



Quarterly Report on the Economic Environment

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GLOBAL ECONOMIC ENVIRONMENT Third quarter 2020

Introduction

The third quarter of 2020 was widely anticipated to be the start of a vigorous recovery for the world economy, albeit perhaps not impervious to bumps, in light of the worst slump ever experienced in peacetime, thanks to the COVID-19 pandemic and the measures adopted to contain it. While July and August even saw the rate of recovery exceed expectations, the second wave of the coronavirus, uncontrolled in several countries, has thrown cold water on the numbers and indeed on the expectations of many economic stakeholders, all while feeding the political debate, which has been there since the onset of the crisis, over the best strategy to minimise the human, social and economic costs.

This Quarterly Report opens with our now familiar general situation summary chart, Economic Climate and Trends, diagnosing the current situation and the outlook for the world economy. Our Ten-Point Analysis opens with a graphic presentation of the comparison of the economic and human costs of the pandemic for the world's principal economies and the restrictions enforced for citizens and different activities as part of the response. Unfortunately, Spain does not occupy a particularly favourable position in this comparison. We proceed with some reflections on some essential aspects of economic performance over recent months, from the changes in macroeconomic policies (including the new structure approved by the Federal Reserve of the United States for monetary policy) to the most important market movements in commodities and currencies including the potentially concerning appreciation of the euro. And not forgetting the debates on the continuation of exceptional support for companies and workers introduced in response to the coronavirus, or the International Monetary Fund's plea to Governments to substantially increase public investment. We also consider the "economic results of Trump" on the eve of a presidential election that could map the global economic future.

Finally, in our Under the Microscope section, we look at the resignation for health reasons of the Japanese Prime Minister Shinzo Abe, and assess the extent to which his famous "Abenomics" have proven successful or not, and the three arrows (monetary, fiscal, structural reform) that were to transform the stagnant Japanese economy. We close this Quarterly Report by considering whether the Japanese experience serves as warning for the economy of the Eurozone. The final chart in this section shows that the similarities are, to say the least, concerning.

Economic Climate and Trends

Determining factors	Current quarter		Previous quarter	
	Status	Trend	Status	Trend
Economic activity		Negative		Positive
Trade and exchange tensions		Neutral		Neutral
Monetary policy		Expansionary		Expansionary
Fiscal policy		Expansionary		Expansionary
Commodities markets		Neutral		Positive
Geopolitical tensions		Negative		Negative

Understanding the Economic Climate and Trends Chart:

a. **Economic climate:** defined for each of the determining factors as of the time of writing using a colour-coded scale from the most negative negative/contractionary level for the performance of the world economy (red), up to the most positive/expansive (blue) in the following order:



b. **Trend:** indicates the projected performance, from the time of writing and in the short term (forthcoming 3-6 months), for each of the determining factors, as either positive/neutral/negative (expansionary/neutral/contractionary in the case of macroeconomic policies)

c. **Determining factors:**

1. Economic activity: assessments based on the latest activity and confidence indicator measurements (World Bank industrial production index; IFO, ZEW, Tankan, Chicago ISM and various PMIs).

2. Trade and exchange tensions: evaluations based on the latest World Bank Merchandise Trade Index and Trade Policy Uncertainty Index measurements (calculated by Economic Policy Uncertainty) accounting for protectionist/free trade-oriented measures offered in the Global Trade Alert, and the measures and statements which could be considered exchange rate manipulation by the major countries in the global economy.

3. Monetary policy: assessments based on the weighted global interest rate of the world's major central banks (accounting for about 77-80% of world GDP), and the movements in the reference rates they set in the six months prior to the publication of the report. Forward guidance implemented by managers of these central banks is also considered.

4. Fiscal policy: assessments based on the fiscal position and the ability to implement expansionary fiscal policies of the world's 40 major economies, with a joint weight of 88% of global GDP between them and individual weight of at least 0.4% of global GDP. Data from the International Monetary Fund's Global Fiscal Monitor database.

5. Commodities markets: assessments based on the latest data from World Bank Commodity Price Data, with five major indices including up to 72 commodities, as well as the events that may significantly alter the behaviour of basic commodity prices in the short term.

6. Geopolitical tensions: assessments based on the latest data from the World Uncertainty Index, (offered by Economic Policy Uncertainty) and events and statements likely to significantly affect the international geopolitical context, potentially significantly affecting the global economy.

Ten-Point Analysis

I. For several weeks, the news on the pace of the economic recovery was manifestly positive. Combined with the practical elimination of the restrictions on productive activity in most countries, plentiful monetary and fiscal support, particularly in the West, and the return of consumer spending both on durable goods, purchases of which had been postponed during lockdown, and local service activities which had been restricted or prohibited. Unfortunately, the end of summer and the fall have seen a second wave of the pandemic, much more severe in the West and Latin America (where it could be argued that the first wave never even reseeded) than in Asia and Africa but which, in any case, brought the return of restriction on everyday activity and production, as well as an uncertainty that threatens to freeze spending again. As the first determinant of our Economic Climate and Trends section reflects, Economic Activity has been decidedly more dynamic in the third quarter than the second, but the early expectations have darkened considerably.

The performance of the different economies and geographic areas, and even different areas within them, diverge notably, something that also happens with the human and social costs of the pandemic and the measures taken in response. So, in this first point of our Ten-Point Analysis, we present a series of graphics that present this aforementioned divergence of results for the G-20 economies, Spain and Sweden.¹ To do so, we used the following indicators:

- Economic: difference between economic growth forecasts for the countries by the OECD in late 2019 and its latest forecast, released in September 2020.²
- Healthcare workers/humans: number of cases and number of deaths (adjusted for population), according to the information offered up to 5 October by Johns Hopkins University³.
- Limitation of activity: average number of daily restrictions (general mobility, economic activity, schools), between early March and late September 2020, following the information provided by Oxford University⁴.

Please bear in mind that the graphics presented below constitute a summary of the information available for the principal world economies in the categories mentioned, and do not include at this time any assessment of alternative explanations that may be found for such ostensible differences in results.⁵ These include those of an economic nature (productive structure of the country, flexibility of the economy to respond to shocks of his magnitude, speed and eligibility of public assistance offered, etc.), those pertaining to the quality of the response to the pandemic (speed in adopting measures, intensity thereof, continuation of decisions over time, coordination with implementing administrations, etc.) and those of social/psychological nature (type of leadership of the leaders of each country, citizen acceptance of restrictions imposed, social customs, demographic structure, etc.). The debate will be endless and likely very difficult to resolve unequivocally for all the literature written on the subject.

In any case, there can be doubt that those positioned towards the north-east of Graphs 1-3 are in the poorest position and this is where we find Spain.

Figure 1. Economic and health impact of the pandemic. G-20 countries plus Spain and Sweden.

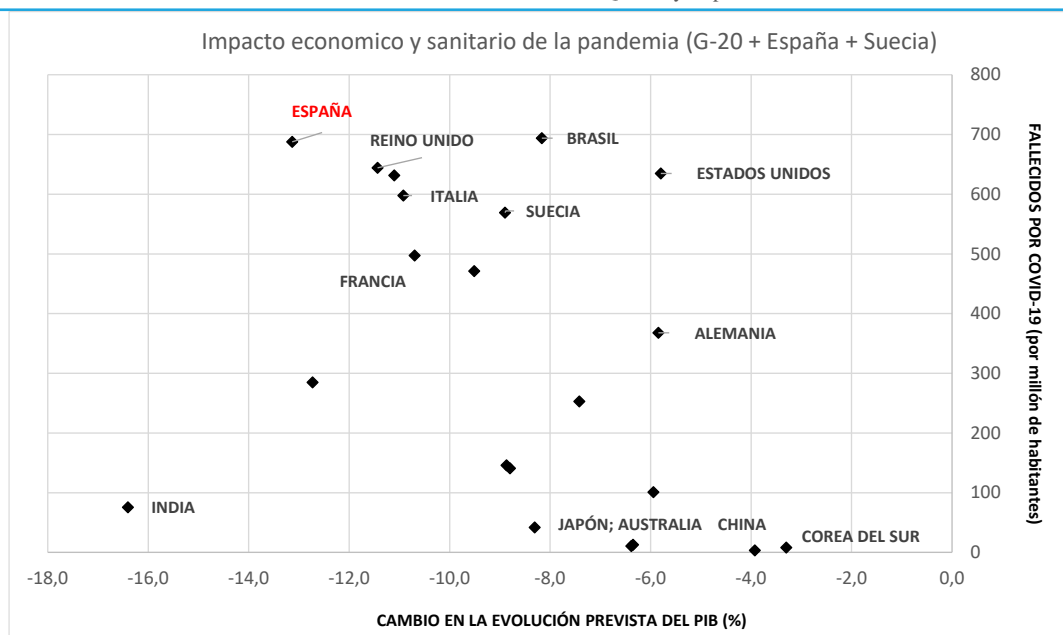
¹Sweden is included in the analysis because of the different strategy adopted by the Government there in response to the pandemic.

²In the cases of Spain and Sweden, not included in this most recent OECD forecast, the closest forecasts from their respective Central Banks are used.

³See the complete information offered by the *Coronavirus Research Center* at this US university at <https://coronavirus.jhu.edu/>

⁴You can see the excellent work carried out by Oxford in monitoring the activity of governments through the *Oxford COVID-19 Government Response Tracker* at <https://www.bsg.ox.ac.uk/research/research-projects/coronavirus-government-response-tracker>.

