GLOBAL MARKETS ANALYSIS

"Monetary policies and the 2024 elections in Japan: economic implications and political dynamics"

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Balancing Inflation and Growth: How Japan's 2024 Elections Could Shape the Future of Monetary Policy and Economic Stability

With Japan set to have elections in 2024, the path of the nation's monetary policy has emerged a major issue. However, the BOJ has conducted its ultra-low and even negative interest rate policy called "Abenomics" for the past 10 years to combat deflation and stimulate economic growth. Because inflation and currency instability climbed, the Bank of Japan made a small pivot to positive interest rates, taking a tentative step away from ease. The election offers two different paths to economic prosperity: The ruling Liberal Democratic Party (LDP) favours a more gradual tightening approach, with an eye on economic stability and wage growth. The Constitution Democratic Party (CDP) rides back to a looser monetary policy. Finding that balance between the imperatives of regional stability and those of global economic integration (which may put some upward pressure on prices) will be critical; this will assist consumers and small businesses meet rising costs.

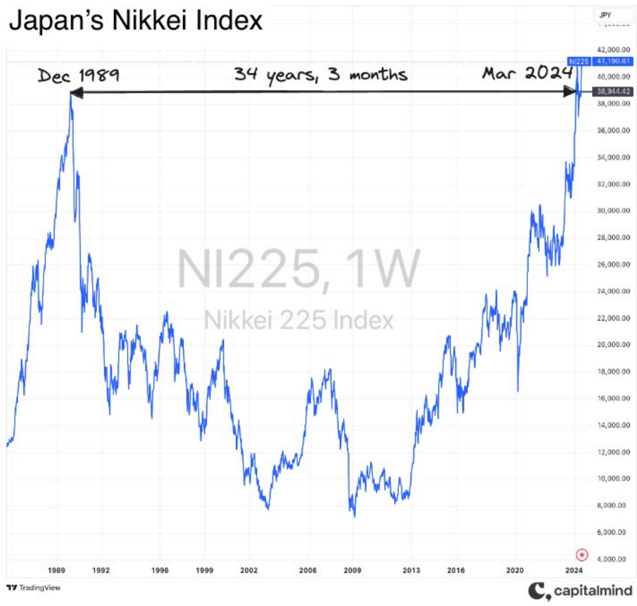
The stakes are high for Japan's economy, with both consumer costs and wider market stability dependent on the outcome of the election. The outcome of the election will determine how the BOJ proceeds with a legacy of Abenomics that affects everything from export competitiveness to investment flows. Japanese voters will face a similar choice at the polls; their decision will determine whether there is status quo incremental tightening, or whether there is a return to monetary easing – both options having extremely powerful long term implications for the Japanese economy.

Beyond these macroeconomic concerns, the election results will have a significant impact on Japan's social climate. With rising costs for consumers and stagnant wage growth, along with a rapidly ageing population, monetary policy cannot be extracted from the wider social problems of our time. With that in mind, if the LDP manages to gain influence via a more conservative course we could experience a relatively stable state of affairs with regards to economic security for older portions of the population still dependent on fixed incomes and thus susceptible to rising prices. Moreover, it can also stifle the wallet needed to cope with income inequality and the needs of our young who want a better lifestyle. Meanwhile, CDP's idea could lure more immediate spending to tackle social equity, but this may put fiscal burden down the road on Japan's younger generations.

In this complex landscape, the BOJ will be pressured to simultaneously embrace global integration and many of Japan's domestic priorities —something that has not been required of the central bank in decades. Japan's status as a developed economy with a terminally old citizenry, slow growth of new people, and an extensive social safety program creates special challenges for monetary policy. As such, this election is not simply a choice between tightening and easing — it is a choice over the future of Japan's economic identity and growth versus stability prioritisation and its interaction with the imported model of globalisation.

