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SuMi TRUST Monthly Commentary

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Anticipated Policies under the Suga Administration and the Desired "4th Arrow"

In view of the rapidly deteriorating economy and employment conditions under COVID-19, we fear the recurrence of a rising gap in household income and economic inequality that existed between the early-2000's and the early-2010's. Employment conditions today under COVID-19 are worse than what we saw during the Lehman Shock. The service industry, where remote working is difficult and involves face-to-face client contact, has suffered, and we have seen notable deterioration in employment among young, non-regular, female workers. Should the income gap continue to widen, the lower income bracket would expand, leading to lower consumption and hence a lower growth rate.

Prime Minister Suga's near term policies will focus on tackling COVID-19, but his basic policies will follow where Abe left off. However, Suga faces numerous challenges that include income disparity and distribution policy. Suga's economic policies must not counterpose his growth strategy with his income and distribution policy. Rather we would expect his income and distribution policy to reinforce his growth strategy. We hope to see the Suga Administration fully support and enforce these policies under the "4th Arrow".

1. Anticipated policies under the Suga administration

Yoshihide Suga succeeded Shinzo Abe as Prime Minister of Japan. Suga was Abe's Chief Cabinet Secretary and had been a long-time supporter of Abenomics. While he is expected to carry on with the policies of Abenomics, his near-term emphasis will be on tackling COVID-19. On monetary policy, we expect the status quo to be maintained under BOJ Governor Haruhiko Kuroda whose term will expire in April 2023. At the recent August 27th FOMC meeting, the Fed announced that it would tolerate inflation beyond 2% and would commit to a long-term 0% interest rate policy. It is thus likely that the BOJ will maintain an ultra-accommodative monetary policy which will also counter any strength in the Japanese yen. We therefore see no changes to the accommodative monetary policy and expansionary fiscal policy under COVID-19. We believe that it will be some time before the virus is contained and thus economic recovery and disease control will be pursued simultaneously. On foreign relations, Suga has had little diplomatic experience. But he has stated that he will receive the advice of his predecessor and will build relationships with Asian nations under the key US-Japan alliance. Whilst there are concerns over Sino-US frictions, it is assumed that diplomatic relations with China, a key economic partner, will be emphasized as well.

Whilst the general macroeconomic framework will be little affected, we expect to see a change from Abenomics at the microeconomic level. PM Suga will attempt to breakdown ministerial sectionalism, implement thorough regulatory reform, and eradicate vested interests. We can also expect the creation of a Digital Agency, a reduction of mobile phone charges, and the promotion of telemedicine and online education. It is through these new policies and actions that we should see accelerated growth lacking under Abenomics.

2. The reappearance of the growing household income gap and economic inequality

Of the Three Arrows under Abenomics, accommodative monetary policy and expansionary fiscal policy led to a weaker yen and higher share prices, stamped out of deflation, boosted household and corporate psychology, and created the second largest economic expansion since the end of World War II. But the growth strategy also left many unsolved issues. Although it is still early stages, PM Suga's leadership and ability are already being questioned.

In addition, the economy and employment conditions are rapidly deteriorating under COVID-19. We fear the recurrence of a rising gap in household income and economic inequality that existed between the early-2000's and the early-2010's. Should the income gap continue to widen, the lower income bracket would expand, leading to lower consumption on a macroeconomic level, which will ultimately lead to a lower rate of economic growth.

3. Employment situation; the difference with the Lehman shock

According to the most recent statistics, the fall in the number of employed has surpassed the magnitude of that during the Lehman Shock. Employment fell by 1.03 million during the period Sept. 2008 to July 2009. But it fell by 1.06 million from December 2019 to August 2020 (Figure 1). The number of job losses are higher, and the speed at which jobs were lost has been much quicker, under COVID-19.