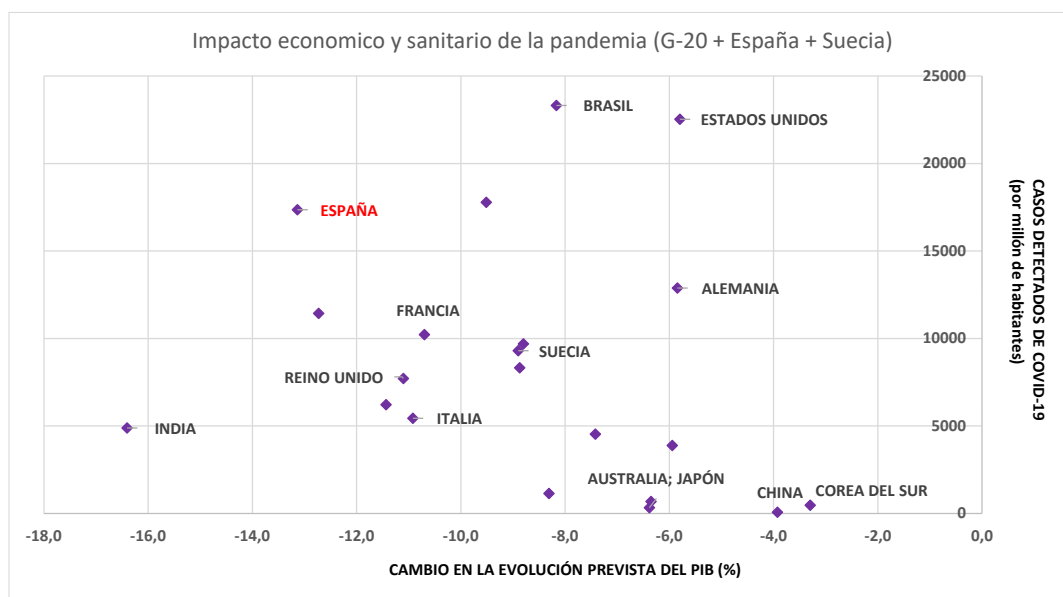
⁵See Chapter 2 of the October World Economic Outlook (<https://www.imf.org/en/Publications/WEO/Issues/2020/09/30/world-economic-outlook-october-2020>) for an attempt to assess that factors that might influence these manifest differences. Note the abundant bibliography provided at the end of the chapter with academic articles tackling these questions, many of them it should be feared, somewhat hastily given the time stage of the pandemic and the limitations and provisional nature of the data.



Source: author's own. Data: OECD; Johns Hopkins University.

Note: See the main text for a description of the variables included in the graph.

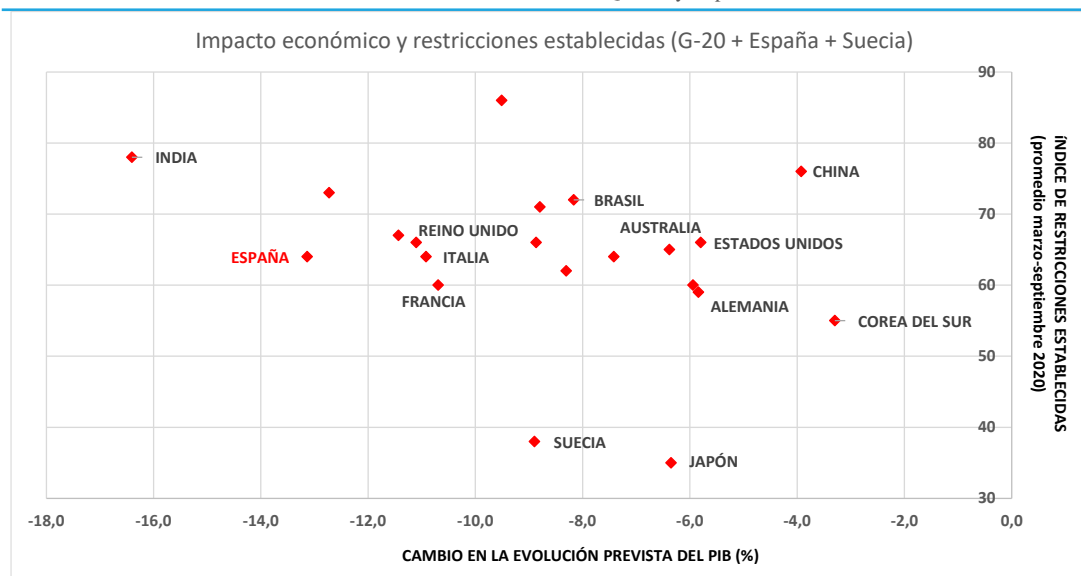
Graph 2. Economic and health impact of the pandemic. G-20 countries plus Spain and Sweden.



Source: author's own. Data: OECD; Johns Hopkins University.

Note: See the main text for a description of the variables included in the graph.

Figure 3. Economic impact and restrictions established. G-20 countries plus Spain and Sweden.



Source: author's own. Data: OECD, Oxford University.

Note: See the main text for a description of the variables included in the graph.

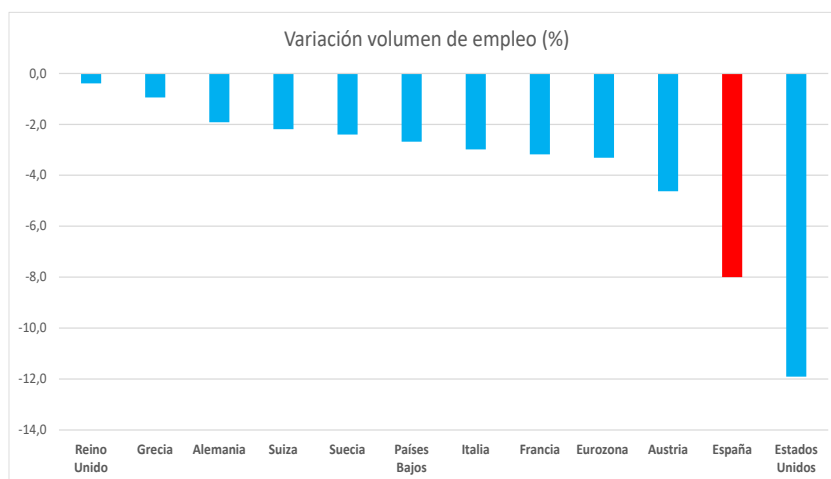
Aside from the poor results obtained in the Spanish case, there are a number of conclusions to be drawn from these three graphs that are worth highlighting. Bear in mind this is not intended as an exhaustive list. Firstly, the combination of economic and health results in Asian countries (we may include Australia here but should leave India out) is clearly better than in the rest of the world. Perhaps that explains the most significant conclusion of the IMF study (see Footnote 5) indicating that intense and early restrictions lead to better macroeconomic results. Because, on the contrary, and this would be the second conclusion to be drawn from the above graphs (in particular Figure 3), there does appear to be a trade-off between the average volume of restrictions and the economic impact of the pandemic; that is, the greater the number of restrictions, the sharper the decline in GDP. Thirdly, returning to graphs 1 and 2, and although for the cases of the United States and Brazil it may be suggested that a certain sacrifice has been made in the interest of a lesser economic impact, the group of 22 countries analysed shows a positive correlation between the economic slump and a higher number of deaths (or cases), when corrected for the size of the population. Fourthly, the results for Germany are slightly better across the three dimensions (economic health, restrictions) than for the other four big European countries and, as has been noted, Spain's are significantly worse. Finally, it is notable that the average number of restrictions on citizen activity and companies has tended to coalesce over time (with the exception of Japan and especially, a radically different response in Sweden); therefore, the major difference in the consequences of the pandemic must be sought in the opportunity, application and stability of the measures (rather than number) or other factors noted above pertaining to other dimensions.

II. Over time, it becomes increasingly imperative to precisely adjust the dimension and objectives of public supports in response to the crisis so that it sustains an activity and employment with a future. There is also a growing need, however, to ensure that the investment of resources in sectors, companies, jobs and projects that are not viable is not prolonged excessively. Certainly, in the very short term, the data are sufficiently alarming for most analysts and institutions to commit to the continuation of supports. The International Labour Organization has estimated the loss of labour activity between the last quarter of 2019 and the second quarter of 2020, the culmination of the crisis in economic terms, at 495 full time jobs (over one sixth of the total in the world). As Figure 4 reveals, for the principal European countries and the United States, these reductions in employment (regardless of the fact that, in most cases, those affected receive subsidies to compensate for loss of income) vary greatly, and again it's not a comparison that is favourable to Spain.

Nevertheless, as the situation improved, it will be crucial to move from a "Keynesian moment", in which the priority is the continuation of activity not only as a way of mitigating the crisis but to avoid loss of business projects (and therefore jobs) with a future, as unfortunately has happened, for example, in southern Europe during the recent Great Recession, to what some experts refer to as a "Schumpeterian moment". That means it will be necessary to end subsidies for business without a viable future (those increasingly referred to as "zombie companies").

Figure 4. Evolution of employment since 2019: Q4 and 2020 Q2 (% of variation of total employment).

Selected economies.



Source: author's own. Data: OECD.

The costs of this artificial continuity are significant. Firstly, it limits the entry of new companies, generally more productive and innovative (in other words, it makes it difficult for them to gain a foothold in the market). Secondly, it leads to the loss of confidence in the economy; on the one hand, with respect to the quality of bank credit, damaging the financial system and on the other hand, the other companies, which will suffer growing losses when the “zombie” companies are unable to meet their commitments.