History of Japanese Monetary Policy: The "Lost Decade" and the Burst of Japanese Asset Price Bubble

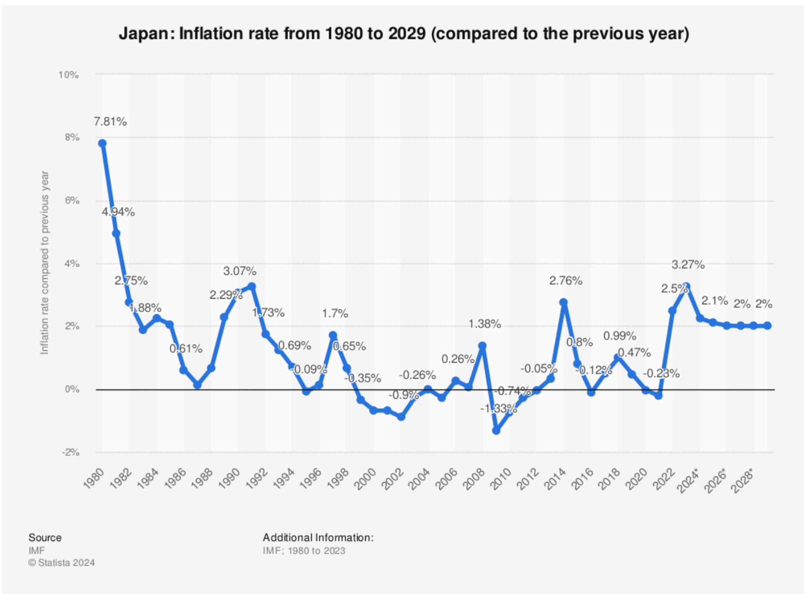
Since the 1990s, the Japanese Economy has faced a unique period known as the "Lost Decade" (originally the 90s, but extended into the 00s and 10s), a period of minimal economic growth X and deflation. The root of the issue can be traced starting with the 1985 Plaza Accords, a treaty signed between Japan and the United States with intent to appreciate the Japanese Yen (JPY) in relation to the Dollar (USD). Japan had experienced tremendous economic growth X, in the Post-World War II years, largely due to its industrial might, competitive exports and Trade Balance Surplus. Through the Plaza Accords and the appreciation of the JPY, the United States achieved its aim at decreasing the trade deficit with Japan. For Japan, however, an appreciated JPY meant the price of Japanese goods



on foreign markets nearly doubled, threatening the Japanese economy, which had been heavily bolstered through its exports. The following years, the Bank of Japan (BoJ) applied loose monetary policy and decreased interest rates "to stimulate the economy, boosting the price of assets, land, and shares. (capital mind) The combination of an appreciated JPY and loose monetary policy led to "increased speculation and a soaring stock market and real estate valuations." For reference, Japanese equity made up "15% of world stock market capitalization in 1980 By 1989 it represented 42% of the global equity markets" (capital mind) Yet, the tremendous growth of equity in the 80s, was not accurate representative the growth in earnings of the leading Japanese companies, and "Japanese share prices increased three times faster than corporate earnings." The Nikkei reached an all time high of 38, 915 index points in December of 1989, however the bubble in asset prices was unsustainable in the long run and the bubble burst in the following months. By September of 1990, the Nikkei was below 30,000 index points, and by August of 1992 below 15,000 points, a dramatic decrease of over 50% in less than 3 years. Japan's economy has yet to fully recover from the asset bubble burst and the Nikkei was only able to reach its 1989 index points in July of 2024, perfectly illustrating the "Lost Decade(s)" and the severity of stagnation of the Japanese Economy.

History of Japanese Monetary Policy: Stagnation, Deflation and Quantitative Easing

The stagnation of the Japanese Economy during the "Lost Decade(s)" and the lack of consumer confidence of the Japanese people, still traumatised the he rapid crash of the Nikkei following the Asset Price Burst, lead Japan to decades of minimal inflation and in many cases instances even deflation. In the last 3 decades, Japan's annual

