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Japan Market Rout Fuels Debate Over Abenomics

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TOKYO—Continued turmoil in Japan's financial markets is fueling a debate about the effectiveness of Abenomics, Prime Minister Shinzo Abe's broad package of growth-enhancing policies that had triggered a surge in optimism over the economy in recent months.

After three weeks of roller coaster trading in stock and currency markets wiped out big chunks of the gains attributed to the policy package, economists and market participants are caught in a heated debate over whether Mr. Abe's bold attempt to nurse Japan's moribund economy back to health is working.

Proponents of Abenomics say the policies are beginning to have the intended effects on the real economy as some indicators are beginning to show. Critics say that unwarranted optimism generated by monetary and fiscal steps unveiled earlier has receded since Mr. Abe unveiled his new growth strategy, seen by many as the most important component of the package. They say the strategy failed to deliver the bold plans needed to fundamentally reform the economy.

"Could this be the end of the fantasy called Abenomics?" Kazumasa Ogura, an economist at Tokyo's Hosei University, wrote in a Twitter post Thursday morning as stocks tanked. "There were huge expectations. But it didn't take long for people to realize the reality isn't that easy," he said in a subsequent interview.

Gerald Curtis, a Columbia professor and longtime observer of Japan said: "I thought for the past four months that there has been a kind of irrational exuberance over Abenomics. Now there can be excessive disappointment."

Others disagree.

"Abenomics is working and will continue to work," said Grant Lewis, head of research at Daiwa Capital Markets Europe Ltd. in London. "A few days or weeks of market turbulence are no reason to believe that Abenomics is doomed to fail."

A solid first-quarter growth rate is among the promising signs for the economy Mr. Lewis sees. Japan's gross domestic product grew an annualized 4.1% in January-March, beating the results of other Group of Seven major nations. He also cited improved confidence among consumers and

businesses, and the firming of the job market, as seen in the best job-to-applicant ratio in nearly five years.

The debate over Abenomics became particularly intense Thursday as sharp movements in markets brought Tokyo shares and the yen back to levels they were at before Japan embarked on the latest round of monetary easing. The Nikkei Stock Average tumbled 6.4% during the day to 12,445.38, down 20% from its recent peak on May 23, while the dollar hit a two-month low against the yen at ¥93.90. Before the Bank of Japan 8301.JA -5.09% unveiled its easing program in April, the Nikkei was around 12,150 and the dollar was ¥92.90.

Economists may be sharply divided over the effects of Abenomics but they agree on one thing: All this is coming at an inconvenient time for Mr. Abe.

The prime minister is traveling to London this weekend to attend the annual economic summit of the Group of Eight nations. There, his primary task is to pitch his policy package and convince his colleagues of his resolve to end the deflation that has ailed his country for two decades and spur growth.

Keeping gains in the stock market is also crucial for Mr. Abe during the weeks leading up to national elections on July 21, a poll that will shape the strength and longevity of his administration.

In time for his U.K. trip, Mr. Abe's cabinet is expected to approve on Friday the broad package of long-term growth policies that make up the "third arrow" of Abenomics, following the monetary and fiscal steps defined as the first two arrows. The growth strategy is a grab bag of policies aimed at generating 2% annual growth over the next decade through deregulation and tax incentives.

Some economists blame disappointments over the third arrow for the cooling of market sentiment. For one, they say, it was missing a few key policy items that markets and the business sector were hoping to see, including a reduction in the corporate tax rate and deregulation of employment rules to aid corporate restructuring.

The drip-by-drip way in which the steps were announced also diluted their impact and created the image that the government was simply reacting to deteriorating market conditions, rather than doing strategic thinking to create long-term growth. The policies were unveiled in piecemeal style on three different occasions over the past several weeks before being thrown together in a broader plan to be approved Friday.

When that didn't stop the slide in the market, the government said it would come up with more measures during an extraordinary parliament session in the fall.

"The growth strategy package has become too bloated. What we needed is a simple one with a few powerful steps," said Mr. Fujishiro of Dai-Ichi Life Research.