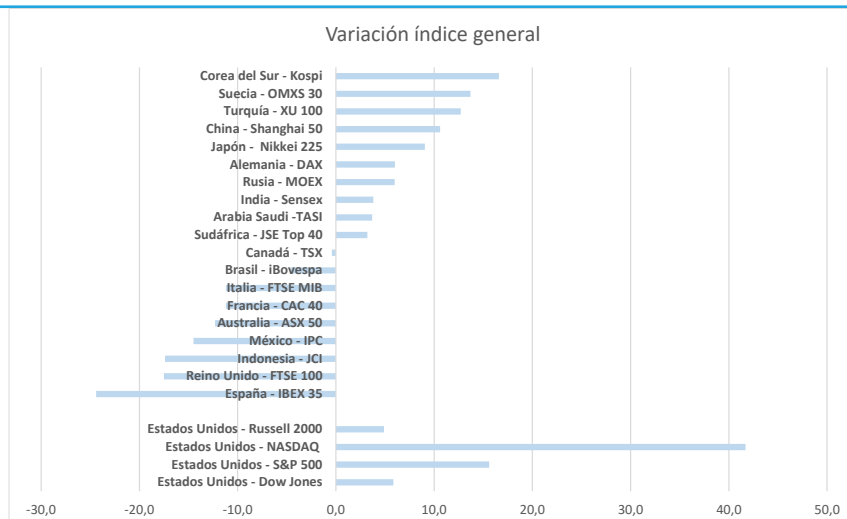
Of course, ceasing to sustain these companies will result in job losses that, in some countries, can be considerable. Shifting the approach from the protection of employment to the protection of the worker (with effective requalification programmes and incentives to move to other sectors with better prospects) must be paired with this more discerning approach to the granting of subsidies.

III. Over recent weeks, there has been a growing number of comments on the apparent decoupling of the stock markets, with significant upward movements, and the concerning performance of the global economy. The progress in the general indices in the month of August when the global MSCI World Index for developed countries had its best performance since 1986 (+6.6%) and the All Country World Index recorded its biggest jump since 1988 (+6.3%). The fact that these data overlapped with the biggest slumps in economic activity ever recorded in peacetime (those for the second semester of the year) sowed seeds of doubt regarding such disparity and the possible implications. Of course, the first, explanation was that “once again”, massive Central Bank interventions were doing more for Wall Street than Main Street; protecting the financial world over the real economy. Beyond the fact that neither one or the other would have survived the pandemic without substantial damage in the absence of these monetary measures, it is worth adding that some explanatory notes on the divergence between market data and economic growth.

Firstly, as revealed in Figure 5, the performances of the principal international stock market indices have varied greatly in 2020 so far. The correlation between the impact of the pandemic on economic growth and the evolution of these indices is positive and significant (+0.39), especially for developed countries (+0.79). Reality and the Markets therefore, don't seem so out of step. We mustn't forget that the markets have to anticipate the outlook of companies, not look to the immediate past, and it seems evident that the best records are in economies that, at least in the forecasts, will be least punished by the crisis.

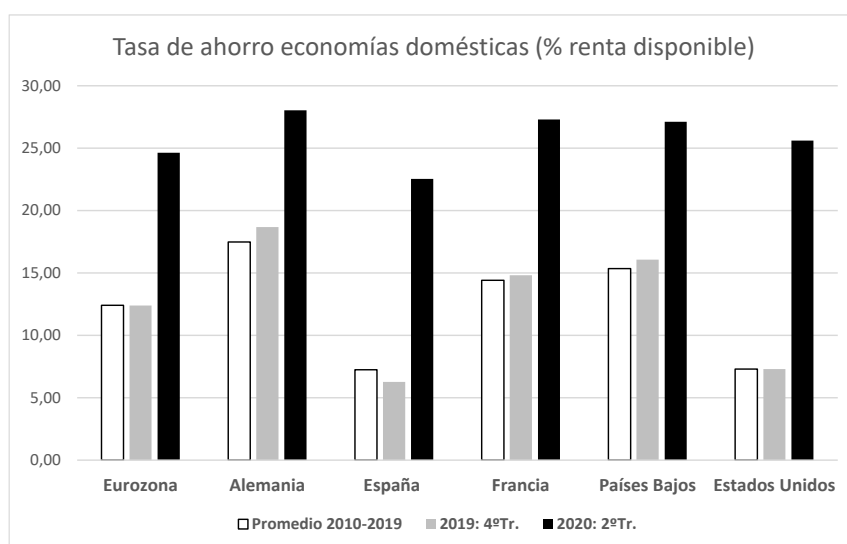
It is also evident that most sectors, especially manufacturing, have been capable of re-establishing their production and distribution cycles at an impressive pace, and are now waiting (and indeed already began to benefit from, at least before the second wave of the virus) pent-up demand among consumers. If savings rates are an indication of the potential magnitude of this postponed consumption (see Figure 6), there are grounds for optimism, at least if we are advancing towards a normalisation of the health situation.

Figure 5. Evolution of international stock market indices. January 2020-early October 2020 (% variation)



Source: author's own. Data: International stock markets.

Figure 6. Rate of saving of domestic economies (% of available income)



Source: author's own. Data: BIS; FRED II.

On the other hand, if we focus our attention on US markets, the spectacular growth of the NASDAQ (42% in the first nine months of the year) contrasts starkly (see the lower part of Figure 5) with more modest improvement for the rest of the main indicators, in which the technology sector weighs less heavily, or which account for a larger number of companies, including medium-sized enterprises (the Russell 2000 Index, for example, rose just 4.9% for the same three quarters). Prices therefore seem to be recognising the advantages of the new economy, with a boosting of digital and remote activity, for the big technology companies that, together with Amazon, have cornered much of the earnings in 2020 so far. That perhaps these share price rises have exaggerated or anticipated those profits to excess is an open debate.

IV. Perhaps the most structurally impactful event of recent months was the Federal Reserve's modification of the monetary policy framework.⁶ Although a detailed analysis of this (and the implications of the new expansive turn in monetary policy, which is what this review really constitutes) is worthy of a more detailed exploration in a future Under the Microscope section, there are a few points to be made in the respect here.⁷

Conceptually, the Federal Reserve has changed its Flexible Inflation Target, in essence achieving inflation of no more than 2% in the medium term, compatible with price stability, for a Flexible Average Inflation Target. The subtle

⁶ The framework governing the monetary policy of the European Central Bank is also under review.

⁷ Although there are many texts dedicated to assessing this change of strategy, interested readers should read the presentation by the Vice-Chairman of the Fed, Richard Clarida, to the Peterson Institute for International Economics (accessible at <https://www.federalreserve.gov/newsevents/speech/clarida20200831a.htm>).

nuance of incorporating the word Average has significant implications, because it means that periods of annual inflation below 2% (the most common since the Great Recession) must follow not periods of inflation of around 2%, as previously the case, but periods of annual inflation of *above* 2%. In practice, this new approach is closer to Price Level Targeting, whereby deviations from an annual rate of 2% below the growth path should be corrected by deviations in the other direction. It is possible that for the Fed, Flexible Average inflation Target has two advantages over Price Level Targeting; firstly, it confers greater flexibility on the correction of deviations; secondly, it avoids changing the main nucleus of the objective (inflation level of prices), which, in these times of transparency and the value of good communication) might not be superfluous.

Another two elements of the new framework should be underlined. Firstly, there is increase in weight of full employment in the Fed's strategy. While it was already, along with price stability, part of the objective of the Federal Reserve⁸, crucially, the idea that the Fed would respond to deviations in the rate of employment with respect to its estimate of full employment for the concept of the response only in the case of deficits (shortfalls) in employment with respect to this estimate for full employment is amended. The Fed will no longer act (in the absence of inflationary pressure) when the rate of employment rises slightly above (estimated) full employment. Strengthening this substantial aspect, and although it may prove anecdotal, in the new strategy the full employment objective in the drafting *ahead of*, and not *behind*, the price stability objective.

The other aspect we highlight in this general approach to the change made by the Federal Reserve is that this strategy is defined as *symmetric monetary policy*. Two notes on this. Firstly, although the relative change in the inflation target effectively constitutes an effort towards a more symmetric approach to inflation, the maximum employment target is exactly the opposite; it eliminates the existing symmetry of the previous strategy. Secondly, if there is one thing that has, at least in the opinion of a good number of experts and market analysts, characterised the Federal Reserve over recent decades, it is an asymmetry in the opposite direction to that it intends to take with this change of strategy. This is to say that the Fed has been energetic in reacting quickly to reduce interest rates when the situation has called for it (or even not so much) and more cautious and timid when what's required is a tightening of monetary policy. The concept of the *Greenspan put*⁹ regarding the alacrity of the Fed when it comes to relaxing monetary conditions, does not come out of a vacuum.

So, what are the foreseeable implications of the new strategy of the Federal Reserve? An ostensibly greater demand to, firstly, initiate, and later develop, the normalisation of monetary policy. With excessive inflation (and that should be considerably higher than 2% for a prolonged period to be considered such) the only element that could bring about a tightening of monetary policy (unemployment, as low as it goes, no longer warrants this) and the forces of globalisation stymieing the slightest growth in the prices of goods and services (which, by the way, continue to be ignored in the Fed's review of objectives), we can very expect a lower for longer dynamic. That is to say, we can expect minimal rates and quantitative easing¹⁰ for years to come. The market forecast is for reference interest rates to remain at essentially zero until 2023.

Some see this as a low forever strategy, whereby rates even moderately north of zero just won't be seen in the future.

And some of us, a minority (for now) believe that these changes will end up leading to rates remaining too low too long, once again.¹¹

V. Along the same line as its recommendations over recent months, the International Monetary Fund used the analytical chapter of its recent Fiscal Monitor to impress upon governments the need to increase public investment not only as a response mechanism to the current crisis caused by the pandemic but as the best way to transform their economies and boost future economic growth.¹² The IMF claims that an increase in public investment of 1% as a

⁸While in general reference is made to a dual objective (price stability and full employment) the statutes of the Federal Reserve of the United States also refer (and this has not been changed in this review) to the need to “maintain moderate interest rates over the long term”. Usually, this third part is omitted, either because it is much vaguer than the first two, or because, at least in recent years, it takes some effort to accept the notion that current interest rates of close to zero could be defined as “moderate”.