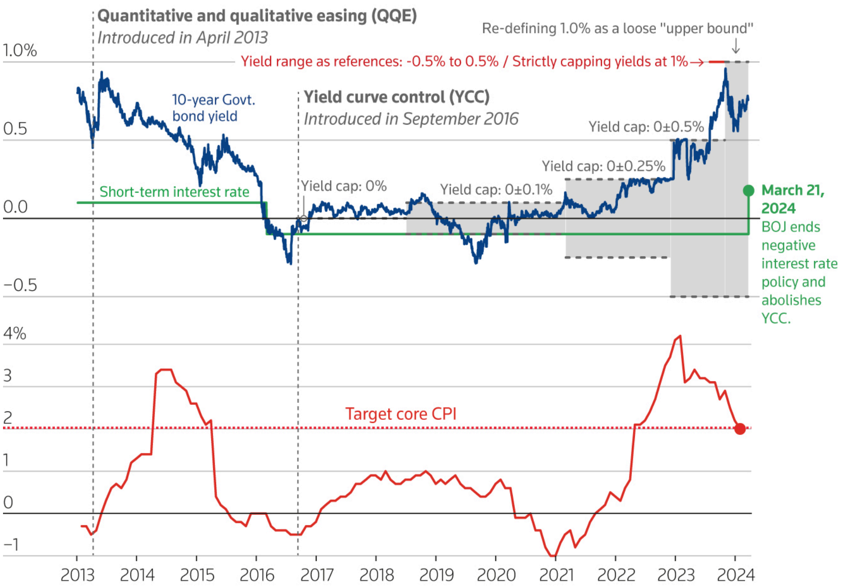


inflation rate has been below the BoJ's target rate of 2% in the vast majority of the years except for 2015, and the most recent years heavily affected by the global increase in inflation due to the Covid-19 pandemic. On the other hand, during many occasions, Japan has faced deflation, notably the period of 1998 - 2003 and a record high deflation rate of 1.33% in 2010. As a response to the unusually low inflation rate, the BoJ has implemented a series of "ultra-loose monetary policy ultra-loose monetary policies for decades in a bid to stoke inflation and growth." (global treasurer). Starting back in 1999, when the BoJ first introduced the "0% interest rate policy" interest rate, short-term interest rates have only been raised on 3 occasions, 2000, 2006, and 2007. However, in 2016, the BoJ implemented the unorthodox policy of having negative interest rates, at -0.1% on short-term loans. Such policy was possible as the BoJ would charge commercial banks for the excess reserves, highly incentivizing commercial banks to lend out money. The unusual policy of negative interest rates was only abandoned in March of 2024. Additionally, the BoJ has implemented an aggressive quantitative easing by purchasing high amounts of government and corporate bonds in an attempt to inject liquidity into the economy. Since 2010, the BoJ has also purchased riskier assets like equity through exchange-tradable funds (ETFs). Yet, despite these policies, inflation constantly remained below the target rate of 2%, until the most recent years.

The recent spike in Japanese inflation can mostly be attributed to 3 main reasons: the rise in global inflation due to Covid-19 also in Japanese markets, rise in wage growth, and change in leadership of the BoJ. Rising wages is likely the most significant cause as " wage negotiations between large companies and unions have resulted in a pay rise of 3.8% this year, the biggest increase since 1993" (Global Treasurer), illustrating a significant increase that certainly also bolstered inflation. Additionally, the new governor of the BoJ, Kazuo Ueda, is a significant factor, as Ueda has "acknowledged the risks of adverse side effects from continued ultra-loose monetary policy." (Global Treasurer) Under Ueda's leadership and due to the rise in inflation in recent years, the BoJ announced in July of this year its first raise in interest rates in 17 years, marking a significant shift in Japanese monetary policy history. The increase in target interest rate from the range of 0-0.1 to 0.25 on short-term loans, might still seem low in comparison to other countries, but for Japan, it is an extremely significant shift in policy that might shape the new path for the Japanese economy moving forward.

BOJ exits ultra-loose monetary policy

The BOJ ended negative interest rates, bringing its decade-long massive stimulus programme to a close. The Bank set the overnight call rate as its new policy rate and will guide it in a range of 0-0.1%.

