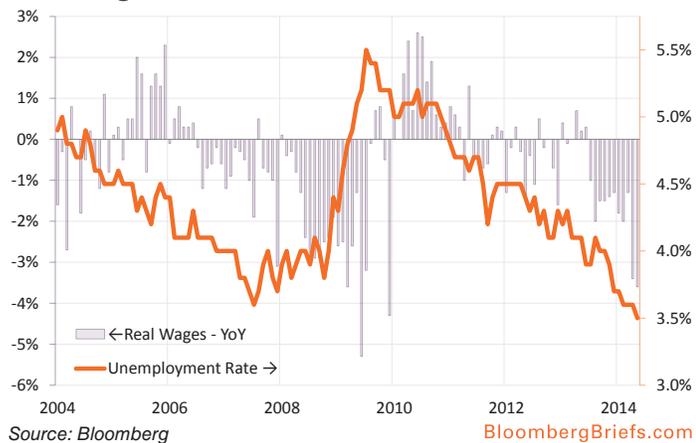
A year and a half into Japan's attempt to defeat deflation, aggressive monetary easing has raised prices. The CPI rose to 3.7 percent year on year in May 2014 from minus 0.1 at the end of 2012 — with an increase in the consumption tax accounting for about 2 percentage points of the increase. Inflation expectations have also risen.

### BOJ Says Zero Slack Is Pushing Prices Up



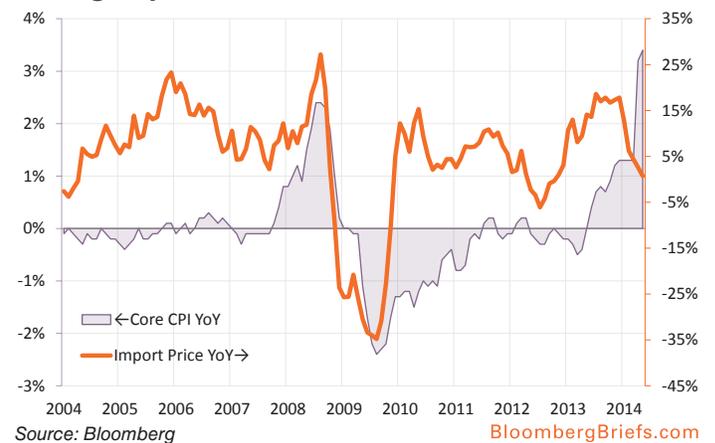
The Bank of Japan points to low unemployment and reduced spare capacity as the main reasons for rising prices. The Tankan survey supports that thesis, showing excess demand for workers and firms operating close to full tilt. Governor Haruhiko Kuroda says the central bank is on track to hit its 2 percent target for core CPI.

### Real Wages Continue to Fall



Other analysts argue that demand side inflation remains muted. Even with low unemployment, wage growth has been limited, with incomes falling in real terms. That means households have so far not felt the benefit of Abenomics and raises questions on the sustainability of higher inflation.

### Fading Import Prices Threaten to Knock CPI Down



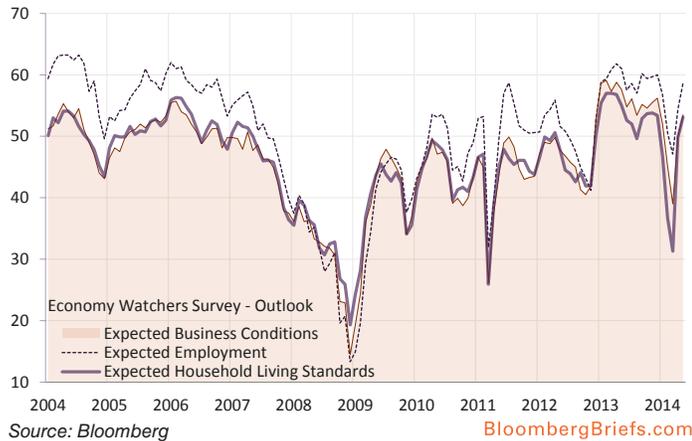
As the yen stabilizes, fading import price pressure threatens to push core CPI away from the BOJ's target. Kuroda has said that the CPI may edge down over the summer before resuming a rising trajectory in the fourth quarter.

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**ABENOMICS...**

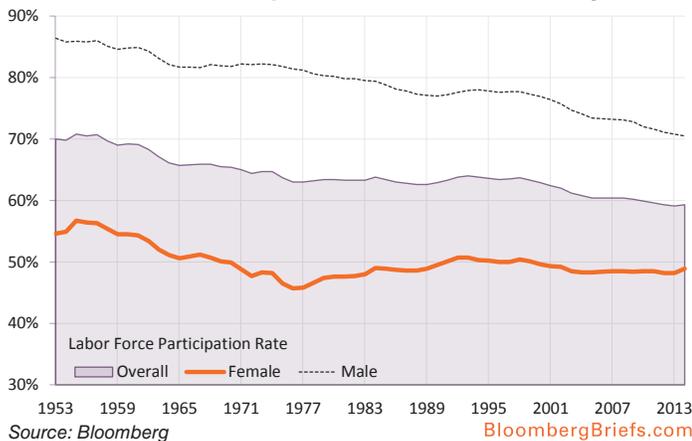
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**Slump Following Tax Rise May Be Short-Lived**



