BEYOND ABENOMICS: JAPAN POISED TO OUTPERFORM IN 2020

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PM Abe's economic policy leadership credentials got a huge boost last week, with his cabinet approving a massive extra fiscal spending package. This confirms Japan is a standout amongst G7 countries—the only government capable and willing to enact rational, pragmatic and decisive countercyclical fiscal policies. Where American and European political leaders appear stuck and forced to compensate for their own inability to actually design and implement targeted, innovative and timely fiscal policy by constantly insisting that it is the central bankers who need to do more, Japan wastes no time. "Team Abe" simply "gets it done." For the 2020 outlook, Japan now has the lowest recession risk.

Politically, it is tempting to contemplate why it is that Abe's Japan and Xi's China are left as the only major economies where the ruling elite appears to have taken to heart the lessons learned from the lopsided global obsession with monetary policy. Effective crisis management—absolutely—but the diminishing economic returns and disproportionately negative impact on social stability of all-out monetary dependency have been documented all too well to not be taken seriously. In the end, both the Japanese and Chinese ruling elite are far too united and pragmatic to entrust their nations' futures to the "cut rates, buy assets and good things will happen" mantra. What do Japan and China share that "the West" does not? Functioning government: China by undemocratic top-down dictate; Japan by a de-facto supermajority in a democratically elected Parliament.

Financially, the positive impact of fiscal policy on market performance should not be underestimated. Yes, size matters, and Abe's new package is a massive ¥26 trillion, equivalent to almost 5% of GDP. Of this, about half of the funds are poised to feed GDP directly, primarily by rebooting public infrastructure spending. Here, one part is almost immediate: shovel-ready projects to rebuild the destruction heaved by this year's incredible typhoon season; the other part will be phased in later in 2020, designed to counter the post-Olympics downcycle. All said, 2020 GDP should get a boost of around 0.5–0.75%. Consensus forecasts for next year will have to be revised up.

So, "Team Abe" deserves a 10 out of 10 for timely, decisive and pragmatic countercyclical policy action. But what about true structural policies that lift Japan's potential longer-term growth rate? Here, there is more to be done.

Specifically, here are my top two suggestions for economic policy actions that should significantly raise the chances of Japan's future prosperity, as well as Abe's historic legacy as economic policymaker. On the first one, there is real movement; on the second one, we'll hear more in 2020.

First, create a "startup nation Japan" entrepreneurship ecosystem: Nothing ensures sustainable prosperity like a thriving entrepreneur culture. Every 1% increase in the number of entrepreneurs raises potential GDP by approximately 0.5% (which means Japan could easily double her potential growth rate). Good news: The government tax council just proposed a tax incentive for corporate investments in start-ups, with 25% of any start-up investment eligible for a tax deduction (for investments up to $1 million). For 2020, this tax incentive is poised to turbocharge the already nascent trend of corporate venture capital in Japan. Note: This tax incentive applies only to corporate VC investments, not to pure financial venture capital funds. Still, the net effect should be a positive boost to Japan's longer-term potential growth rate and, thus, corporate profits.

Second, cut entitlements by introducing means testing. To introduce a greater sense of social fairness and guarantee sustainability of Japan's socialized medical and social security systems, raising out-of-pocket contributions proportionally to net financial assets is a pragmatic solution. In fact, post-Abe Liberal Democratic Party (LDP) young leaders are beginning to seriously study how to get this done. For certain, for a nation obsessed with actively minimizing the gap between the haves and have-nots, financial means testing for public services should prove politically popular. If worked in tandem with more deregulation in the medical services sector, the net impact should help boost potential growth as well as reduce fiscal uncertainty.

All said, Japan is on track for exemplary policy pragmatism, with the immediate cyclical outlook, as well as the longer-term structural one, poised to deliver positive upside surprises for 2020 and beyond. Against a backdrop of attractive valuations and record-high underweight positioning by both domestic and global investors, Japan could well be poised to become a top performer in the 2020 Olympic year.

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