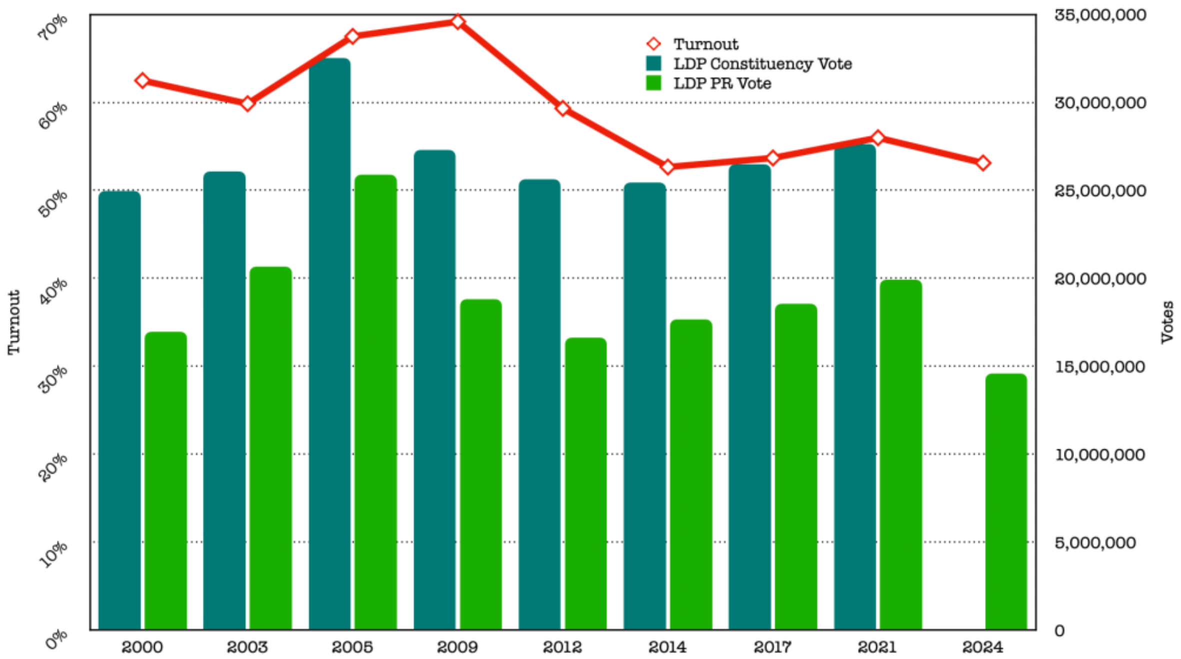


Source: LSEG Datastream

Riddhima Talwani and Pasit Kongkunakornkul • March 19, 2024 | REUTERS

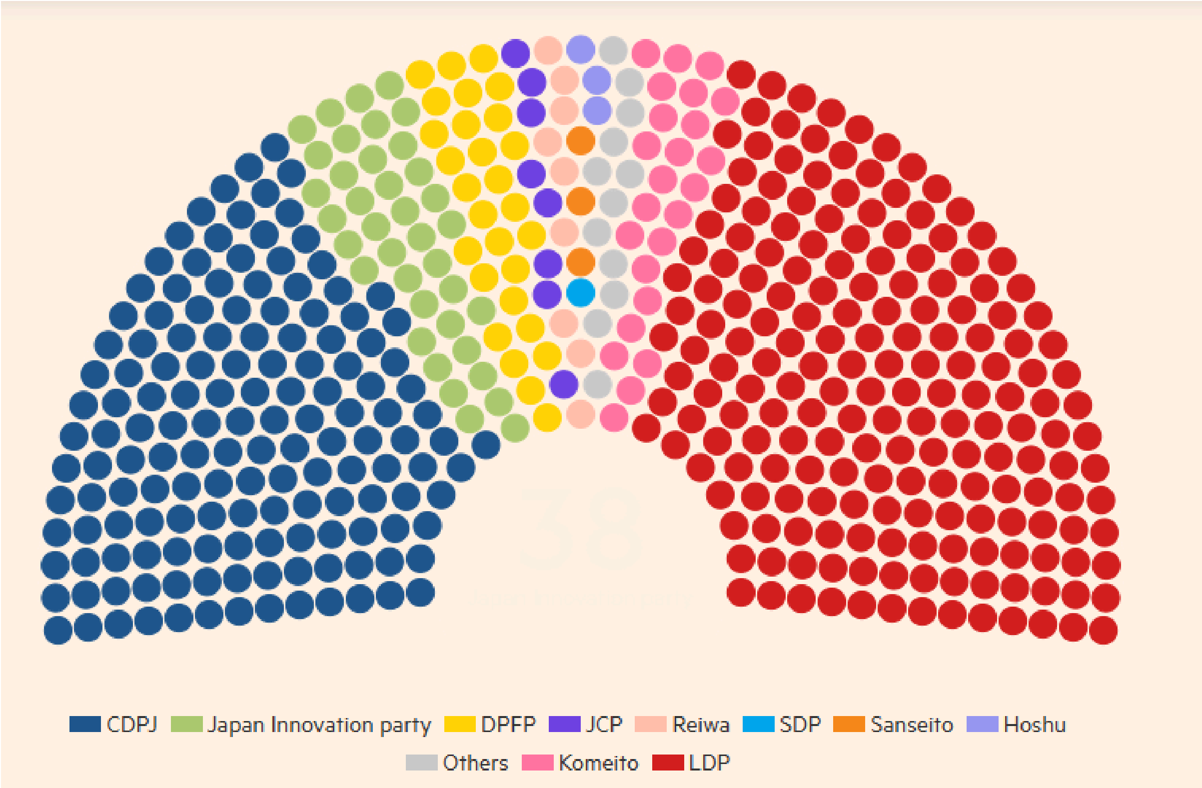
Japan's 2024 Election Tests Kishida's Leadership: Rising Voter Demands and Opposition Gains Signal Shift in Political Landscape