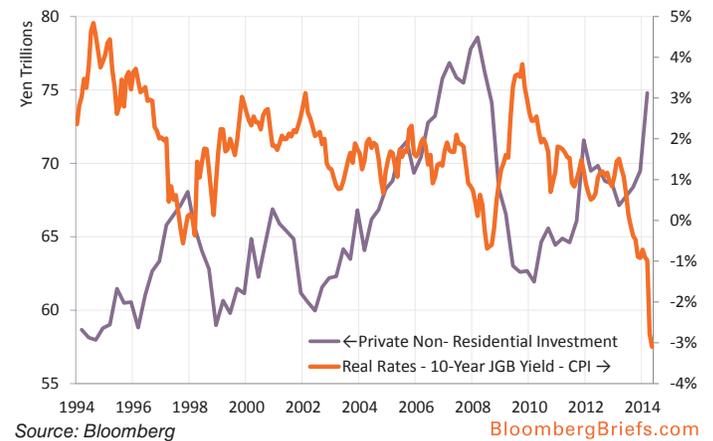
The second quarter slump — following April's increase in the sales tax — looks set to be temporary. Forward indicators point to a broad-based recovery. A decision by the Ministry of Finance to frontload public spending helped smooth out the decline in demand from households.

**Labor Force Participation Rates Stubbornly Low**



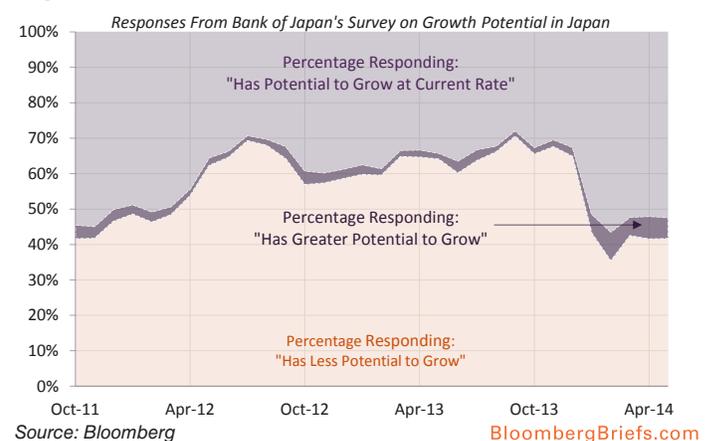
Turning around a long-term decline in labor force participation — to offset unfavorable demographics — is also essential. Japan's working age population will shrink to 60 million in 2030 from 71 million in 2010, according to projections from the United Nations.

**Boosting Potential Growth Is a Bigger Challenge**



Supporting longer-term expansion in output is a tougher task. Despite record low borrowing costs and high corporate profits, capital spending remains below pre-financial crisis levels. Without an increase in the capital stock, Japan's growth will languish.

**Japan's Households Remain Pessimistic**



So far Japan's households appear impressed with the Abenomics effort but unconvinced about the outcome. Just 5.9 percent of respondents on a Bank of Japan survey believe the government has done enough to boost potential growth. That's important because without a change in mindset, Abenomics will be hard-pressed to achieve a change in outcomes.

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# LABOR MARKETS

TOM ORLIK, BLOOMBERG ECONOMIST

## Freedom to Fire No Panacea for Japan's Labor Market Problem, Gordon Says

What happens in Japan's labor markets is critical to the success or failure of Abenomics. Rising wages and an expanding workforce could spell success. Lagging salaries and low female participation would guarantee failure. Andrew Gordon, a professor at Harvard University and author of *A Modern History of Japan*, talked to Bloomberg economist Tom Orlik about Japan's labor markets.

**Q: Unemployment in Japan is low. Why isn't that driving stronger increases in wages?**

**A:** Part of the reason is atrophy in the labor unions. Unions have accepted that wages have to be contained within the limits of productivity and profit growth. Even in years when the economy is doing better, management will argue that unions face a tradeoff between higher wages and job security. In many years there is zero increase in wages. The threat of union action has dwindled to basically zero.

Now the terms of debate are different. Employers are profitable, hoarding cash. Prime Minister Shinzo Abe's Liberal Democratic Party — which has traditionally sided with the employers — is now starting to sound like a union leader calling for higher wages. It's a strange spectacle.

**Q: Do you think increased labor market flexibility could drive higher growth?**

**A:** I'm skeptical that more labor market flexibility is the solution to Japan's problems. Rigidity is exaggerated. We've seen significant increases in labor market flexibility in the last 20 years. The labor force used to be 85 percent regular workers with strong employment protections. Now that number has fallen to about 60 percent. Firms can get rid of workers if they want to. So flexibility has increased, but I haven't seen that driving big increases in productivity and growth.

**Q: The government also wants to raise labor force participation to offset negative demographics. What are their chances of success?**

**A:** I'd give them a modest chance of success in this area. There are three potential avenues: increasing women's employment rates, raising the retirement age and allowing more immigration.