⁹To which some, albeit fewer, analysts added the *Bernanke put*, in reference to Ben Bernanke, successor of Alan Greenspan as Chair of the Federal Reserve.

¹⁰Quantitative easing, that is, the acquisition of assets is understood as part of the convention instruments of action of the Federal Reserve at the root of this strategy review. Another element is the expansive turn in this regard.

¹¹Interest rates that are too low for too long constitute, for some analysts, the author of these Quarterly Reports included, one of the reasons behind the Great Recession.

¹²The cited text can be read here: <https://www.imf.org/en/Publications/FM/Issues/2020/09/30/october-2020-fiscal-monitor>.

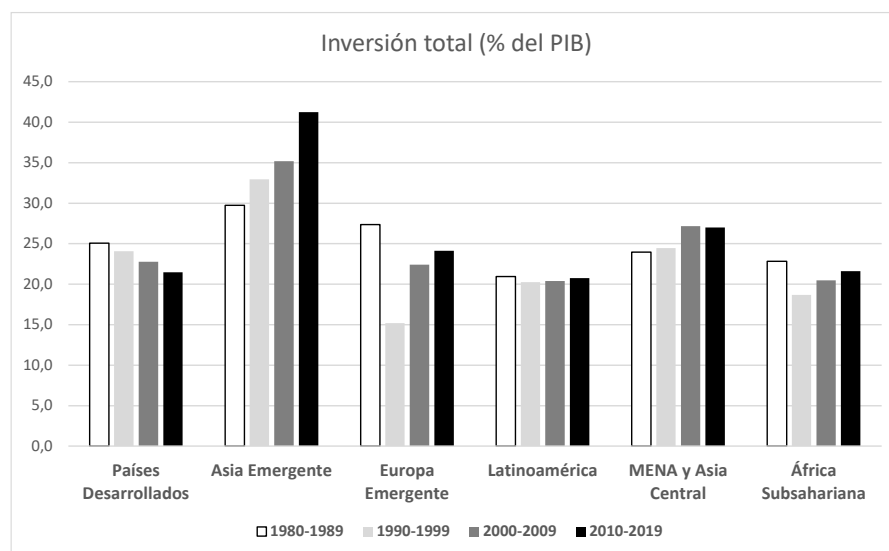
percentage of GDP would increase production levels by 2% after 2 years (the moment of the highest multiplier effect) and would allow for the creation of between 20 and 33 million indirect jobs, which would be welcome when the true cost of the pandemic in employment terms (once the protecting schemes sustaining barely viable companies and jobs come to an end) manifests itself.

The IMF definitively identifies three lines of investment in the search for an authentic structural transformation: infrastructure (not only the construction of new elements but, very especially, the maintenance of a significant portion of existing infrastructures in much of the West that is evidently deficient); digitalisation, especially for citizens and companies and in particular SMEs; and green transformation, essential beyond the economic sphere. These priorities coincide with those of the Recovery Plan for Europe (“Next Generation EU”) or the French Plan to boost European financing, with 100 billion euros, which also includes substantial fiscal discounts for companies. The German plan, while not ignoring the same objectives, is skewed more towards consumption.¹³

The timeliness of these IMF recommendations is notable from a general perspective. Firstly, due to the severity of the crisis brought on by COVID-19 and secondly, due to the negligible cost of financing public debt, especially in developed countries, even over longer terms. Thirdly, because there is scant risk to squeezing private investment, given its weakening in an environment of great uncertainty, even before the pandemic and discussed here since these Quarterly Reports were first published a year and a half ago now.

However, the following graphs also demonstrate that the need to grow investment (public investment has its own value and also to incentivise private investment) is a structural one. Figure 7 shows that, except in Emerging Asia, where rates are not only high but growing, investment as a percentage of GDP has been falling systematically over recent decades (West), or remained stagnant at clearly insufficient for the development of the respective economic spaces (Latin America, Africa, Middle East and North Africa).

Figure 7. Total investment rates (% of GDP)



Source: author's own. Data: IMF.

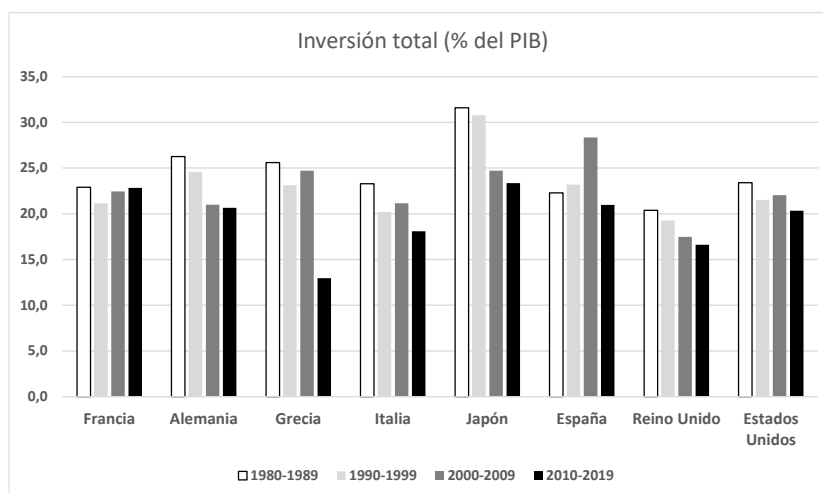
Figure 8, on the other hand, reveals the decline in investment in much of the West, from Japan to Germany to the United States over the last 40 years.¹⁴ In some cases (Greece, Italy, the United Kingdom), current levels are wholly insufficient and the downward trend reinforced by the consequences of the last Great Recession for the public finances and private expectation.

It is, without doubt, time for extensive international expansion productive investment programmes in the areas outlined by the IMF and the European recovery plan, and even if only for the current low rates of investment, and the easy of availability of cheap credit, the West must lead this global effort.

Graph 8. Total investment rates (% of GDP)

¹³ The Spanish Government's plan, while already outline, seems to rely almost entirely on European funds, and it now appears that the roll-out of these to the Member States might, mistakenly and unfortunately, be significantly delayed.

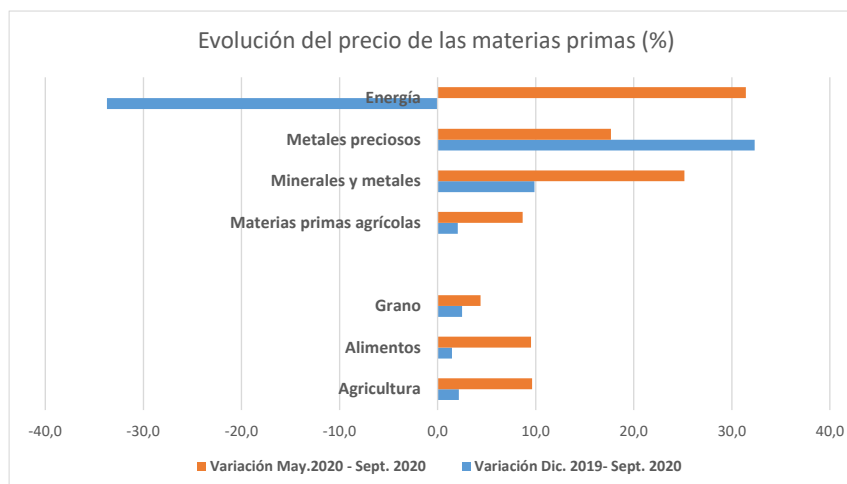
¹⁴ The boom witnessed in Spain in the 2000s, of course, was not due to growth in useful investment to structurally transform the economy but large-scale construction of housing.



Source: author's own. Data: IMF.

VI. In our Ten-Point Analyses we usually take some time to analyse the performance of the principal commodities markets. In general, these retain their expectations of consolidation of recovery (or not), in light of prices rebounding (particularly in the case of energy) from the minimums brought on by the pandemic. Mostly (but not in the energy component), as shown in Figure 9, prices have recovered or indeed exceeded the levels late last year, which were not exactly buoyant given the uncertainty around even then in relation to global economic growth.

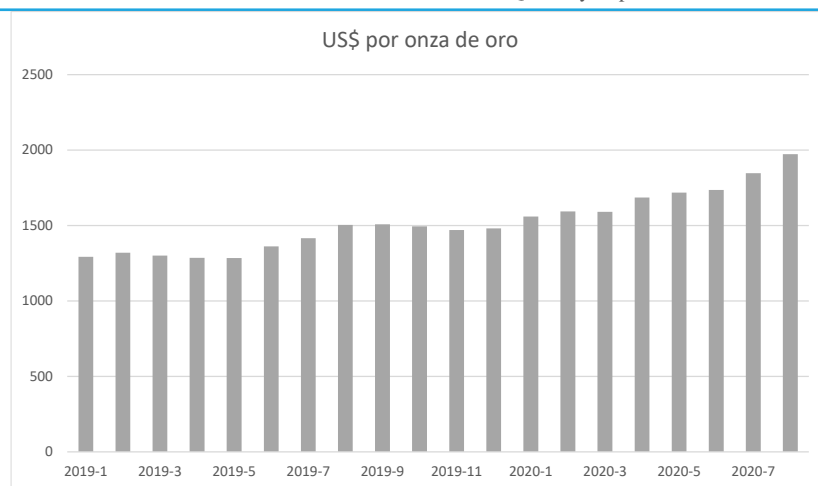
Figure 9. Evolution of raw materials (%) Selected groups



Source: author's own. Data: World Bank.

But recent months have seen two types of commodities draw attention for their upward price trajectory.

