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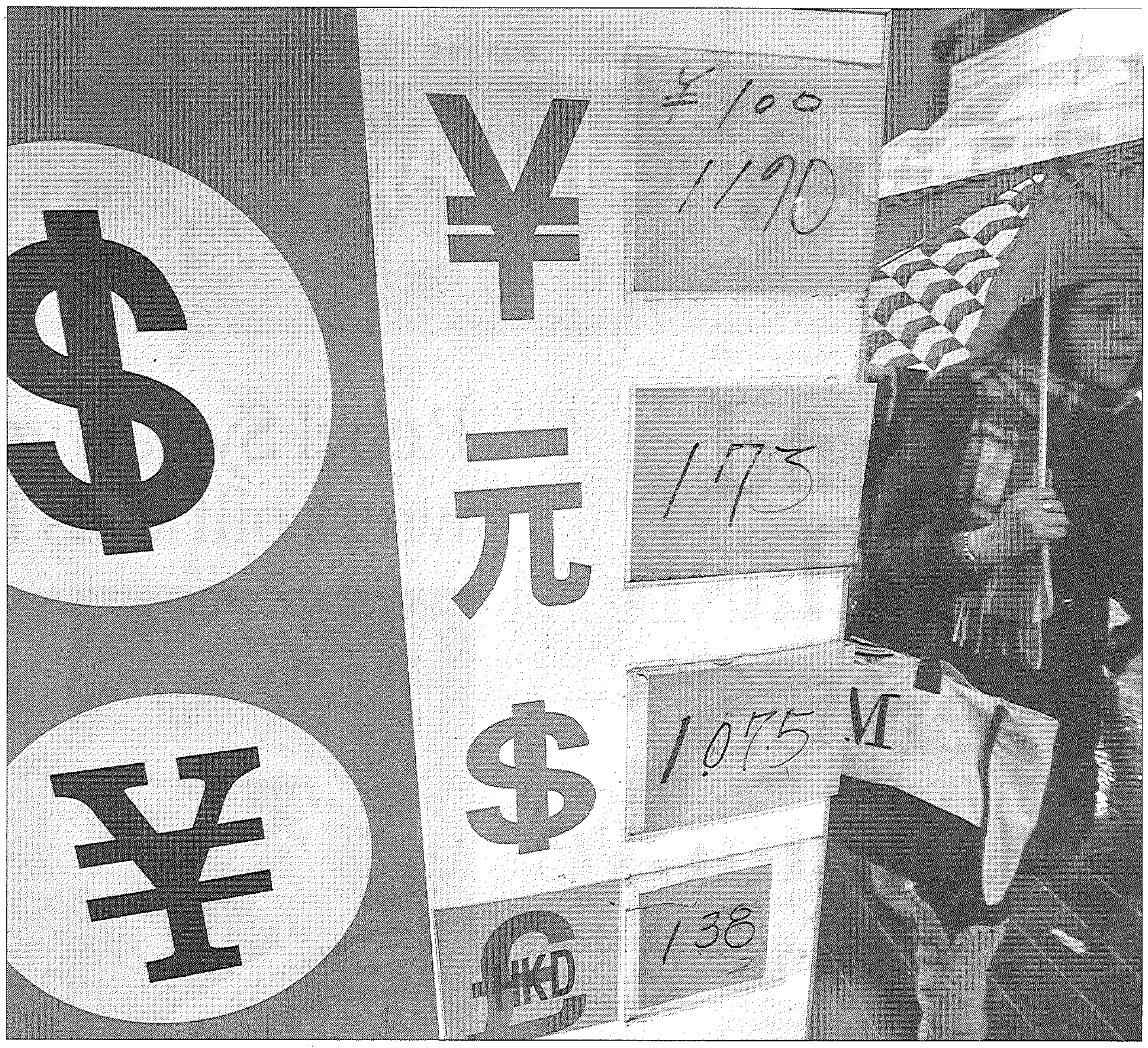
WORLD NEWS

Weaker yen tests Abe's strategy to lift growth



Japanese stimulus

While the currency's fall is helping Tokyo tackle deflation, a trade deficit and weak investment present tough challenges, writes **Ben McLannahan**

So far, so good for "Abenomics". Japan's stock markets are soaring, property is bubbling and consumer confidence is at its highest level for six years. And after months of expectations for aggressive monetary easing, the yen has been bumping up against the key threshold of 100 to the dollar, a level it last reached just over four years ago.

Since mid-November, when it became clear that Shinzo Abe's campaign to reflate the world's third-largest economy would carry him to victory in parliamentary elections, Japan's currency has lost at least one-fifth against every one of the G10 currencies, causing trading partners from South Korea to Russia to mutter about unfair advantages.

But does a much weaker currency really make Japan Inc a more formidable competitor?

Economists are unsure. In the past, the correlation seemed a reliable one: a weaker yen would lift profits at exporters, which would then plough more funds into hiring, higher wages and capital investment.

A general rule of thumb is that a 10 per cent fall in the dollar/yen rate causes Japan's gross domestic product to rise by about 0.3 per cent the following year, says Kiichi Murashima, chief economist at Citi.

Now, though, the backdrop is different. Since the earthquake of March 2011, Japan's trade balance has flipped into deficit after decades of comfortable surpluses, as utilities have scrambled to import fuel to replace lost nuclear capacity.