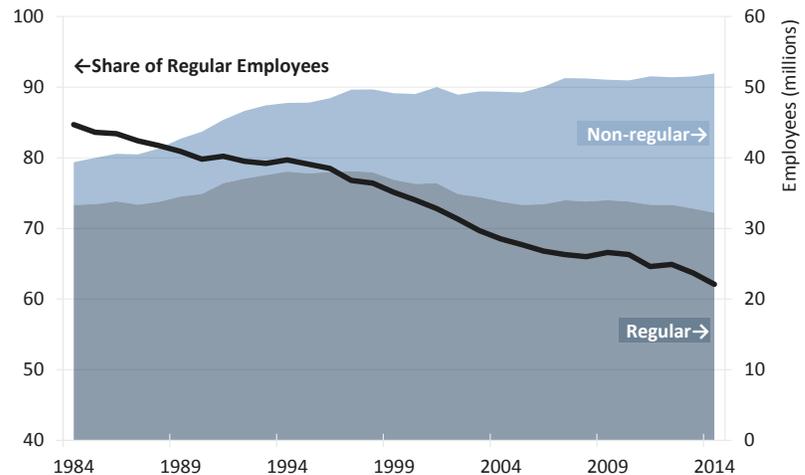
On women's employment rates, what the

government is doing is expanding childcare. That will have some impact. The bigger challenge though is making work more attractive to women. In the Japanese office, the way to earn your stripes is to work crazy hours. To increase female participation, there needs to be a shift in workplace culture. So far I don't see a big push from women, and firms are mainly paying lip service.

On the retirement age, there's some prog-

ress. Given the national debt, the government wants people to work and pay pension contributions for longer. On immigration, there's a fearfulness in Japanese society about having immigrants enter. They are seen as a source of disorder and danger. When the economy turned down in the 2000s, the government gave immigrants money to go home.

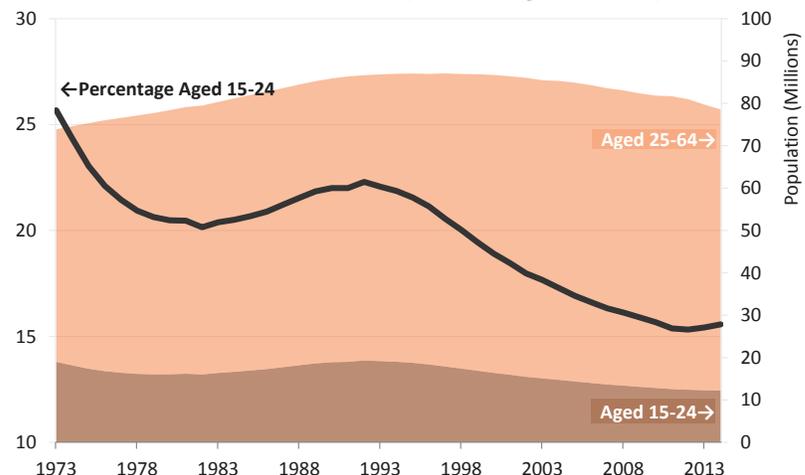
### Casual Labor Category Grows as Regular Worker Share Falls



Source: Bloomberg

[BloombergBriefs.com](http://BloombergBriefs.com)

### Older, Smaller Workforce Requires High Participation



Source: Bloomberg

[BloombergBriefs.com](http://BloombergBriefs.com)

# YEN OUTLOOK

GUEST COMMENTARY BY TOHRU SASAKI, JPMORGAN CHASE & CO.

## Yen Poised to Rise on Rate Differential, Fall on Trade Deficit

The yen has had a stable start to 2014, staying within the range of 101-to-104 per U.S. dollar. In a free-market economy though, the exchange rate cannot stay the same forever. In the short term, frustrated expectations of further easing by the Bank of Japan could see the yen strengthen past 100. In the medium term, trade deficits in Japan and higher interest rates in the U.S. mean the yen could push toward 110 during the course of 2015, at most.

The probability of additional monetary easing measures by the Bank of Japan is

becoming increasingly low. Excluding the impact of April's increase in the consumption tax, Japan's core CPI rose 1.4 percent year on year in May, exceeding the BOJ's 1.3 percent forecast for the 2014 fiscal year. A large number of companies plan to raise the prices of their products in July and August — adding further to price pressure.

Against that backdrop, attention will focus less on the chances of additional stimulus and more on whether the central bank will begin tapering. If the Japan-U.S. interest rate differential narrows rather than widens

in the second half of 2014, the pressure would be for the yen to rise.

Expectations that Government Pension Investment Fund asset reallocation will weaken the yen are overdone. The GPIF is expected to increase purchases of foreign bonds and stocks, weakening the yen against the dollar. We project additional foreign purchases will be limited to about 5 trillion yen at the most. With purchases divided into multiple lots in 2015 and the first half of 2016, they will have no meaningful impact on weakening the yen. Note that pension funds actually sold 4.6 trillion yen of foreign equities during 2013, while the yen weakened significantly.