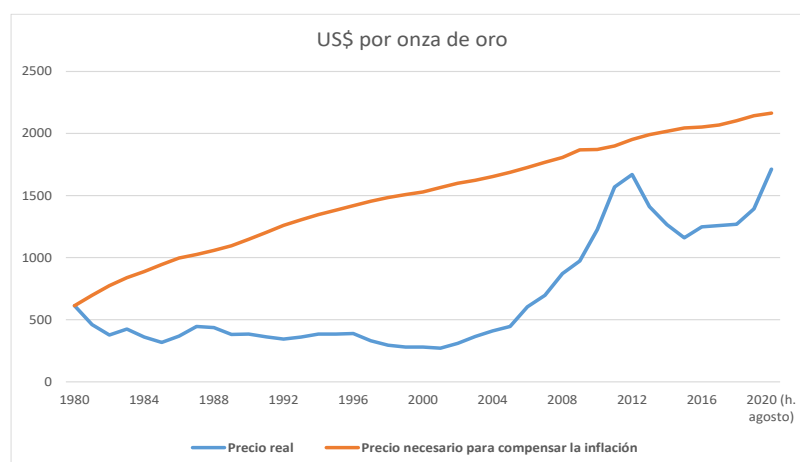
Figure 10. Evolution of the price of gold (US\$ per troy ounce)



Source: author's own. Data: World Bank.

First, gold, which reached an historic maximum in September 2020 with a revaluation of one third from the start of the year and up 24% from the start of the pandemic (see Figure 10). The current capacity of this precious metal to serve as a refuge from both inflation (by not depreciating like currencies) and deflation (with the status of a real asset) mean that its value soars in times of uncertainty. Although few things arouse such passionate debates as passionate in the sphere of commodities, for a metal lacking any significant industrial utility (like, say, platinum), that provides no real profitability and which requires major storage costs is dubious to say the least. The observation of the price of gold over the long-term (Figure 11) removes any doubt: gold is a terrible safe haven asset, with price growth incapable of covering that of the set of goods and services in the economy. In any case, for those capable of taking advantage of the opportunities gold generates in the short term, it is a highly relevant asset. For those more interested in the performance of the global economy, peaks in prices such as those observed recently only serve to demonstrate that uncertainty is at a high.

Figure 11. Price of gold over the long term:
real evolution against the price needed to compensate for inflation (US\$ per troy ounce)



Source: author's own. Data: World Bank; IMF.

Note: inflation rate used is that of developed countries.

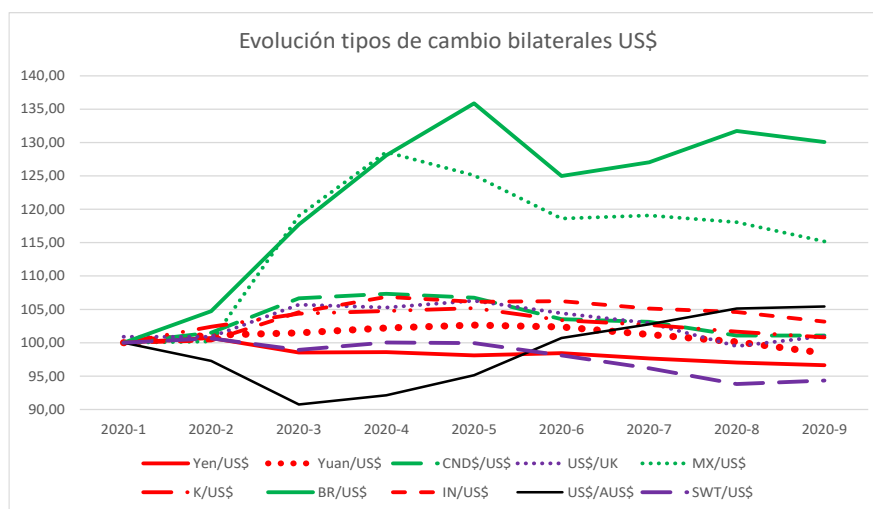
More interesting is the emergence of certain bouts of inflation linked to foods, given the relevance of food from a social and human perspective, constituting an important component of the general price indexes, especially in developed countries. These tensions are striking when, as a result of the restrictions established in many countries in response to the pandemic, demand in the hospitality sector fell dramatically.

Returning to Figure 10, we can observe that, in effect, the past four months have seen the price of agricultural raw materials in general, and food in particular, rise by 10% overall. However, from a somewhat broader perspective, for 2020 as a whole that figure fell by 2%. It would appear to be too soon to worry then. Nevertheless, practices like restrictions on exports, accumulation of inventory or uncollected harvests, which have been seen in different countries

in recent months, could complicate the situation. Given the experience of the last global crisis, when, during the Great Recession, dozens of developing and emerging economies experienced supply difficulties leading to social altercations due to the difficulty or impossibility of covering basic food needs, it would be desirable that such events were not to be repeated.

VII. Turning to currencies, it's the euro-US dollar pair that has aroused the most interest this past quarter.

Figure 12. Bilateral exchange rates against the \$US (2020:1 = 100)



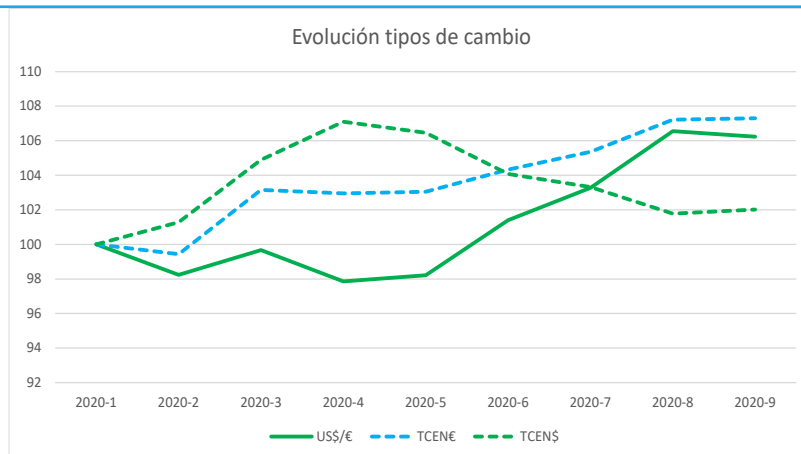
Source: author's own. Data: FRED II.

In the last two Quarterly Reports, we referred to the concern, especially in emerging countries heavily indebted in the US dollar, regarding the notable appreciation of the dollar (see Figure 12 for the evolution of the principal international currencies). As ever in times of grave crisis and even greater uncertainty, the rush for the dollar as a safe haven leads to the considerable strengthening thereof, halted only by an injection of dollars on the part of the Federal Reserve, including currency swaps with multiple Central Banks to make dollars available to financial institutions and non-financial companies in other countries. Only other safe-haven currencies (the yen and the Swiss Franc) and the renminbi, under the control of the Chinese Central Bank, avoided depreciation against the US dollar, which also affected the euro (see Figure 13) during the first weeks of the pandemic.

Once the acute phase of the crisis was overcome, we saw a clear reversal, which can be observed for all currencies in Figure 12 (although, for example, the Mexican peso and Brazilian real are not far off parity with start of the year) and, more starkly, in Figure 13, where we see the Nominal Effective Exchange Rate of the dollar,¹⁵ which appreciated strongly during the Spring, has depreciated over recent months. So, what's so special about the euro-dollar pair? As Figure 13 shows, the euro is the only globally important currency that has risen in respect of the dollar so far in 2020. Furthermore, this strengthening of the euro against its partner currencies overall stands at 7% up to September.

Figure 13. Evolution of the bilateral US\$-euro exchange rate and the Nominal Effective Exchange Rate (2020:1 = 100)

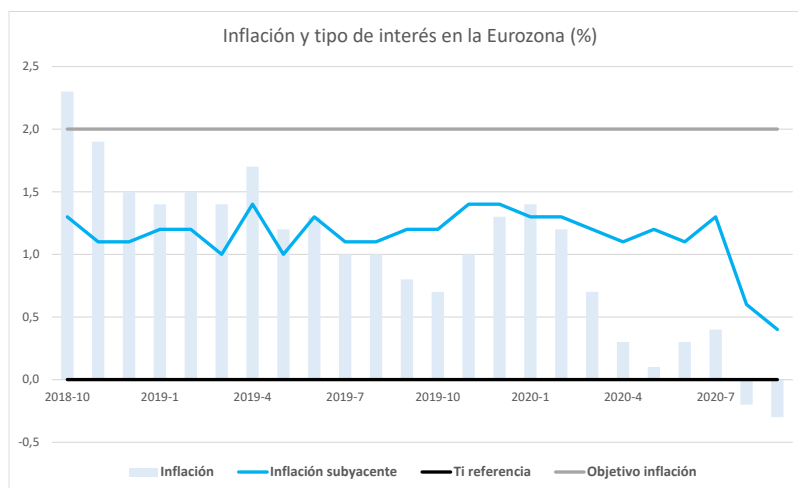
¹⁵ The Nominal Effective Exchange Rate (NEER) of a currency reflects its trajectory against all the trading partners of the country in question, weighting each trading partner of the country, in this case the United States.



Source: author's own. Data: FRED II; BIS.

The optimistic view is that the strengthening of the European currency responds to the European Recovery Plan, well received among operators and analysts, which would place European economies in general, and Eurozone economies in particular, on the road to more dynamic growth, better oriented and structurally more solid. It basically requires one to be optimistic that the funds committed are sufficient, all the more so given the delay in putting those funds on ground for such an ambitious target. The truth, however, is that there are two considerable problems with this appreciation of the euro, which, moreover, brings us back to the hardest moments of the Great Recession. Firstly, it penalises European exports, converted (excessively so in fact) into an essential source of the recovery for the continent after the last crisis. The second problem is that the stronger euro will intensify deflationary pressure (cheaper imports) in the Eurozone, where the rate of inflation has been far off the ECB target for two years (the target being close to, but under, 2%), as reflected in Figure 14 with the latest readings of negative inter-annual rates and underlying inflation¹⁶ falling towards zero. We must remember that all this coincides with unprecedented monetary expansion on the part of the ECB which, although it has reported other benefits, has not been able to bring about a spike in inflation of goods and services, much less with the depressive impact of the pandemic on energy prices and private demand.

