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**Abenomics: Explaining It, Assessing It, and Telling The Untold Story**

*Paul Sheard, M-RCBG Senior Fellow, Harvard Kennedy School*

[\(paul\\_sheard@hks.harvard.edu\)](mailto:paul_sheard@hks.harvard.edu)

**Explaining Abenomics: What is it?**

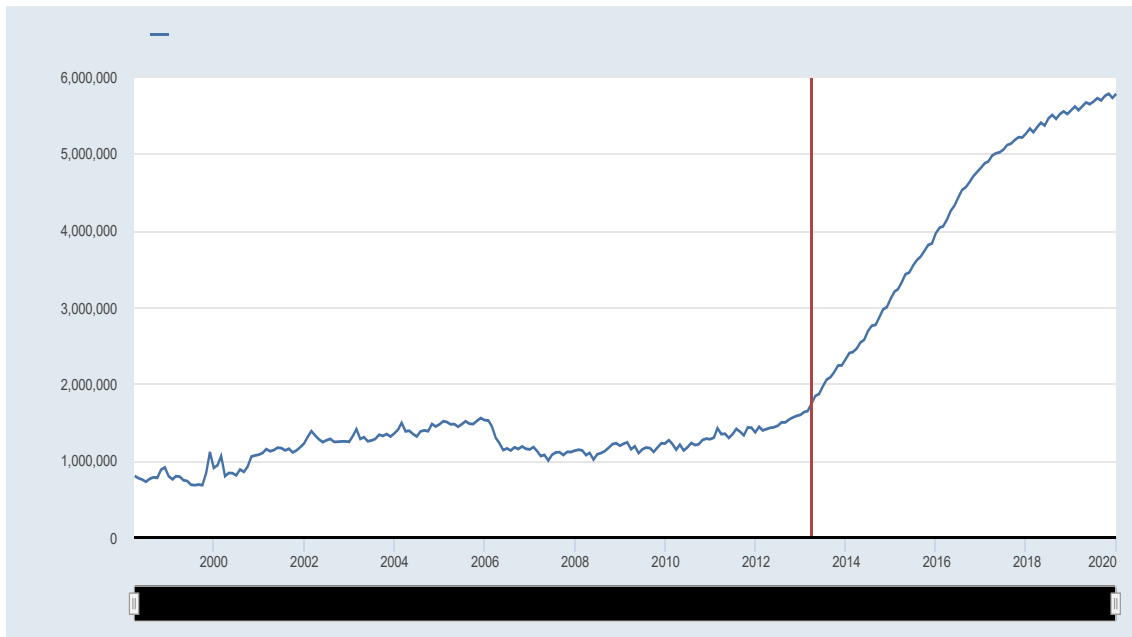
- Shinzo Abe, who had been prime minister of Japan for one year in 2006-07, led the Liberal Democratic Party (LDP) to victory in a December 2012 lower house election on a platform of ending deflation and revitalizing the economy, dubbed “Abenomics”
- Abenomics was marketed as having three components or “arrows”
  - o Monetary policy: end deflation and combat the strong yen
  - o Fiscal policy: pursue “flexible fiscal policy management for two to three years to deal with the domestic downturn and international risks”
  - o Structural reform: implement a growth strategy, centering on deregulation, promoting innovation and improving industrial competitiveness
- The goal was to raise nominal and real GDP growth over the FY2011-FY2020 period: to 3% nominal, comprising 2% real growth and a 1% GDP deflator
  - o The averages for the prior ten (calendar) years was: -0.4%, 0.8%, -1.1%, respectively
  - o Reflation and growth targets were highly ambitious
- At face value, Abenomics was just a conventional, if brilliantly marketed, policy mix: using macroeconomic (monetary and fiscal) policy tools to end deflation and supply-side, structural reform measures to raise real potential growth
  - o Milton Friedman: “Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output”
  - o Growth accounting: real growth comes from using more labor, using more capital, or being more innovative

