

MACROCOSM

Japan Breaks Out -- Does It Matter?

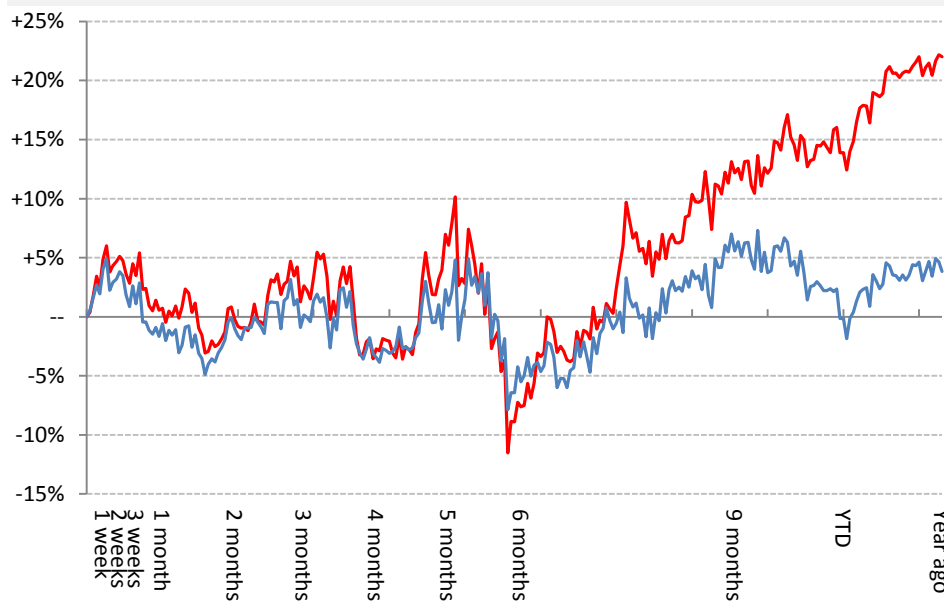
Tuesday, November 19, 2013

Donald Luskin

Abe had the guts to back off from carbon targets -- but so far it's his only profile in courage.

The Japanese equity market broke out of a long consolidation last week. It's been by far the developed world's best-performer in yen terms, and it is tied with the US for best-performer in dollar terms (please see the chart below). Yet the outlook for "Abenomics" just gets muddier and muddier.

Nikkei 225 performance versus S&P 500 — Yen — USD



Source: Bloomberg TrendMacro calculations

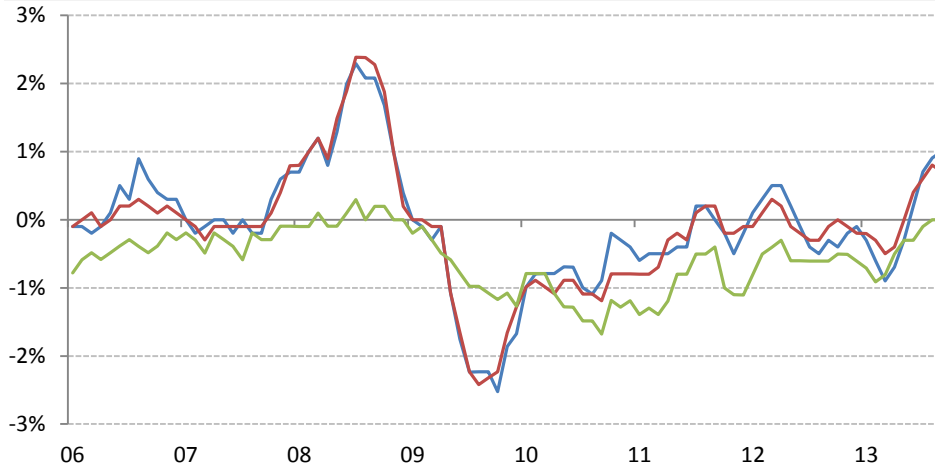
- We identified Japan's growth potential early in the year (see ["2013 Outlook: Think Globally, Shrink Locally"](#) January 14, 2013) and were enthusiastic to buy into the sharp correction in the spring (see ["Japan: At Long Last a Correction"](#) May 31, 2013).
- That all worked out well enough. But there are substantive questions about what's next (see ["Time for Abe to Show Us the Money"](#) September 30, 2013).
- So far, the Bank of Japan's radical quantitative easing (see ["On the April BOJ Policy Meeting"](#) April 4, 2013) has already begun to pull Japan out of 15 years of monetary deflation. While low inflation rates in the rest of the world are falling, in Japan previously negative rates are rising (please see the chart below).