Figure 14. General and underlying inflation and reference interest rates in the Eurozone (%)



Source: author's own. Data: ECB.

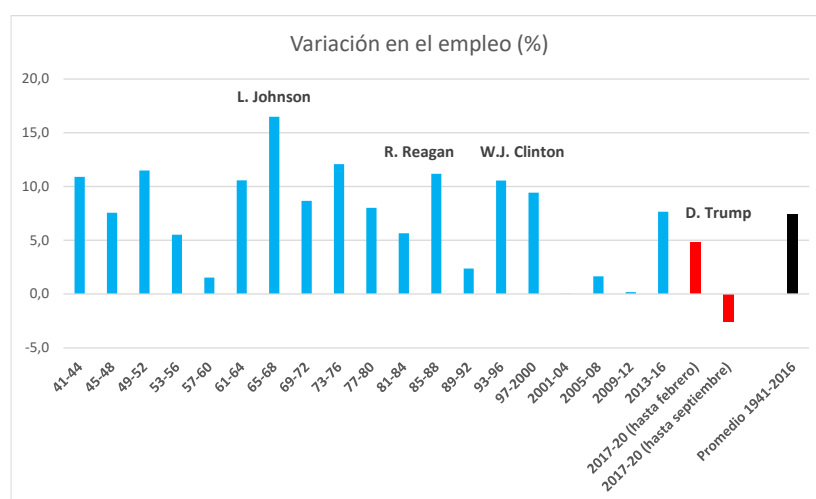
Acknowledgement of these two risks linked to the appreciation of the euro led the ECB President, Cristine Lagarde, to hold a verbal intervention (described as “mild” by analysts), concerned with the euro surge and how it might affect the Eurozone recovery. Although the euro is a currency that floats freely on the markets, it is very difficult to unify the stances of the 19 members as to what constitutes a strong currency and its benefits and drawbacks, and that this is not a good moment, in the context of a global crisis, to even subtly initiate a “currency war”. The prospect that the European monetary authority might find more energetic formulas to reverse the trend of appreciation of the euro should not be

¹⁶Underlying inflation is that which excludes the energy component and non-prepared foods from the general index of goods and services.

ruled out.¹⁷ Ultimately, the current deflation is as far removed from the objective of European monetary policy as inflation significantly in excess of 2% would be.

VIII. This Quarterly Report was drafted some twenty days before the US presidential election on 3 November. It's possible that we might assess the four-year presidency of Donald Trump in the future, especially if, as looks increasingly likely, he turns out to be a one-term president.¹⁸ But, at least for this pre-election Ten-Point Analysis, we can offer some data on two oft mentioned aspects of the performance of the Trump Administration. The first because it is the key variable to assess any presidency: How has employment fared over these four years? Despite the proclamations of Donald Trump on the incomparable greatness of economic growth and employment during his presidency, the most appropriate response would be “nothing special”. And that, so as not to skew the results, is ignoring the effects of the pandemic. Figure 15 effectively shows the percentage of net job creation in the United States for each presidential term since the Second World War. Up to February 2020, the figure for the Trump period was 4.8%, far from the 7.5% for the 19 previous presidencies shown in the graph. Without the pandemic, the gap would have been narrower but it would not have reached the 7.7% of Barack Obama's second term, not to mention the highs set by Lyndon B. Johnson in the late sixties (16.5%) or Ronald Reagan between 1985 and 1988 (11.2%).¹⁹ Evidently, with the outbreak of the pandemic and its devastating consequences, Donald Trump goes into the election with fewer jobs in the economy than when he assumed power.

Figure 15. Employment growth in the United States (percentage variation by presidential term)



Source: author's own. Data: FRED II.

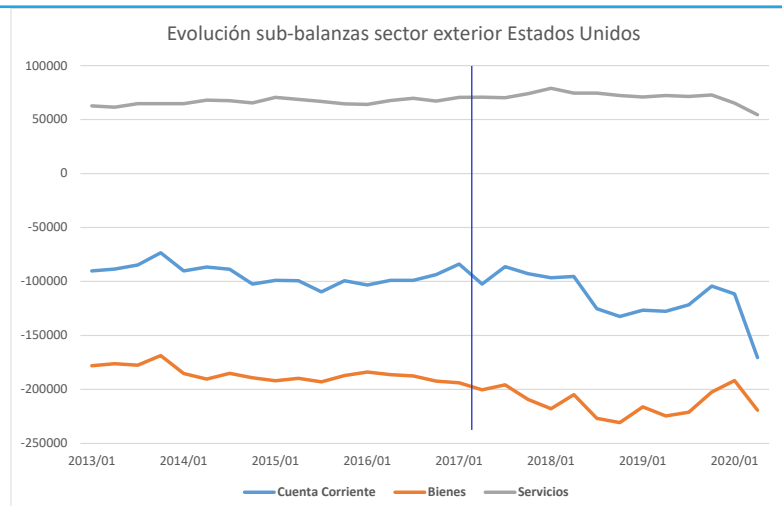
The other aspect we look at here is the obsession of the Trump Administration with the United States' trade deficit, in particular with China, which, especially from 2018 on, led to all manner of outlandish statements and protectionist decisions, not just with respect to China but almost any trading partner, from the EU to Mexico to Turkey, India, Canada and Japan. The result? Nothing, of course. We won't go into the reasons for this “of course” again. Feel free to go back to the Under the Microscope section of the Quarterly Report for the fourth quarter of 2019. We'll limit ourselves to reflecting on what the data show, which is the futility of the Trump Administration's trade policy in relation to the objective pursued.

Figure 16. Evolution of selected sub-balance for the US balance of payments (millions of US\$)

¹⁷What's certain is that recent performance shows that appreciation of the euro appears to have cooled, stabilising at around US\$ 1.18 to the euros and a NEER value of 109 (using the year 2010 as the benchmark year).

¹⁸One should not, of course, completely rule out an even bigger election surprise than in 2016, nor that the transfer of power becomes an episode of unprecedented irregularity, although, for the good of the economy and global stability it would be best if there were no abnormalities in this regard.

¹⁹Looking at the presidents who have been returned for second terms, and aggregating the whole period, Bill Clinton boasts the best numbers. Over his two terms, employment in the US grew by 20% (over 23 million new net jobs).

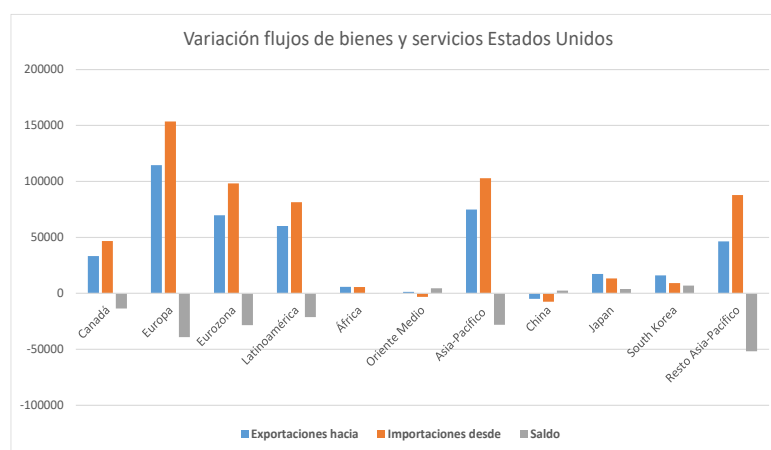


Source: author's own. Data: BEA.

Note: The vertical line the start of the Trump Administration

Figure 16 shows how the trajectory of the balances for goods and services maintains the same profile (the first broadly negative, the second compensating for the former only in part with its surplus) and even higher values (but very similar in relation to GDP which, obviously, is also higher) as during Barack Obama's second term. In fact, if we extend the historical perspective, the last decade has seen deficits of around 4-4.5% of GDP for the goods sub-balance and surpluses of around 1-1.5% of GDP for the services sub-balance. If looking for a more general perspective on the balance of payments offered by the current account balance, since 2009 it has fluctuated between a deficit of 2 to 3% of GDP before Trump and throughout his term. Even with the sharp improvement in the US's overseas energy trade balance, evidence of the fracking revolution over the last decade, it is disappointing even that there has been no improvement (again, I would direct the reader here to the aforementioned Quarterly Report for a possible explanation).

Figure 17. Variation in the flows of good and services in the United States between 2016 and 2019 (millions of US\$)
Selected geographic areas.



Source: author's own. Data: BEA.

But one might think, at least there has been a big change with respect to China. In movements yes but not in the balance. Figure 17 compares the movements of goods and services in the last year under the Obama Administration (2016) with the last full year under of the Trump Administration (2019). While movements with the principal trading partners of the United States (Canada, Eurozone and Latin America, with Mexico at the head) show a significant increase in imports and exports and an increase in the deficit. In the case of China, both figures for 2019 are somewhat below where they stood in 2016 but the deficit has barely shrunk, down 2.5 billion dollars on a total of more than 30 billion dollars. Two significant points in this respect. The improvement in the US balance of payments is greater with respect to Japan and South Korea, who signed new trade agreements in the period in question. Secondly, note the enormous increase in the US trade deficit (more than 51 million dollars) with the “rest of Asia-Pacific” region. It's easy to see where

Chinese production has moved to get around the protectionist measures of the Trump Administration and it's not to Ohio, Wisconsin or Michigan but Taiwan, Vietnam and Malaysia.