- But there were two radical departures in Abenomics (and a minor one)
  - Conceptually, success of reflation efforts was no longer seen as dependent on progress with structural reform
    - Shirakawa (BOJ governor, 2008-2013) view was that the cause of deflation was declining real potential growth, so solution was structural reform to increase it
  - Operationally, there was a dramatic policy (and communications) shift at the Bank of Japan, under incoming governor Haruhiko Kuroda, appointed by Prime Minister Abe
    - BOJ started to communicate that it believed it could achieve 2% inflation target with monetary policy and started to expand its balance sheet aggressively
  - Fiscal consolidation push was sidelined in favor of joint reflationary action with the BOJ

### Evolution of BOJ monetary policy under Governor Haruhiko Kuroda

Date	Description	Content
April 2013	Quantitative and Qualitative Monetary Easing (QQE)	Doubling of monetary base in two years (increase of ¥60-70 tn per annum), aimed at achieving 2% CPI inflation within two years; increasing holdings of JGBs by ¥50-60tn per annum, of equity ETFs by ¥1tn and of J-REITs by ¥30bn; suspension of "banknote rule" (holdings of JGBs to be kept within banknotes in circulation)
October 2014	Expansion of QQE	Target increase in monetary base raised to ¥80tn per annum, and increase in holdings of JGBs raised to ¥80tn per annum, equity ETFs to ¥1tn and J-REITs to ¥90bn; average remaining maturity of JGBs purchased extended by about 3 years to 7-10 years
December 2015	Introduction of supplementary measures for QQE	Introduction of new equity ETF purchases (¥300bn per annum), tied to share of firms proactively making investments in physical and human capital; average maturity structure of JGBs purchases increased from 7-10 years to 7 to 12 years
January 2016	QQE with Negative Interest Rates	Target overnight interest rate lowered from around zero percent to around -0.1% and system of tiering of reserves introduced
July 2016	Enhancement of monetary easing	Equity ETF purchases increased to ¥6tn per annum (from previous ¥3.3tn)
September 2016	QQE with Yield Curve Control	Targeting 10-year JGB yields at around zero percent and overnight rate at around -0.1%; holdings of JGBs to be increased at around ¥80tn per annum and fixed-rate purchasing operations introduced; annual purchases of equity ETFs (¥6tn) and J-REITs (¥90bn) to be continued; commitment introduced to continue to expand the monetary base until CPI inflation overshoots 2% on a stable basis
JGBs; Japanese government bonds; ETFs; exchanged traded funds; J-REITs; Japanese real estate investment trusts		
Source: Bank of Japan.		

## Size of Bank of Japan's balance sheet, 2000-present (¥100mn)



Vertical line marks beginning of Governor Kuroda's tenure. Source: Federal Reserve Bank of St. Louis FRED Economic Data.

## Assessing Abenomics: Has it worked?

- to a certain extent, yes, but more in terms of alleviating deflation than in raising real growth, and then much more slowly than anticipated

## Real GDP growth and its breakdown: Abenomics record vs target and prior history (% y-o-y)

Period	Real growth	Deflator	Nominal growth
Abenomics target (FY2011-FY2020)	2.0	1.0	3.0
Prior ten years (2003-2012)	0.8	-1.1	-0.4
Difference from target (pp)	-1.2	-2.1	-3.4
Prior three years (2010-2012)	1.9	-1.4	0.4
Difference from target (pp)	-0.1	-2.4	-2.6
Abenomics record (2013-2019)	1.1	0.6	1.6
Difference from target (pp)	-0.9	-0.4	-1.4
Difference from prior three years (pp)	-0.8	2.0	1.2

Totals may not sum due to rounding error; pp - percentage points

Source: Japanese Cabinet Office; Federal Reserve Bank of St. Louis FRED Economic Data.