Secondly, we note that the breakdown of job losses is different from 2008-2009. As of July 2009, 93% of job losses were amongst men. However, as of August 2020, over 70% of job losses have been amongst women. In the economic recovery since November 2012 to end-2019, three-quarters of job gains, or 3.53 million people, had been amongst women. But as of end-August 2020, one-fifth of that number, or 760,000 women, have lost their jobs since the beginning of 2020.

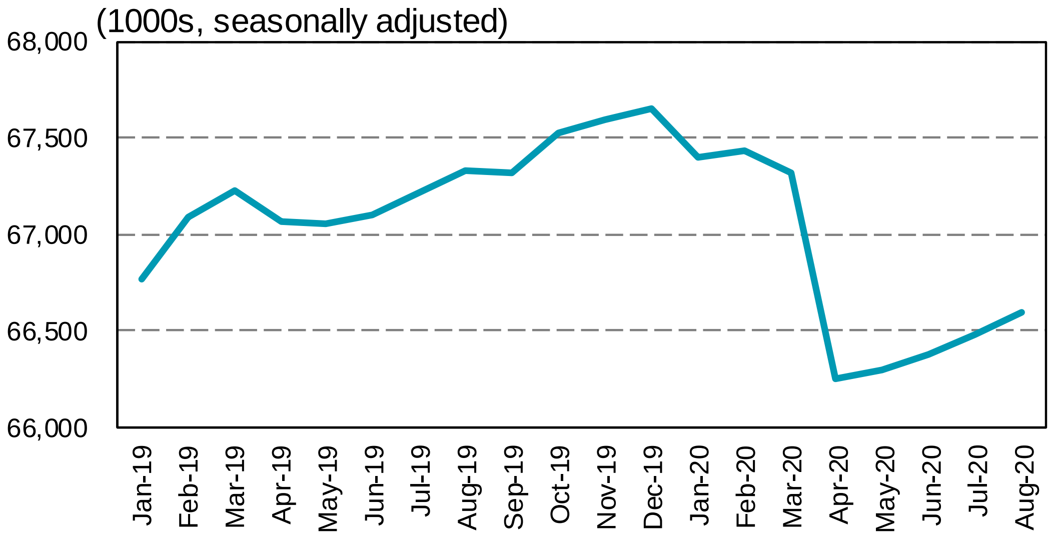
Thirdly, men who lost their jobs during the Lehman Shock continued to search for jobs, whilst women who lost their jobs in 2020 have largely given up their job search. During the Lehman Shock, unemployment had reached 5.5%. This time, of the number of employed which fell by 1.06 million, there were 450,000 people, mostly women, who have given up looking for a job and are now out of the labor force. Should these 450,000 people be included in the workforce statistics, the unemployment rate would have been 3.6%, or up 0.6 percentage points.

Fourthly, the number of non-regular employees unemployed this time is much higher in 2020 than 2009. As the number of COVID-19 cases worsened, 1.09 million non-regular employees had lost their jobs by August 2020. As a comparison, the job decrease was just 350,000 from July to September 2009. Of particular note is that the decrease among young, non-regular employees between the ages of 15-34 accounted for 53% of the decrease among all age groups.

Fifth, the industry composition of job losses contrasts between the two periods. In the 10 months after the Lehman Shock, there was a large-scale employment reduction of 1.01 million people in the manufacturing industry, mainly by exporters. But in the COVID-19 crisis, by August 2020, 700,000 people had lost their jobs primarily in the wholesale and retail businesses and the accommodation and food service industries, which rely on face-to-face sales and customer service. These industries are generally labor-intensive, not always highly productive, and the wages are relatively low. The nature of the industries generally do not allow remote work, digitalization or doing business online.

Boldly summarizing, the employment impact from COVID-19 has already surpassed that of the previous Lehman Shock, and is particularly noticeable in the decrease in employment among young, non-regular females, especially in the service industry which require face-to-face client service and where remote work has been difficult. Moreover, many jobs have been maintained through employment subsidies and cash drawdowns. But going forward, we believe that there will be a hiring freeze amongst many companies and higher turnover in the markets which will lead to further deterioration in employment conditions.