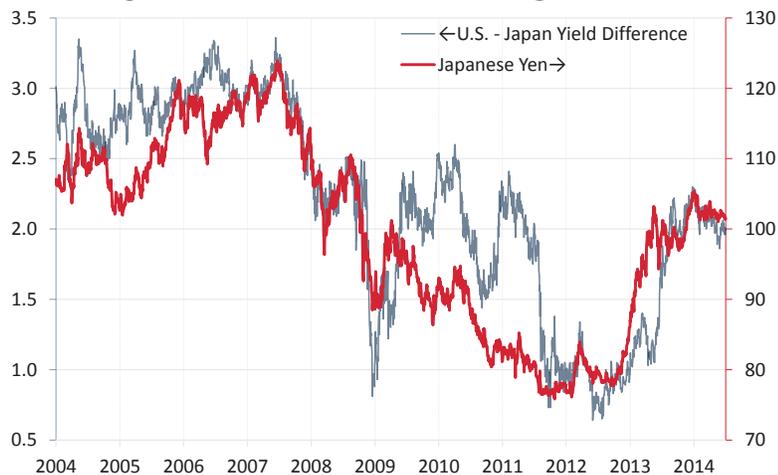
Other actions by pension funds might add to pressure for the yen to strengthen. Sales of foreign currency-denominated assets in line with the dissolution of employees' pension funds warrant special attention. It would not be surprising if these pension funds sell foreign currency and buy yen equal to around 1 trillion to 2 trillion yen in the next two months.

Given these factors, it is very likely the yen will rise against the dollar and break the level of 100 in the near term. Looking further out though, the yen will probably weaken against the dollar in the mid-term into 2015. A crucial question is how stable global financial and capital markets will be. If the current low-volatility environment continues through next year, the yen will eventually serve as a funding currency — hence, a weak currency.

Shifting patterns of trade and expectations of rising rates in the U.S. also add to medium-term pressure for depreciation. The transfer of manufacturing centers to Asia has increased the likelihood of structural trade deficits. Japan may face a current account deficit this year for the first time since 1980. A strong dollar supported by higher interest rates as the Fed exits its stimulus will also result in the dollar-yen going up.

Despite those pressures, it is unlikely that the yen will weaken much further than 110 against the dollar. In June 2007, the yen touched a low of 124 per dollar, which was the weakest level since 1970 in real terms. That translates to about 107 yen per dollar at the present value based on the rate of inflation in Japan and the U.S. Considering the inflation rate in Japan is currently higher than that of the U.S., downside room in the Japanese currency may increase to about 110 against the dollar through next year.

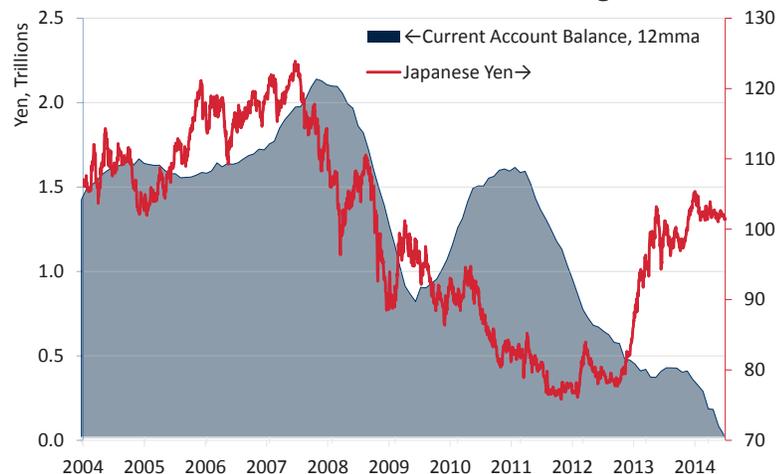
### Narrowing Rate Differentials Set to Strengthen Yen



Source: Bloomberg

BloombergBriefs.com

### Shift to Current Account Deficit a Game Changer



Source: Bloomberg

BloombergBriefs.com

# DEBT MOUNTAIN

GUEST COMMENTARY BY NAOHIKO BABA, GOLDMAN SACHS GROUP INC.

## Slow Progress on Fiscal Consolidation Adds to Reliance on Bank of Japan

Eighteen months down the Abenomics path, questions are being asked about the feasibility of the “three arrows” of reform. The Bank of Japan launched the first arrow in April 2013. The BOJ has purchased 70 percent of newly-issued JGBs in total and over 100 percent on a net basis under its unprecedented monetary easing program. For the second arrow, the government has looked to Keynesian stimulus of effective demand through two large supplementary budgets.

These monetary and fiscal undertakings were designed to buy time for the third arrow — structural growth strategies — and to act as economic shock absorbers. The idea was that structural reforms would take time to deliver and involve a painful breaking down of regulations and vested interests. Yet even after 18 months of Abenomics, the growth strategies so far seem to be geared toward

supporting the stock market. Policies that would lift potential growth, such as solutions to the country’s rapidly aging population, labor market reforms and broad-ranging trade agreements, are poorly defined. Without such policies, Japan’s potential growth rate is likely to decline further, obstructing the path to growth-oriented fiscal consolidation through higher tax revenues.

Japan has suffered from a prolonged period of fiscal deterioration. Growth in social security expenditures due to an aging population and a decline in tax revenues due to deflation have been the main causes. The government has been unable to halt growth in the debt-to-GDP ratio, raising concerns about long-term solvency. However, because of high savings rates by Japan’s household and corporate sector, and persistent current account surpluses, the government has been able to run persistent deficits while enjoying low and stable borrowing costs.