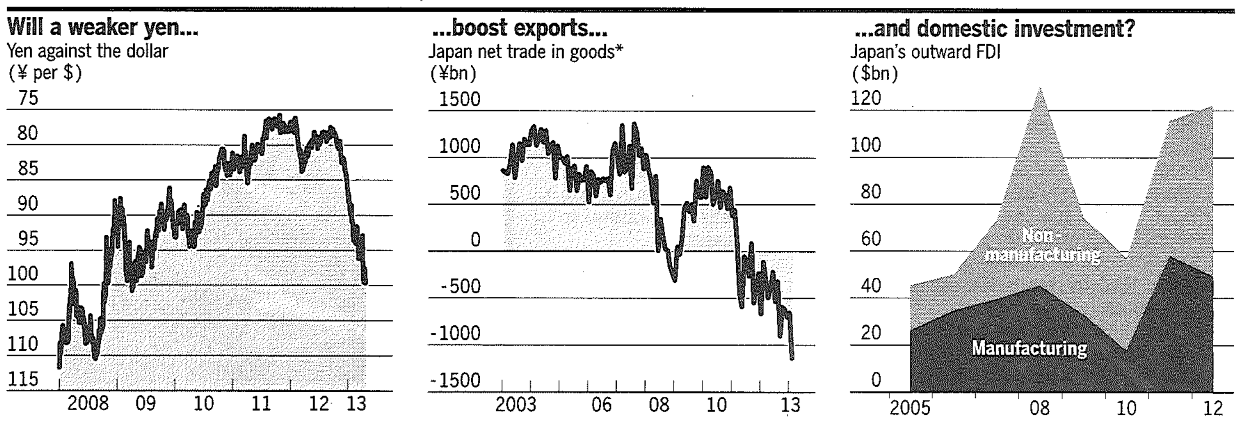
Japan's bill for liquefied natural gas, for example, was Y621bn in March – exactly double the average amount paid in the three months before the earthquake. As a result, households are already paying about 11 per cent more for electricity, on average, than they were two years ago. Any further rises caused by a weaker yen could weigh on consumption, "blunting the boost" to the country's exporters, says Frederic Neumann, co-head of Asian economic research at HSBC.

It is also uncertain whether a lower currency will spur much investment back home. Japanese companies have accelerated the pace of their investments overseas in recent years, as they seek to take advantage of lower costs and stronger demand elsewhere.

Japan's net outward foreign direct investment stood at $122bn in 2012, according to Bank of Japan data, not far off the record high seen in 2008.

More significantly, perhaps, is that investment was once again led by non-manufacturing sectors like mining, retail and communications, where profits tend to be less sensitive to the level of the currency. Such sectors have accounted for about 60 per cent of Japan Inc's outbound investment since the Lehman crisis, from well under half a decade ago.

That trend may be hard to reverse. In a recent survey by the Japan External Trade Organisation, 69 per cent of companies said they wanted to expand operations overseas over the next three years – little changed on the 73 per cent which were eyeing expansion outside Japan a year earlier. Meanwhile, profits generated overseas may stay there. At Shizuoka-based Star Micronics, for example, which sells and produces most of its automatic lathes and wristwatch components outside Japan, just Y2bn ($20m) of a total Y10bn in cash is held at home. Despite much better-looking financial statements as a result of the weaker yen – "we're big fans of Abenomics", says board member Mamoru Sato – investment will stay focused elsewhere.

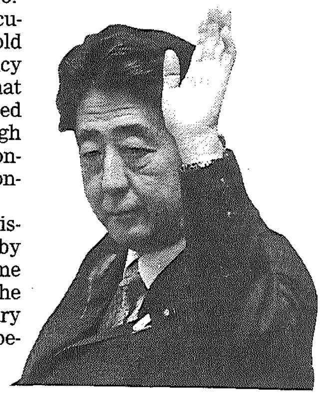


Sources: Thomson Reuters Datastream; Haver Analytics; Jetro

"I don't think stronger export earnings will boost domestic capital investment to the extent they once did," says Tetsuya Inoue, chief financial markets researcher at the Nomura Research Institute in Tokyo.

After all, many analysts and executives note that many of Japan's old problems remain. The strong currency is just one of the "six headwinds" that Japanese companies have grumbled about in recent years, along with high taxes, tight trade, labour and environmental laws, and curbs on energy consumption.

Mr Abe has asked a panel of ministers and business leaders to report by June on the best ways to tackle some of these problems. But so far, after the clean strikes of fiscal and monetary stimulus, this "third arrow" of Abenomics seems "rather poorly focused and articulated", says Masamichi Adachi, senior economist at JPMorgan in Tokyo, referring to the prime minister's growth strategy.



The yen is now at a key threshold of 100 to the dollar, above. Shinzo Abe, right, is preparing further reforms

In that context, many consider the current level of about 100 yen to the dollar to be about right, as Japan attempts to pull off an exit from more than a decade and a half of deflation. For now, they say, such a level looks weak enough to shake Japan out of its funk, but strong enough to prevent import costs really hurting while Mr Abe prepares his reforms.

"It is hard to pinpoint exactly where yen depreciation turns from welcome to unwelcome," says Yasunari Ueno, chief market economist at Mizuho Securities in Tokyo. "But the optimal level is probably around where it is now."

Rising energy costs, www.ft.com/japan

Anger over shrine visit

China has protested against the visits of Japanese cabinet members to the controversial Yasukuni shrine in a widening fallout over the move, **write Kathrin Hille in Shenzhen, Jonathan Soble in Tokyo and Simon Mundy in Seoul.**

Beijing lodged solemn representations to Japan over the visit on Sunday of Taro Aso, finance minister and deputy prime minister, and other Japanese leaders to the shrine, said Hua Chunying, foreign ministry spokeswoman. "Only when Japan faces up to its aggressive past can it embrace the future and develop friendly relations with its Asian neighbours," said Ms Hua. Japanese leaders who were convicted of war crimes following the second world war are honoured alongside fallen soldiers at the memorial.

Earlier, Seoul's foreign minister suspended plans for a trip to Tokyo after the shrine visit. The ministry lamented the decision to visit Yasukuni "even though we have expressed repeated concerns".