JAPANESE FISCAL STIMULUS TO THE RESCUE

Jesper Koll – Senior Advisor
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On Monday evening, Japanese Prime Minister Shinzo Abe announced a commitment to a fiscal stimulus package worth ¥108 trillion, which is approximately 20% of Japan's gross domestic product (GDP). This is almost double the ¥60 trillion package recommended last week by his team of experts. In our view, this confirms Abe's total commitment to preventing the inevitable recession from becoming a depression.

The package is divided into two parts. The first intends to immediately support income and cash flow for households and small enterprises, while the second seeks to boost demand toward a V-shaped recovery once the COVID-19 infection rates have come down.

In my view, this two-stage approach is a good one, creating new incentives for enterprises to actually reinvent themselves for a better future, which should allow for more positive multipliers than merely cushioning companies to get back to business as usual. Yes, Japan's policy is now laying the groundwork for a possible investment multiplier to kick in once the current demand shock is over. Politically, it also builds a new war chest for Abe to ensure he can sweeten the recovery mood once the immediate virus concerns begin to fade and the race to be first out of the gate in the upturn begins.

And, yes, the BOJ...

Although no details are available as to how much of the ¥108 trillion extra boost will need actual new funding, the Bank of Japan (BOJ) is poised to be called upon to absorb the added public borrowing requirement. To wit, even if only one-third of the ¥108 trillion required new Japanese government bond (JGB) debt, this would more than double the original ¥33 trillion of new issuance that the Ministry of Finance (MOF) has budgeted for this fiscal year. Good news: The BOJ has approximately ¥50 trillion of "spare capacity" in its JGB buying budget.

Make no mistake, this Japan budget almost certainly will turbocharge BOJ bond-buying and quantitative easing in coming months. Yes, Japan's monetary and fiscal policies are being put to work together and the foundations for a V-shaped recovery into 2021 are being built, in my view.

Full details of the package are expected to be announced this week, focusing on the first part, which is for immediate support. For the second part, details are still expected to remain a work in progress, to be unveiled as the pandemic stabilizes (and after more ideas are presented to, and deliberated by, Team Abe).

For now, the following concrete policies are expected to be confirmed this week:

- ¥6 trillion for households directly affected, including ¥300k ($2,700) cash grants and an added ¥10k for households with children
- ¥26 trillion for companies via a one-year deferral of corporate tax and social security costs (Japan's total tax revenues were approximately ¥62.5 trillion last year)

- Payroll support for companies that maintain their payroll (amount currently unspecified)

Direct coronavirus policy:

- raise coronavirus testing to 20,000 per day, up basically five-fold from February levels
- boost hospital capacity and ventilator availability

BOJ to the Rescue – JGB Issuance Could Double to Fund the Boost

For now, there are no details on how this extra budget will be funded, and obviously the wider the gap between the headline ¥108 trillion of added fiscal boost and the required new borrowing, the less credibility the package will have. Given that total government bond issuance is budgeted at ¥33 trillion for the current fiscal year, it would not be surprising to see actual JGB issuance more than double, even if somehow only one-third of the ¥108 trillion required actual new funding this year.

Who will buy? The Bank of Japan. Their budget to buy JGBs is still up to ¥80 trillion, and over the past six months their annualized run rate of actual purchases has been less than a quarter of this. So, there is plenty of war chest left for the BOJ to absorb the added fiscal boost.

State of Emergency

In addition, Abe signaled he may declare a state of emergency this week. Most likely this would be applied to the major urban areas, greater Tokyo and greater Osaka, as well as Fukuoka. Together, these account for approximately two-thirds of Japan's GDP. Although details will come tomorrow, the emergency is expected to last for one month, until just after Japan's Golden Week holiday.

Importantly, public transport, food supply, convenience stores, restaurants, and other services will not be affected, and, unlike many Western democracies, a full lockdown is not legally enforceable in Japan. However, it is widely expected that Japanese civil obedience and social mores will result in a slowdown in activity similar to those observed elsewhere.

If we assume a 25%–30% added drop in activity due to the emergency, the annualized drag on GDP would come to approximately 20%, similar to the size of the budget just proposed (although this is just algebra, not economics, as there will be multipliers on both the downside and the upside from the fiscal boost).

More importantly, a state of emergency does give local governors the powers to, for example:

- fix prices for essentials like food and medicines
- make priority purchases of food and medicines and equipment needed to fight the virus
- expedite loans and grants to private enterprises deemed essential (using public lenders)
- appropriate land and buildings to be used as temporary medical facilities
- restrict or cancel private and public events and schools

All said, Japan's economic policy actions continue to impress. While concerns over the virus spread and emergency rule remain a justifiable focus of media attention, from an economist's perspective, a solid and strong foundation for a V-shaped recovery into 2021 is being built.

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DEFINITIONS

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Recession : two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemploymen.

Japanese Government Bond (JGB) : A bond issued by the government of Japan. The government pays interest on the bond until the maturity date. At the maturity date, the full price of the bond is returned to the bondholder. Japanese government bonds play a key role in the financial securities market in Japan.

Quantitative Easing (QE) : A government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.