Update to strategic view

ASIA STOCKS: Japanese stocks broke out from a long consolidation last week -- but then again, stocks were up all over the world. If there as a news trigger, it was Japan's brave withdrawal from aggressive carbon emission reduction targets, even while the Philippines are still counting the dead in Typhoon Haiyan. Other than that, Prime Minister Abe has not had the political courage to implement Abenomics except in half measures. Now the Trans-Pacific Partnerships Talks, Abe's best platform for reform, have gotten tangled up in US congressional politics. While Abe dithers, Japanese stocks -- the best-performing in the world this year -- are a hold, not a buy.

[\[Strategy Dashboard home\]](#)

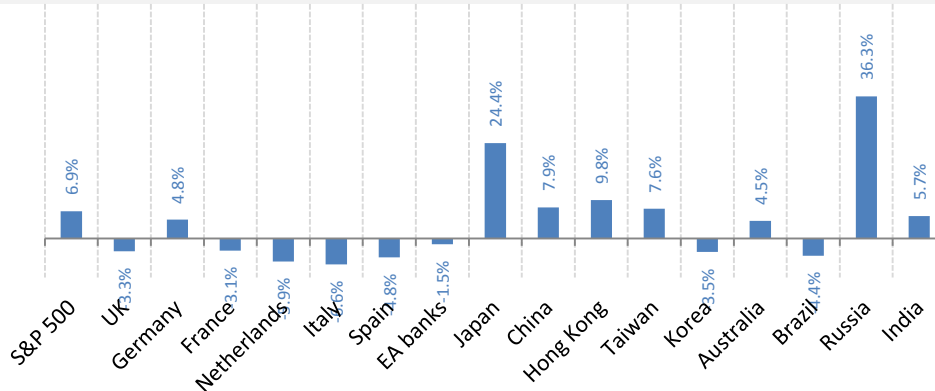
Japan Consumer Price Index YOY — All items — Ex-energy — Core



Source: Cabinet Office, TrendMacro calculations

- And the excitement from new prime minister Shinzō Abe's evangelism for "Abenomics" has lifted animal spirits (see "[The Abe Restoration](#)" May 10, 2013). Consensus forward earnings growth in Japan is among the strongest in the world (please see the chart below).

Consensus forward EPS growth Bottom-up, YOY



Source: Bloomberg, TrendMacro calculations

- This is all low-hanging fruit, but now it has been picked. It is still nourishing -- which is why, despite lack of tangible progress in unleashing more pro-growth supply-side reforms, Japanese stocks have broken out of their long consolidation.
- But stock markets world-wide have broken out over the last month, too, so Japan's break-out isn't evidence of any special merit. *For another round of truly superior growth, Japan will have to pick the higher-hanging fruit that can only be reached by making difficult political decisions.*
- And it will have to make those decisions correctly. It was no doubt politically difficult for Abe to acquiesce in raising the consumption tax next April from 5% to 8% -- but that doesn't make it right. With

**Contact
TrendMacro**

On the web at
trendmacro.com

Follow us on Twitter at
twitter.com/TweetMacro

Donald Luskin
Chicago IL
312 273 6766
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Lorcan Roche Kelly
Sixmilebridge Ireland
617 600 6969
lorcan@trendmacro.com

[\[About us\]](#)

10-year Japan government bonds selling at yields below 1%, surely placating global deficitphobes wasn't the highest priority. Abe was able to use that decision to make small cuts in corporate taxes, but not the wholesale cut in top corporate tax rates that many had hoped for.