Figure 1 - Employed population



Source: Ministry of Internal Affairs and Communications

4. Looking back at the income disparity

The Lehman Shock made it very clear that income disparity had been expanding through the 2000s. According to the Ministry of Health, Labour and Welfare's "Income Redistribution Survey," the Gini coefficient, which measures income inequality (adjusted for the number of household personnel) rose sharply from 0.42 to 0.48 between 2000 and 2013. Around this time in Japan, while real wages were declining, widening disparities were noticeable especially among those with relatively low incomes. In fact, according to the Ministry's "National Life Basic Survey," the percentage of households with a disposable income of less than 3.5 million yen increased by 13 percentage points from 2000 to 2015, and the number of households who answered that they had no savings increased by 7 percentage points.

In the United States, the income gap was especially notable amongst the highest income group as the wealthy got wealthier. But in Japan, the income gap widened mainly in the relatively lower income group leading to "poverty among the middle class". In fact, between 2000 and 2012, the relative "poverty rate," or proportion of people with less than half the median disposable income, rose from 15.3% to 16.1%. Welfare recipients also remained high at 17% between 2013-2015, or 9 percentage points higher than in 2000. According to an international comparison by the OECD, Japan's relative "poverty rate" was the 10th highest among the 36-member countries as of 2015 (Figure 2). One must look not only at the elderly, but to the emergence of intra-generational disparities among young and middle-aged people. The slogan, "All 100 million Japanese are middle class", quickly began to fade, and the problem of disparity was highlighted. According to the results of the World Values Survey, until 2005, most respondents said that there should be some income disparity to raise motivation. But by 2010, 63% of respondents said that "there should be income equality" and it remains at these levels today. Although employment recovered under Abenomics in the latter half of the 2010's and income inequality had improved somewhat, the results of these surveys show that widening inequality remains a concern for most people.

Figure2-Poverty rate in OECD countries as of 2015

1	US
2	Korea
3	Lithuania
4	Turkey
5	Israel
…	…
10	Japan
…	…
36	Iceland

Source: OECD

5. Correcting disparities which should not impede economic growth

We often hear that correcting income disparity and distribution policies are incompatible with economic growth, and many tend to fall into the argument of choosing between growth and income redistribution. However, the impact of inequality on growth is not uniform. For example, amongst the relatively high-income group, income disparity is an incentive to make one richer, and raising taxes to correct the inequality will merely result in a loss of incentives. On the other hand, for those with relatively low incomes, widening disparities make them aware of their differences with others, work negatively on their motivation, fail to cover sufficient education expenditures, and miss the opportunity to increase their incomes. As a result, it can lead to a hotbed for social unrest and the rise of populism.

Which one is dominant? According to the results of an empirical analysis conducted by OECD staff in member countries after numerous surveys and studies, not only does inequality correction not hinder economic growth, but the redistribution policy among low-income groups in fact promotes growth. In particular, it's been suggested that investment in education contributes to the subsequent growth potential through the formation and accumulation of human capital.

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6. Seeking inclusive growth

The Japanese economy must undergo major changes and transformation in the post-COVID-19 era. Investing in human capital to flexibly adapt to trends and to take the lead is important. It is necessary to focus not only on childhood and adolescence education where you "begin to learn", but also to "re-learn" in your mid and elderly life and recurrent education.

What is required of economic policy is not to counterpose growth strategy with income and distribution policy (For example, investing in education, and boosting support for workers affected by COVID-19.) Rather it is critical that income and distribution policy act to reinforce the growth strategy. This is the aim of "inclusive growth" advocated by the OECD. That is, the realization of an economy and society in which no one is left behind and everyone can live in happiness. I hope that the Suga administration will take an actively promote the "fourth arrow".

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