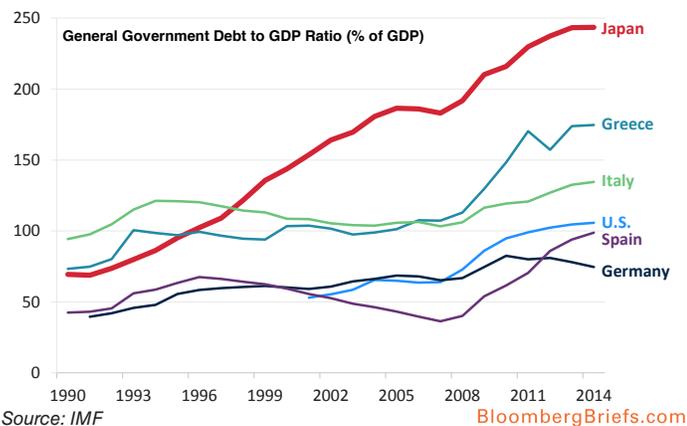
Although the Abe administration has raised the consumption tax once, the overall attitude to fiscal consolidation appears one of reluctance. The government has undertaken wide-ranging fiscal stimulus, but lacks any bold policies to control expenditure even as a graying society drives up spending on social security by 1 trillion yen each year. The consumption tax increase is a positive first step, but history has proven that countries which have relied heavily on tax increases without sufficient expenditure cuts tend to exacerbate their fiscal predicament.

This imbalance in policy conduct may well serve to increase the government’s reliance on the BOJ to continue buying large volumes of JGBs. The consensus expects the BOJ to miss its target for 2 percent inflation during a two- to three-year time frame. What would happen if the target was reached, pressuring the BOJ to cease buying vast quantities of Japan’s debt?

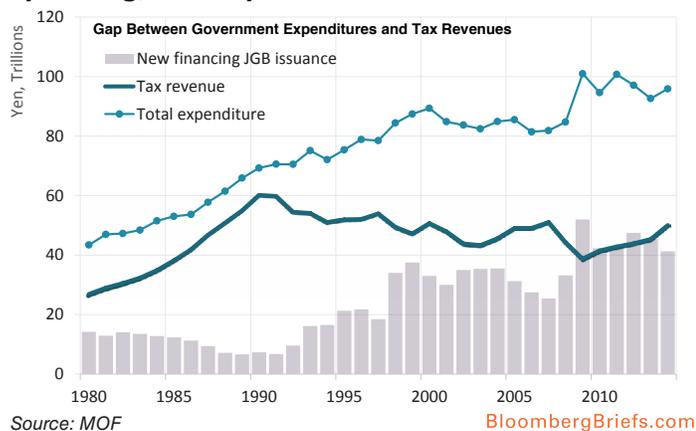
First, given the JGB market is more susceptible to small shocks due to dried-up liquidity, a decline in BOJ purchases might destabilize the market, pushing up yields and adding to the government’s debt servicing costs. Second, as the pronounced contraction in the current account surplus demonstrates, Japan’s private sector now has significantly less capacity to absorb JGBs. Massive purchases by the BOJ have kept yields down. If 2 percent inflation were achieved and the BOJ scaled back its purchases just as Japan’s private sector could no longer absorb any more JGBs, foreign investors would need to step in. With government debt well above 200 percent of GDP, they would demand a significant risk premium. The ensuing rise in debt servicing costs would tip Japan’s finances into crisis territory.

One of two outcomes seems likely. Either the BOJ keeps buying large quantities of JGBs in pursuit of a 2 percent inflation target that remains beyond its reach, or the target is somehow attained but the BOJ is obliged to continue its purchasing scheme out of a need for financial repression. With Japan’s fiscal consolidation and structural growth strategies at an impasse, the JGB market could represent the greatest tail risk for the economy. The stability of this market hinges on how long the BOJ can sustain its large-scale JGB purchases.

### Japan’s Public Debt the Highest in World



### Spending, Tax Gap Continues to Widen



**TRACK ECONOMIC FORECASTS** **ECFC**

## THE FUTURE OF QQE

TOM ORLIK, BLOOMBERG ECONOMIST, AND JENNIFER BERNSTEIN, BLOOMBERG BRIEF EDITOR

### BOJ Inflation Target Slips Further Out, Government's Path Continues to Narrow: Kanno

Masaaki Kanno, chief Japan economist at JPMorgan Chase in Tokyo, talks to Bloomberg Brief's Tom Orlik and Jennifer Bernstein on Qualitative and Quantitative Easing and why the Bank of Japan may be too optimistic on inflation.

#### Q: What's the difference between your inflation forecasts and the Bank of Japan's?

**A:** We disagree with the BOJ's view that we will have 2 percent inflation next year. It will take longer — probably inflation will rise above 2 percent in 2017 or 2018.

At the moment, we have 1.5 percent inflation in terms of core CPI year-on-year change. The rapid increase was mainly because the core CPI was more sensitive to the weakness of the yen. What is likely to happen is that as the base from the weak yen fades, the inflation rate should fall from the 1.5 percent marked in April toward 1 percent — likely in the fourth quarter. Unless we see rapid yen depreciation, upward pressure on the inflation rate is very much limited. We don't share the BOJ view that inflation expectations jumped.

Another reason the BOJ strongly believes we will have 2 percent inflation in the near term is it believes the output gap is closed — that the tightened labor market should push up the wage rate and, so, the inflation rate. We agree with the framework but expect a much longer timeline. The unemployment rate and the job offers-to-application ratio show the labor market has tightened. Still, there is more slack in labor than the BOJ thinks. To the extent that part-timers are the main source of the increase of employment, the upward pressure on wages will remain limited.