### Real GDP growth and its breakdown: Abenomics record vs prior history (% q-o-q, sa)

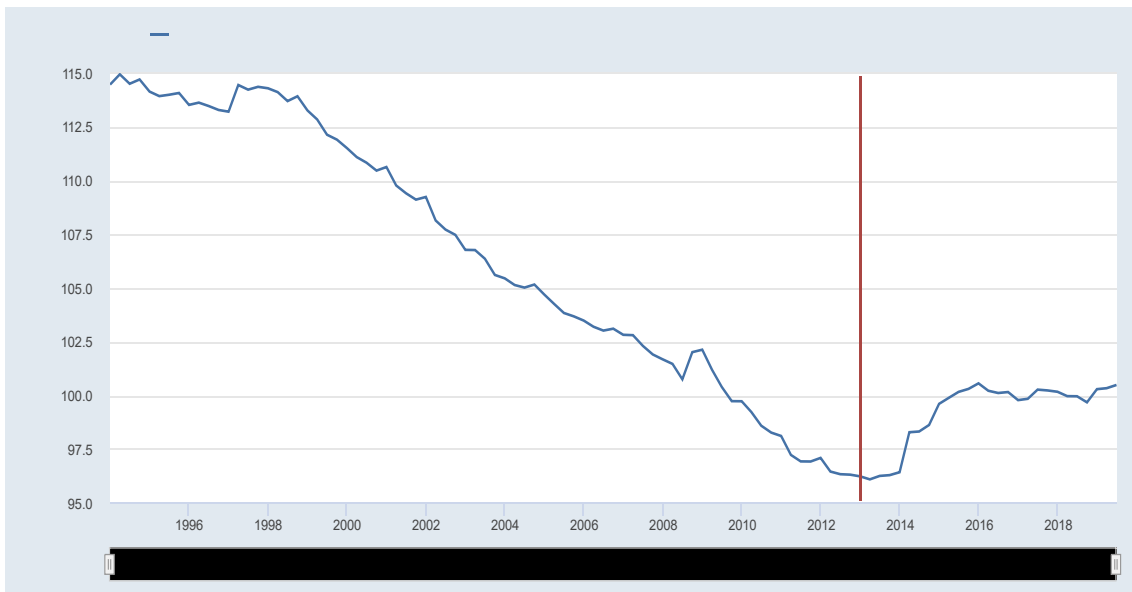
Period	Real growth	Deflator	Nominal growth
Abenomics record (2013-2019)	0.2	0.2	0.4
Prior ten years (2003-2012)	0.2	-0.3	-0.1
Difference (pp)	0.0	0.5	0.5
Prior three years (2010-2012)	0.3	-0.3	0.1
Difference (pp)	-0.1	0.5	0.3

Totals may not sum due to rounding error; pp - percentage points

Source: Japanese Cabinet Office; Federal Reserve Bank of St. Louis FRED Economic Data.

- the steady decline in the GDP deflator has been arrested
- part of the rise is due to the April 2014 hike in the consumption tax

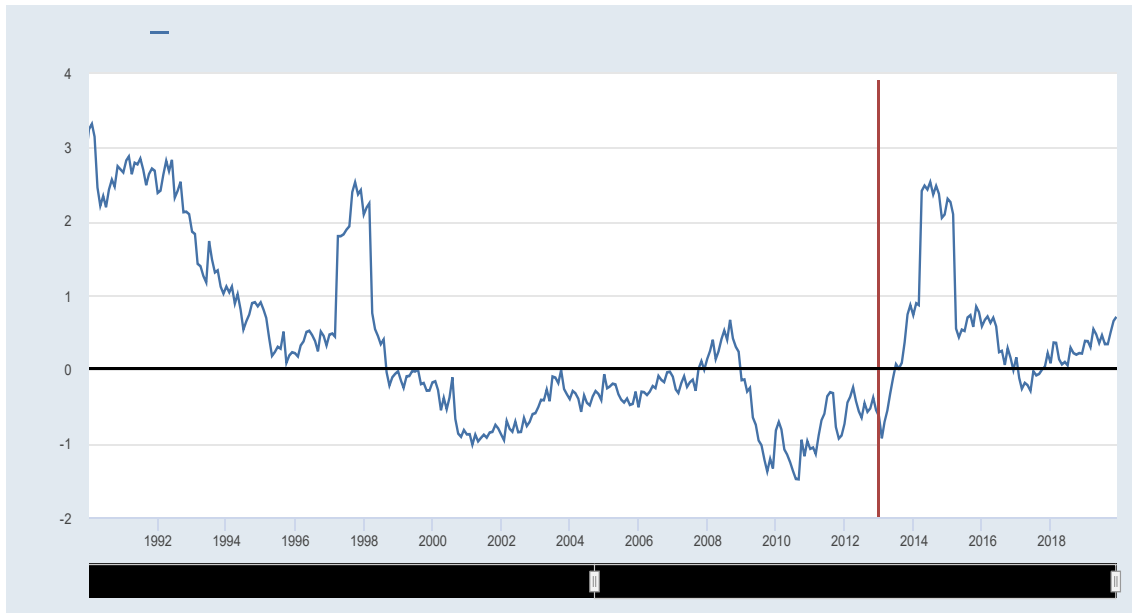
### Japan's GDP deflator, 1994 to present (index, sa)