IX. The disappointing news continues with respect to the assistance the developing world is receiving from more advanced countries and the major emerging countries. This is one of the issues on the agenda, at the time of writing, of the weekly summit being held between the International Monetary Fund and the World Bank.

The current situation is a very delicate one for developing economies, given the collapse in income from exports of raw materials, tourism Foreign Direct Investment; sources of essential currencies for these economies. It is a collapse that has occurred as a consequence of the pandemic, and this income has not yet been recovered or, in some cases, has been only partially recovered. Faced with this, the star aid programme articulated by the G-20, the Debt Service Suspension Initiative, has only offered relief on payment of 5.3 billion dollars of interest payments on the debt of public creditors between April and December 2020 (note that this is suspension, not forgiveness). In fact, only 43 of the 73 countries that could have applied for the initiative actually did so. And only three have entered into negotiations to suspend debt payments to private creditors, with no agreement in that respect reached to date. It is certainly disappointing. The “stigma effect” of availing of this programme, modest in itself, and the threat of rating agencies to punish countries that request these suspensions by downgrading their credit ratings, explains why many developing countries haven't even used this option for suspension.

In this context, these developing economies are enjoying some good news which, although insufficient, is some help in the short term. Health results for example, at least in Africa, are better than expected. The low average age of the population, the community mechanisms for assistance and transmission of information and the experience of tackling epidemics with undesirable frequency seem to be behind these results, certainly not shared with other areas of development. Furthermore, an indirect transfer of income from western support programmes to the developing world is being detected in an increase in emigrants' remittances. The substantial subsidies (often more generous than the usual income for immigrant workers) that Governments in developing countries are rolling out to sustain the income of citizens, are enabling many foreign workers to increase the remittances they send back to their home countries. Finally, faced with the negligible profitability of many financial investments in developed countries, and after suffering unprecedented capital flight, the emerging and developing world has managed to place up to 775 billion dollars of bonds so far in 2020, including some 150 billion on the international markets. That said, and this is concerning, most of these are short-term bonds that will have to be refinanced.

Despite this positive news, the World Bank estimates that, unless there is a radical change in aid to the developing world, around 100 million people in these countries could fall into extreme poverty (living on less than \$1.90 per day), more than reversing the progress made over the last 5-year term for which data is available (2013-2017). Concerning to say the least.

X. We close our Ten-Point analysis with one of those situations that often go unnoticed but are of great importance and question the seriousness of the institutions. The World Bank has been forced to suspend publication of one of its benchmark reports, *Doing Business*, which includes a supposedly objective assessment, using reliable data, of the ease and confidence with which business activity is conducted in different countries. Given the fact that the classifications provided by this report influence direct and financial investment decisions of many stakeholders, the lack of credibility has real implications for the countries involved. This is no mere academic exercise.

The validity of *Doing Business* had already been brought into question due to the suspicion that several governments were taking measures aimed more at climbing the ranking (ultimately, and necessarily, based on limited number of variables) than at improving the economy in question. More seriously, the then Chief Economist of the World Bank, the renowned macroeconomist Paul Romer, resigned in 2018 because he considered that the World Bank's assessments were biased due to political motivations. This time, the World Bank itself as an institution has been forced to recognise irregularities in the data provided by a number of developing and emerging countries, including China. The most striking result has been Saudi Arabia's improvement, in just one year, of more than 30 places on the ranking. Although, as has been said, these irregularities do not seem to be new, this time, they are considered sufficiently important to suspend the publication of the report. It seems unlikely that, when it returns, it will be given the same importance as a benchmark it has enjoyed in the past.

Under the Microscope

Japan and “Abenomics” A Sign of Things to come for Europe?

The “Revolution” reduced to more of the same and stability

A familiar definition of madness, attributed to various historical figures (Albert Einstein, Mark Twain and Benjamin Franklin among others) is “to do the same thing over and over again expecting different results”. The Japanese economy has, for more than two decades, since the bursting of the gigantic property and stock market bubble generated in the 1980s, trod the same path of lukewarm growth, risk of deflation, scant efficiency in its production sector (its formidable export core notwithstanding), trade surpluses in parallel with high internal savings rates and a banking system in perennial crisis, while applying the same recipes over and over again: monetary expansion, conventional and non-conventional, and growing public debt. In December 2012, the new Prime Minister,²⁰ Shinzo Abe, of the Liberal Democratic Party (LDP), which has held close to a monopoly on power since the Second World War, came into government with an economic programme soon dubbed “Abenomics” after its proponent, that would transform the Japanese economy. A combination of macroeconomic policies and structural reforms, it was supposed to cement success.

On 28 August 2020, after a longer period in power than any modern Japanese prime minister, Abe announced his resignation due to what he described as serious difficulties fulfilling his function due to chronic health problems arising from ulcerative colitis, which had worsened. He has been replaced by his Chief Cabinet Secretary, Yoshihide Suga, expected to continue with more of the same, at least in the short term. In this Under the Microscope, we assess the processes and results of Abenomics. We will see how, in reality, it has differed little, with some modest exceptions, from previous policies, with very limited progress on the structural measures and the same macroeconomic policies, only intensified, especially in terms of monetary policy. And while the Japanese economy has not suffered from madness, the results have been more of the same.

All, admittedly, in an environment of greater internal stability in terms of governance, good foreign relations (with the exceptions, during certain period, of China and South Korea) and a more philosophical than effective nationalist shift, aspects that, naturally, we won’t pay more than marginal attention to within the scope of this report. Finally, we ask whether the events of recent decades in Japan offer a glimpse of the future of Europe.

Presenting the Japanese economy: a continuous decline, without drama but without stem

In 2020, Japan, barely resembles the ascending power that, in the mid-1980s, according to some of the most adventurous analysts, could replace the United States as the number one economy in the world.²¹ The progressive but prolonged decline of its economic dynamism (coupled with demographic decline) has seen the country retain its status as the most developed Asian economy, but with a loss of position both with respect to other countries, especially in relation to the neighbouring economic area of emerging Asia which has experienced greater economic growth over the last quarter century. That said, we must not forget that this is a developed economy, with sufficient resources to stem or even reverse this decline with the right policies. Let’s look at the data at the heart of this.

Figure 1 reveals the contrast between strong growth of Japanese income per capita in the 1980s (3.9% annually) and the modest subsequent growth (0.9% per year). Similarly, while the first decade shown in the graph saw Japan reach its peak in terms of its weight in the global economy (surpassing 9% in 1991) the subsequent decades have seen significant decline to reach the 4% it now stands at. In absolute terms, Japan is currently the fourth largest economy

²⁰Relatively new, as he had already held the position between 2006 and 2007, when he was forced to resign for health reasons.

²¹A forecast only outdone by those who in previous decades claimed that the Soviet Union would replace the United States as the world’s main superpower.

in the world (after China, the United States and India) and, although the Global Competitiveness Report ranks it the fifth most competitive economy in the world, many other indicators (the Human Development Index, Legatum Prosperity Index and the World Bank's ease of doing business index to cite just some) place Japan between 20th and 30th position in the world, in line with its income per capita (28th in the world). An advanced economy, but not at the cutting edge.

Figure 1. GDP per capita (US\$; PPP) and weight in the world economy (%; PPP)

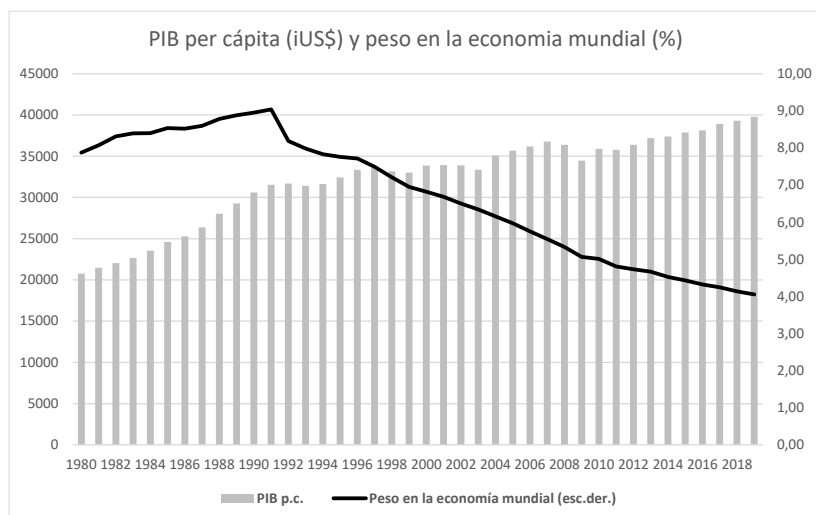
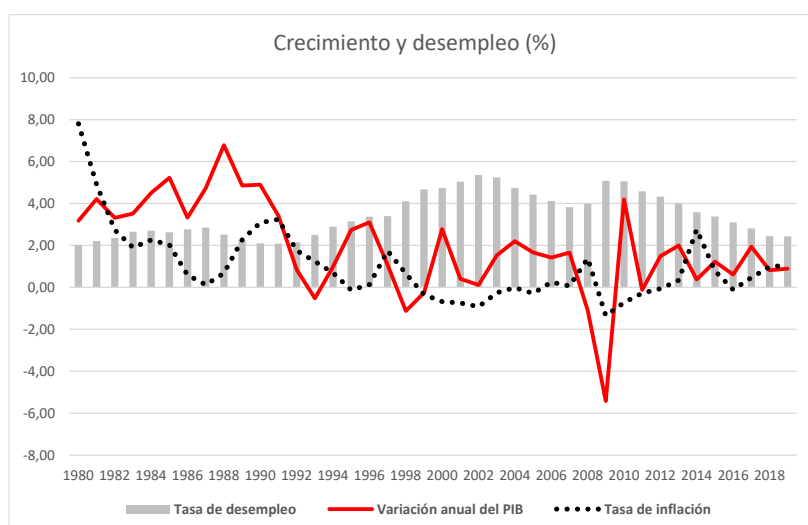