Within two or three years, the slack in the labor market will disappear as the expected growth rate will be larger than the population growth rate. If it takes more than two years before we have 2 percent inflation, we will have more breathing room.

#### Q: What does this mean for monetary policy?

**A:** The BOJ is unlikely to announce additional monetary easing this year or next year, if our economic and market forecasts materialize. Governor Haruhiko Kuroda

said the BOJ expects the inflation rate will be around 1.25 percent, and in the second half of the 2014 fiscal year the CPI inflation rate should pick up. We don't believe that is the case. Inflation should be around 1 percent or slightly above 1 percent in the coming quarters.

The international environment is important. We expect the U.S. economy will grow 3 percent or so in the coming quarters. The Fed will end tapering by the end of the year and start tightening probably in second half of next year. If that is the case, the current BOJ policy will remain quite effective. The bond yield gap between Japan and the U.S. will widen. As we expect U.S. yields will rise in the near term toward 3 percent, the yen will weaken. By the end of the first quarter next year, the dollar-yen is expected to rise to 107. Under

*Kuroda's is a very strange  
monetary policy. ...  
Once 2% inflation is achieved,  
then debt monetization will be a  
big problem.*

those circumstances, the Nikkei will rise and the economy will grow. In the first half of 2015, the BOJ might need to extend the deadline for achieving its 2 percent inflation target from 2015 to 2016 or so.

#### Q: When should we worry about monetizing debt?

**A:** The bond market remains very quiet mainly because we don't have 2 percent inflation. Kuroda's is a very strange monetary policy. Everybody knows the BOJ is monetizing the debt. To the extent the BOJ has unlimited funds to buy JGBs, no one tries to challenge the BOJ at the moment or in the near future. Once 2 percent inflation is achieved, then debt monetization will be a big problem.

#### Q: Once people start expecting the BOJ to taper, what happens to the Japanese government bond market?

**A:** We can't foresee clearly how the bond market will respond. Imagine what will happen: at that time, everybody will believe we'll have 2 percent inflation, so definitely no one will be willing to buy JGBs at 0.6 percent yield. So the yield should jump at least 2 percent or maybe more — depending on what kind of fiscal outlook there is at the time. In the U.S., the bond market was very volatile last summer when Bernanke hinted the Fed would start tapering. In Japan, the shock is likely to be much, much bigger. Just how big depends on the outlook for the fiscal deficit. The bond market could make a soft landing with yields somewhere between 2 percent and 3 percent only if market participants are convinced that the fiscal deficit will be cut dramatically from today's level.

#### Q: What are the BOJ's options for backing out of stimulus without causing enormous turmoil?

**A:** To push up inflation expectations and to raise inflation pressure, the BOJ will accept overshooting the inflation target. So, they want to see above 2 percent inflation — for example, 2.4-to-2.5 percent — and then they will announce tapering and tightening. The inflation rate will then come back to 2 percent at the zero output gap. This is how we see the trajectory of monetary policy. In order to pull down the actual inflation rate from above 2 percent to the target rate, eventually the BOJ will have to tighten policy, which means it will have to raise the policy rate. The question is whether they can do that when the debt-to-GDP ratio is so high.

If people lose confidence in the BOJ and in government debt, then inflation will rise or people will like to hold real assets including foreign currencies. That is likely to be a big risk. In order to avoid the turmoil, two things must be done. The government must cut the deficit with a sustained increase in the consumption tax rate at least to 20-to-25 percent, and a growth strategy must be fully implemented. We have a very narrow path, but we have to get through.

# The Third Arrow

BY TOM ORLIK, PEKKA AALTO AND JENNIFER BERNSTEIN

The plan for turning Japan's economic fortunes around was simple: monetary stimulus to end deflation; fiscal stimulus to kick start the recovery; and structural reforms to expand potential growth. On the first two objectives, Prime Minister Shinzo Abe's arrows have hit their mark. Limited efforts on structural reforms risk an early end to the Abenomics success story. Below are the main numerical targets of Japan's revitalization plan, listed in no specific order.

## PROGRESS TO DATE:

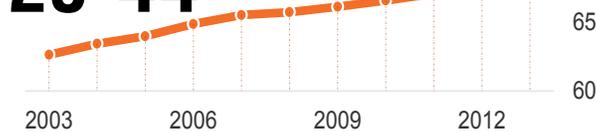
- ON TARGET ● For the main economic measures where data is available, a traffic-light scheme indicates progress to date.
- PROGRESSING ●
- MISSES THE MARK ●

### WOMENOMICS



TARGET: 73 percent employment of women aged:

# 25-44



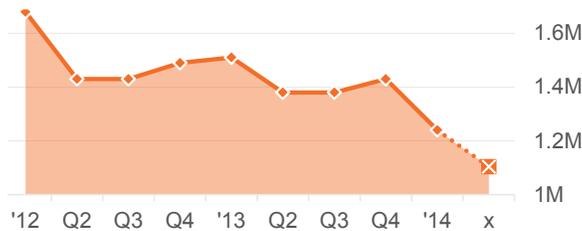
Implementation of the Zero Childcare Waiting List will secure childcare for 0.4 million. Employment for women aged 25 to 44 edged up to 69.4 percent in April.

### JOB



TARGET: In the next five years, decrease those who have been unemployed for more than six months.