Vertical line marks beginning of Abe Administration. Source: Federal Reserve Bank of St. Louis FRED Economic Data.

- CPI inflation is above zero but below 1%, so, after seven years of QQE is still well short of the BOJ's 2% target, let alone overshooting it

### Japan's CPI, excluding food and energy, 1990-present (% y-o-y)



Vertical line marks beginning of Abe Administration; CPI: consumer price index; Source: Federal Reserve Bank of St. Louis FRED Economic Data.

- The BOJ policy shift arrested the rise in the yen and pushed it into a lower trading range

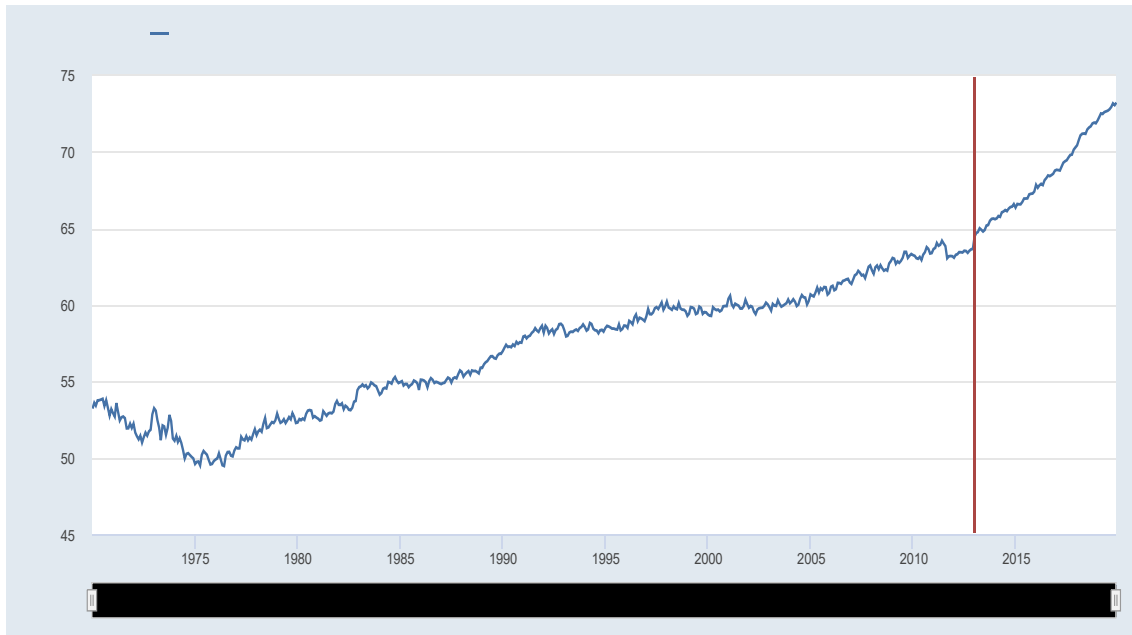
### Yen-dollar nominal exchange rate, 2007 to present



Vertical line marks beginning of Abe Administration. Source: Federal Reserve Bank of St. Louis FRED Economic Data.

- “Women-omics” was a plank of the third arrow of Abenomics: progress appears to have been made

### Japan’s female labor force participation rate (%)



Vertical line marks beginning of Abe Administration. Source: Federal Reserve Bank of St. Louis FRED Economic Data.