The 2024 Japanese general election, held on October 31, marked a pivotal moment for Japan's political landscape as Prime Minister Fumio Kishida's Liberal Democratic Party (LDP) faced significant challenges in maintaining its position. The LDP, which has dominated Japanese politics for decades, encountered headwinds from a fragmented opposition and increasing public discontent over economic stagnation and social issues. Despite some setbacks, the LDP emerged from the election holding a slim majority, though the results underscored the vulnerabilities within Kishida's administration.



A central issue during the campaign was Japan's ongoing economic challenges, including wage stagnation, rising living costs, and concerns about Japan's aging population. Kishida, known for his moderate stance, had promised to address these issues by revitalising the Japanese economy and implementing policies aimed at distributing wealth more evenly. However, some critics argued that his measures lacked ambition and struggled to resonate with voters seeking more immediate solutions.

In response, opposition parties sought to capitalise on these concerns. The main opposition, the Constitutional Democratic Party (CDP), and other groups like Nippon Ishin (Japan Innovation Party) aimed to differentiate themselves by advocating for more aggressive reforms in healthcare, education, and economic policy. While the opposition did not succeed in displacing the LDP, their gains in seats highlight a growing demand for change, especially among younger voters who are increasingly frustrated with Japan's traditional political structures. In particular, CDP added 50 seats to reach 148 in total, which arguably makes it look like a "proper" opposition party for the first since 2012 – in every prior election, the CDP's sub-100 seat count made it impossible to present as a credible government-in-waiting. Now, only 43 seats behind the LDP's total, the party has the numbers to start building towards its ultimate goal of retaking power in a future election.



This election also featured a notable shift in voter sentiment toward environmental and social policies. Issues such as climate change, nuclear energy, and immigration gained prominence, with some opposition parties proposing bold shifts from Japan's historically conservative policies in these areas. However, the LDP’s cautious stance, reflecting traditionalist views, likely helped retain support among older, rural voters who prioritise stability over rapid reform. The results signal a complicated future for Kishida's government. While the LDP avoided a significant loss of control, the pressure from an energised opposition may push the ruling party to adopt more robust policy changes to address public grievances. The outcome also suggests that Japan may be on the cusp of more substantial political shifts, as younger generations demand reforms that reflect their modern economic and social realities.

This election not only tested Kishida's leadership but also highlighted the evolving priorities within Japanese society. Moving forward, balancing conservative interests with progressive demands will be critical for the LDP's survival and the country's stability in a rapidly changing world.

Conclusion

The 2024 Japanese election marks a turning point for Japan's future, with choices around monetary policy, economic growth, and social reform revealing the nation’s complex challenges. As Japan confronts persistent issues like inflation, wage stagnation, and an ageing population, the election results underscore a rising demand for change, particularly among younger voters seeking a more responsive government. The outcome of the election will guide the BOJ, and it will not only determine Japan's economic stability, but alsosocial resilience by balancing long-standing idealism with progressive ideals.

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