# ↓ 20% UNEMPLOYED MORE THAN 6 MONTHS



Policy is shifting toward job creation, and stronger growth is boosting demand for workers. There were 1.24 million long-term unemployed in 1Q14, down 10 percent from 1.38 million in 2Q13.

### HIGHER EDUCATION



# 10 UNIVERSITIES / 10 YEARS

TARGET: Place more than 10 Japanese universities in the top 100 world universities in 10 years.

In 2014, Japan had two universities in the top 100, according to Times Higher Education rankings, unchanged from 2013. University of Tokyo edged up to 23rd place from 27th.

#23 Univ. of Tokyo, #52 Kyoto Univ., #125 Tokyo Institute of Technology, #144 Osaka Univ., #150 Tohoku Univ.

### TOURISM



TARGET: Increase the number of foreign visitors to Japan

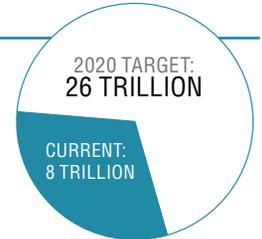
# 10M BY 2013, 30M BY 2023

Japan welcomed 10.4 million foreign visitors in 2013, up 24 percent from 2012. Visa restrictions for Asian neighbors have been eased and the number of international flights have increased.



### ENERGY INDUSTRIES

TARGET: Capture domestic and international market share of energy-related industries of approximately 26 trillion yen by 2020.



### HEALTH SERVICES



# ¥ 10 TRILLION

TARGET: Expand the markets for health promotion, preventive care and living assistance industries from the current 4 trillion yen to 10 trillion yen by 2020.

# ¥ 16 TRILLION

TARGET: Expand the markets for pharmaceuticals, medical devices, and regenerative medicine from the current 12 trillion yen to 16 trillion yen by 2020.

# ¥ 1.5 TRILLION

TARGET: Capture 1.5 trillion yen share in overseas medical technology and service markets by 2020.

### BROADCAST



TARGET: Triple the overseas sales of broadcast contents by 2018 from the current level (6.3 billion yen).

### STUDENTS ABROAD



TARGET: By 2020, double the number of students who study abroad.

**THE THIRD ARROW...**

Continued from previous page

# Structural Reform

**SMALL, MEDIUM ENTERPRISES**

**SME EXPORTS × 2**

**TARGET:** Double the export amount of SMEs compared with 2010 levels.

**PPP / PPI**

**TARGET:** Expand Public Private Partnerships and Private Finance Initiatives to 12 trillion yen in 10 years.



**INFRASTRUCTURE**



10 TRILLION YEN

30 TRILLION YEN

**TARGET:** Raise infrastructure sales from the current 10 trillion yen to 30 trillion yen by 2020.

**BUSINESS STARTUP RATE**

**TARGET:** Raise current 5 percent business startup and closure rate to 10 percent range on par with the U.S. and U.K.

**FARMING / THE "SIXTH INDUSTRY"**

**TARGET:** Expand the market of the "Sixth Industry"

**ONE → TEN** (TRILLION YEN)

**TARGET:** Expand the export of agricultural, forestry and fishery products.

CURRENT: 450 BILLION

TARGET: 1 TRILLION

**2×**

**TARGET:** Formulate a strategy to double the income of farmers and farming communities as a whole over the next 10 years.



**80%**

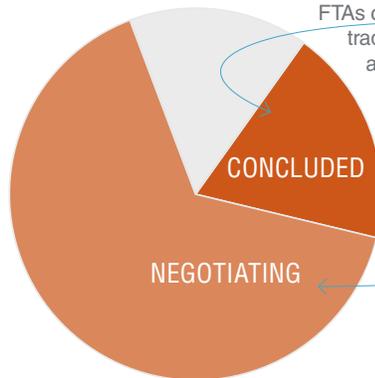
**TARGET:** In the next 10 years, 80 percent of all farmland should be used by skilled and diverse responsible entities.

The cost of rice production can be reduced by 40 percent compared to the current national average cost. The number of corporate farmers will increase to 50,000 companies.

**FREE TRADE**



**70%** TRADING FTA RATIO BY 2018



FTAs currently cover **18.9** percent of Japan's trade. Negotiations are underway on agreements covering a further **65.5** percent. Abe is trumpeting an agreement with Australia as a sign of progress. A bigger win would come from agreement of the TPP.

**EASE OF DOING BUSINESS**



**TOP THREE** AMONG OECD

**TARGET:** Ranking for 'Ease of Doing Business.'

The government plans significant reduction in corporate tax rate and reform of corporate governance. Japan is ranked 15th of OECD members in the Doing Business 2014 Report.

**INNOVATION**



**TARGET:** Become the number one global innovator within the next five years.

- #1**
1. FINLAND
  2. SWITZERLAND
  3. ISRAEL
  4. GERMANY
  5. JAPAN
  6. SWEDEN
  7. U.S.
  8. TAIWAN
  9. SINGAPORE
  10. NETHERLANDS

Japan came in fifth in the 2013-14 WEF rankings, down from fourth in 2011-12. The WEF report says Japan's problem is not innovation but "severe macro-economic weakness."

**CAPITAL INVESTMENT**



**TARGET:** Bring capital investment back to pre-Global Financial Crisis levels in the next three years.

**¥ 70** TRILLION PER YEAR

67 TRILLION YEN

Higher profits and lower borrowing costs have boosted capital spending. Investment hit 67 trillion yen in FY13.