- The Abe Administration has (tentatively) embraced the idea of relying more on foreign workers: 2.4 times increase in seven years

### Number of foreign workers in Japan and year-on-year rate of increase (%)

2010	650,000	
2011	686,000	5.5
2012	682,000	-0.6
2013	718,000	5.3
2014	788,000	9.7
2015	908,000	15.2
2016	1,084,000	19.4
2017	1,279,000	18.0
2018	1,460,000	14.2
2019	1,659,000	13.6

Data as of October of each year; Source: Statista Research Department.

## Telling the Untold Story

- The genesis of Abenomics, and the radical monetary policy shift by the BOJ, was in the August 2012 consumption tax legislation, passed by the (then) Democratic Party of Japan (DPJ) Noda Administration (the LDP was then in opposition), which authorized the government to double the consumption tax rate from 5% to 10% in two stages (to 8% in April 2014 and to 10% in October 2015, the latter subsequently being delayed to April 2017 and then again to October 2019)
  - o The “fiscal hawks” in Japan badly wanted to raise the consumption tax and pointed (erroneously) to the euro area sovereign debt crisis as the kind of fate that awaited Japan if it did not get on with serious fiscal consolidation
  - o For the fiscal hawks to win the debate, given the contractionary impact of the hikes, they needed the BOJ to change its position and adopt a much more confident and aggressive reflation stance
- Abenomics, while containing many good measures, served as a “Trojan Horse” for the government to justify pushing ahead with the doubling of the consumption tax rate
- The August 2012 consumption tax legislation contained a two-part “conditionality clause,” which stated as follows (my translation of rather convoluted Japanese syntax and text):

"When it comes to hiking the consumption tax, because implementation is dependent on bringing about an improvement in economic conditions, with a view to escaping from a situation where the price level is continuously falling and to revitalizing the economy, as well as taking other necessary steps, comprehensive policies will be implemented in order to soon approach a state of desirable economic growth aiming for nominal economic growth of about 3% as well as real economic growth of about 2%, on average, over the decade from FY2011 to FY2020.

After this law is promulgated, from the viewpoint of responding flexibly to sudden changes in economic and fiscal conditions as well as carrying out a judgment of economic conditions pertaining to the hikes of the consumption tax rate, before putting into effect the respective hikes in the consumption tax rates stipulated in

articles two and three, with regards to the improvement in economic conditions, nominal and real growth rates, price trends, and various economic indicators will be checked, and, after a comprehensive consideration of economic conditions in the light of the measures stipulated in the previous section, necessary steps, including suspending putting it into effect, will be taken."

- Press commentary in Japan focused on the second part – that economic conditions at the time of hike should be amenable – but it is the first condition that was critical and required a dramatic monetary policy shift
- Mr Abe was on the backbench at the time of that the consumption tax legislation was debated and passed
- The opposition parties (LDP and Komeito) controlled the upper house and, in order to secure their agreement and pass the legislation, Prime Minister Noda agreed to call a general (lower house) election “soon”
  - o An election was not due until August 2013, but PM Noda agreed to dissolve the lower house for a December 2012 election
  - o After this deal was done, Mr Abe contested and won the September LDP leadership election and led the LDP to victory in the election
    - The blueprint of the economic agenda he ran on was in the consumption tax legislation
- BOJ Governor Masaaki Shirakawa’s five-year term ended in March 2013
- Newly installed Prime Minister Abe was able to appoint a new governor and two deputy governors of the BOJ
- The government should have delayed the consumption tax hikes until the BOJ had declared victory on attaining its 2% inflation target

Background reading:

Paul Sheard, 2013: “Change Of The Guard – And The Deflation Storyline – At The Bank Of Japan,” Standard & Poor’s Ratings Services RatingsDirect, March 28, 12pp

Paul Sheard, 2013: “All You Need To Know About ‘Abenomics,’” Standard & Poor’s Ratings Services RatingsDirect, June 12, 13pp

Paul Sheard, 2013: “The Bull’s-Eye Of The Third Arrow Of Abenomics,” Standard & Poor’s Ratings Services RatingsDirect, November 8, 11pp