On the other hand, we are absolutely delighted to see Japan risk the world's disapproval by [unilaterally backing away from aggressive carbon emission reduction targets](#), citing as its excuse the loss of nuclear power in the wake of the Fukushima melt-down.

- This was very difficult politically, while the [United Nations climate change conference](#) is ongoing in Warsaw, days after Typhoon Haiyan devastated the Philippines, with [emerging nations blasting developed ones](#) for not doing more to limit emissions.
- *If we had to hang our hat on one news trigger for the breakout in Japanese stocks last week, that would be the one. So far it is the Abe government's only real profile in courage.*
- We don't assign any particular importance to [Finance Minister Taro Aso's very pedestrian remarks](#) last week that were interpreted as hinting at future currency interventions.

No, if the breakout was anything beyond a sympathetic reaction to rallies in most world markets last week, it was Abe's rare show of courage on carbon emissions. *Because other than that, all the progress so far in Abenomics has been in baby-steps and half-measures.*

- We've been hoping -- and expecting -- that Abe will have the courage to slash tariffs on rice, wheat and beef within the framework of the Trans-Pacific Partnership talks (again, see "[Time for Abe to Show Us the Money](#)").
- Unfortunately, the TPP talks have become enshrouded in the fog of global politics -- with the US House of [Representatives now poised to deny fast-track approval](#), primarily over concerns that Abenomics is resulting in [lower US prices for Japanese automobiles](#). Without fast-track authority, the fate of the TPP in the US congress becomes quite uncertain, which dulls the edge of urgency for negotiators from all countries who will be party to it.
- In the meantime, Abe's government proposed [removing quotas and subsidies that benefit rice farmers](#). On the face of it, this is just the kind of politically difficult supply-chain reform we've hoped Abe would undertake. And maybe we should accept it at face value and be glad for it. But in context, we can't help but be concerned that this may be intended to take the place of the more difficult and more economically liberating removal of tariffs on imports.
- Japan's socialistic employment-for-life policies have not been substantially liberalized. The only reform is [the extension from five years to ten](#) on the limit for employing contract workers exempt from lifetime employment rules.
- Abe's government is [moving ahead with his idea for "special economic zones"](#) with lighter regulations and taxes. But so far

there's been nothing but the commitment for government to study the matter further, which probably means some form of "industrial policy" designed not to liberate but to subsidize, by picking winners and losers. Even the head of the government's panel designing the zones is [calling the efforts insufficient](#), and challenging Abe to be bolder in taking on monopolistic special interests.

- Abe [is tip-toeing toward reforms](#) in the governance of the massive Government Pension Investment Fund, which would allow it to invest more aggressively. But there's been no movement toward operationalizing the privatization of Japan's postal savings system -- enabling legislation for which was passed almost a decade ago.
- Other initiatives have simply flopped. Abe had urged allowing generic pharmaceuticals to be sold on-line, as a down-payment on modernizing Japan's sclerotic health-care system. [But then he decided against it](#), bowing to pressure from the incumbent supply-chain -- prompting the [very angry and very un-Japanese resignation](#) of a high-profile adviser from Japan's tech community.

Bottom line

Japanese stocks broke out from a long consolidation last week -- but then again, stocks were up all over the world. If there as a news trigger, it was Japan's brave withdrawal from aggressive carbon emission reduction targets, even while the Philippines are still counting the dead in Typhoon Haiyan. Other than that, Prime Minister Abe has not had the political courage to implement Abenomics except in half measures. Now the Trans-Pacific Partnerships Talks, Abe's best platform for reform, have gotten tangled up in US congressional politics. While Abe dithers, Japanese stocks -- the best-performing in the world this year -- are a hold, not a buy.