**FOREIGN DIRECT INVESTMENT**



**TARGET:** Double FDI in Japan.

**¥ 35** TRILLION BY 2020

FDI inflows rose 33 percent in 2013 and accelerated in the first quarter of 2014. From a low base, the target still looks tough to hit.

# NOWCAST JAPAN

FIELDING CHEN, BLOOMBERG ECONOMIST

## Japan's 2Q Contraction May Surprise to the Downside, Nowcasting Suggests

Japan's GDP may have declined in April and May to levels seen in the fourth quarter last year, according to Bloomberg's Nowcast index. That indicates zero growth on a sequential basis in the first half of 2014. The economy grew at an annualized 6.7 percent in the first quarter and probably contracted by the same amount in the second.

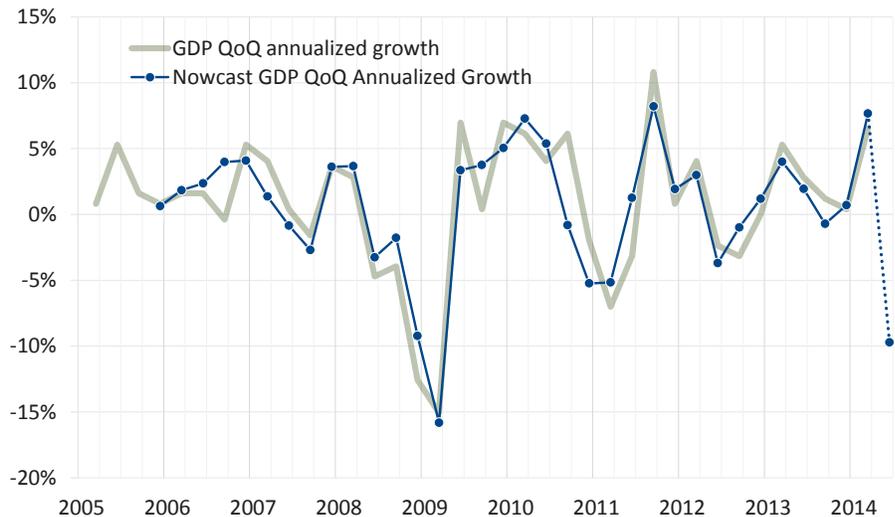
Bloomberg's Nowcast estimates Japan's monthly GDP growth using an econometric model. The model accounts for supply- and demand-side variables, including industrial production, producer price index, nationwide department store sales and export volume. Some monthly inputs — such as all industrial activity and construction orders — are excluded because the data are released one month later than other indicators.

Nowcast estimates show a broad-based contraction in the second quarter, driven primarily by slowing industrial production and sluggish department store sales. Higher producer price inflation and negative export growth also weigh on growth.

During the past five years, the nowcast projections track well with actual trends. Year-on-year growth estimates have an average error of 0.03 percentage points compared with the outcome. Quarter-on-quarter forecasts have an average error of minus 0.1 percentage points. In times of volatility, like the first half of 2014, forecasts are subject to higher estimation errors and may be less reliable.

Consensus forecasts show Japan's GDP growth contracting at an annualised 4.4 percent pace in the second quarter from the previous three-month period. The steeper drop in the economy projected by Bloomberg Nowcast might take the markets by surprise and increase pressure on the Bank of Japan to kick off a second round of easing.

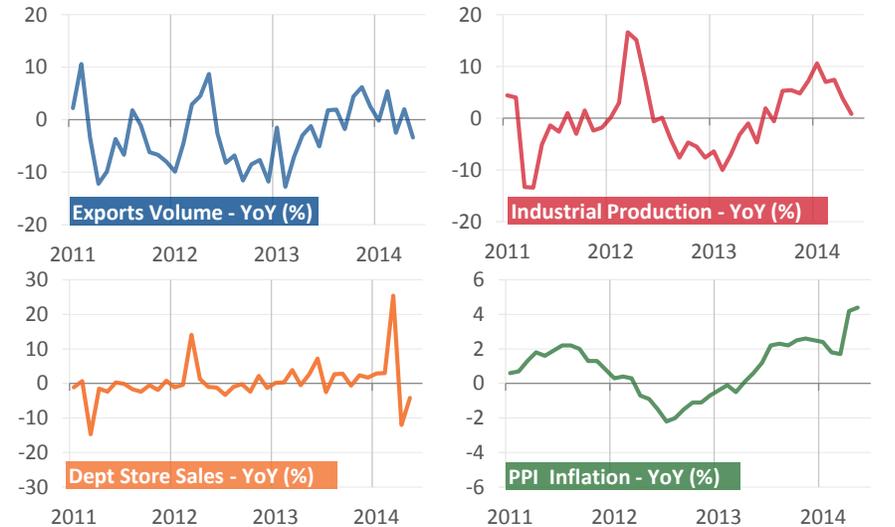
### Nowcast Model Suggests Steep Drop in 2Q GDP Growth



Source: Bloomberg

[BloombergBriefs.com](http://BloombergBriefs.com)

### Estimates Show Broad-Based Downturn in Second Quarter



Source: Bloomberg

[BloombergBriefs.com](http://BloombergBriefs.com)

#### Abenomics Vs. the Deflation Monster | July 2014

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