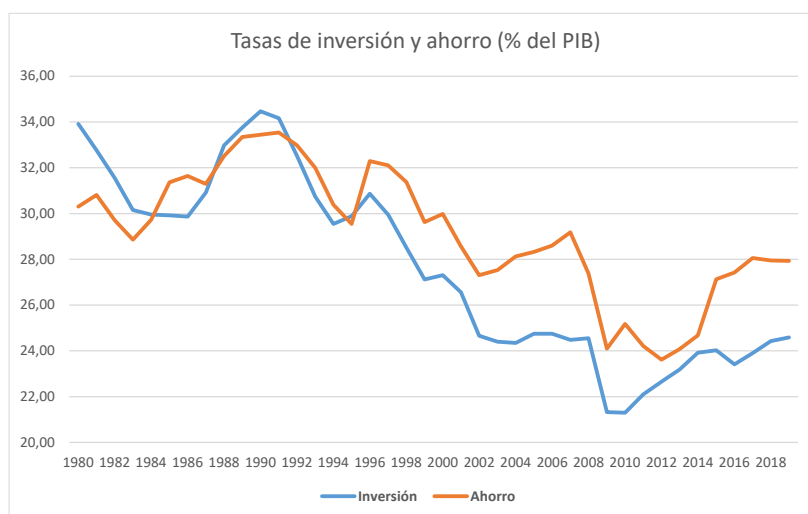
Figure 2. Economic growth and inflation (%). Unemployment rate (% of active population)



Inevitably, behind this decline is the incapacity to stimulate economic growth after the property and financial boom of the 80s. Barely 0.9% annual growth in real GDP (Figure 2), as a result or perpetually slack internal demand and particularly, but not limited to, consumption. Savings, and not just household savings but business savings too in the form of undistributed profits (and not reinvested in the country) have, for more than 25 years, grown consistently to surpass a declining rate of investment in relation to GDP (Figure 3), resulting in a dependence on export growth, traditionally more dynamic than imports and sustaining an interrupted current account surplus (the last Japanese trade deficit was 1980), as reflected in Figure 4. Of course, this has seen the country attain an incomparable position as an international creditor (Japan maintains the highest level of overseas financial savings of any country) and the establishment, through direct investment, of a formidable productive infrastructure outside Japan, especially in south-east Asia. All of which has generated growth in other countries and repatriated income for Japan, but not internal growth. In fact, this weak demand has led to one of the most identifiable traits of the Japanese economy over the last

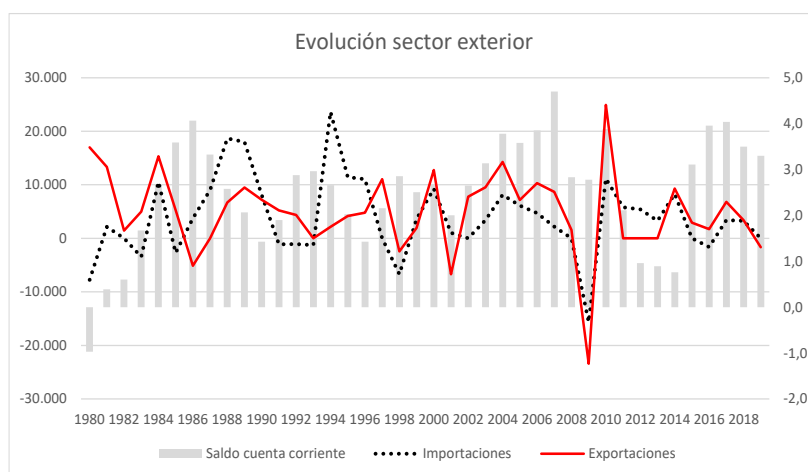
three decades: the absence of inflation (Figure 2). Average annual price growth stands at 0.3%, far below the levels seen as desirable in developed countries in general, flirting with deflation (prices fell in twelve of the last twenty-five years).

Figure 3. Savings and investment rates (% of GDP)



Source: author's own. Data: IMF

Figure 4. Evolution of exports and imports (%). Current account balance (% of GDP)

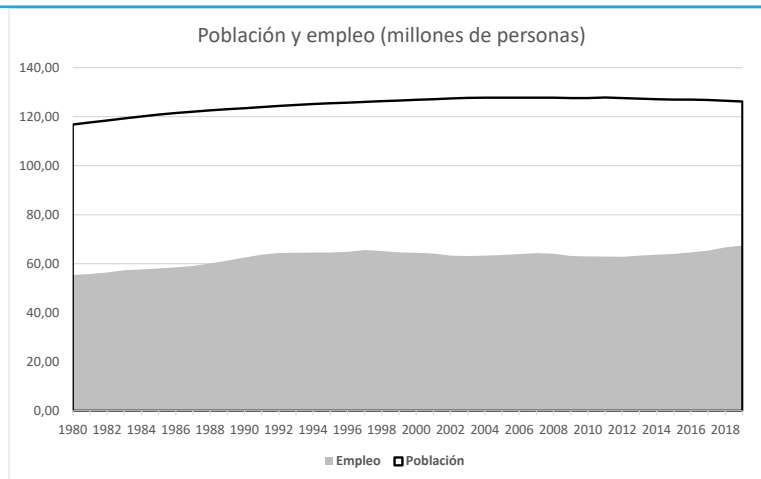


Source: author's own. Data: IMF

Japan's economic stagnation has frequently and (only partially) correctly been linked to parallel demographic stagnation (Figure 5), which, with the resulting ageing of the population, limits strong employment growth and boosts savings to the detriment of consumption. Of course, we must not forget that Japan's demographic density today stands at around 330 inhabitants per square kilometre, ostensibly higher than any of the western powers. This is not an underpopulated country or one lacking in workers (if the necessary reforms are agreed).

Otherwise, the limited incorporation of young people to the labour market and the stagnation of the Japanese labour market which, except for more recent cohorts, places a premium on extreme permanence in the same position, protecting jobs much more than workers, all means that the rate of unemployment (Figure 2) is much lower than is common in Europe or even the United States (average unemployment in Japan is 3.9% over the last thirty years). In saying that, it is a labour market with a rate of female activity fourteen points below male activity, poorly conducive to the promotion of young workers and with salaries virtually stagnant, despite almost null inflation for many years.

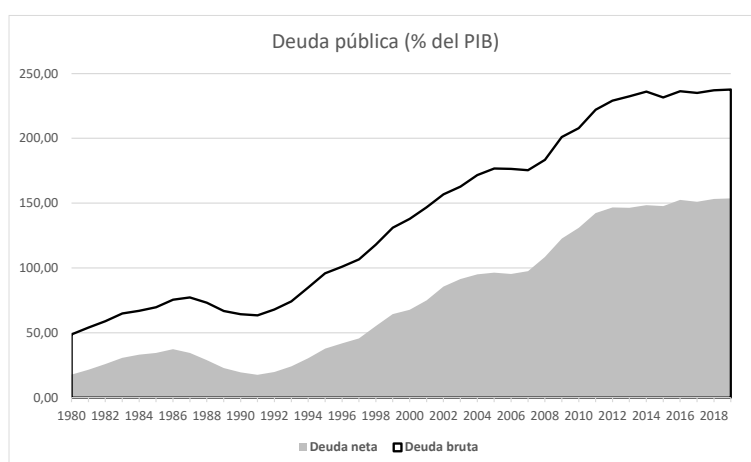
Figure 5. Population and employment (millions of people)



Source: author's own. Data: IMF

Faced with insufficient external demand to sustain the stuttering economic growth of domestic private demand, of successive Japanese governments of the 1990s and 2000s, almost all committed to strategies in which public stimulus, in particular successive fiscal expansion plans, constituted the pillar of growth. The data above are testament to the failure of that strategy. Even though the reference interest rate has not reached 1% from the early 90s, the distrust sown after the double bubble burst, a banking system with systematic problems and reform of which was delayed over time, poor demographic growth and even poorer growth in real salaries, compounded with the disincentivising effect on spending of deflationary episodes, all combine to explain the lack of take-off in private consumption over this time. In the meantime, public debt has spiralled (Figure 6), placing Japan in a separate category from the rest of the world in terms of levels reached.²² We will return to this issue of financing shortly.

Figure 6. Gross and net public debt (% of GDP)



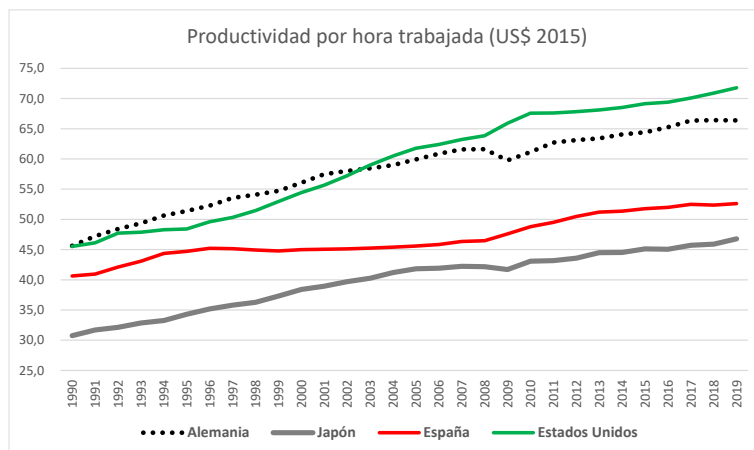
Source: author's own. Data: IMF

What has Japan been ignoring for two decades? The required structural reforms. If the restructuring of the banking system, including massive mergers, was delayed excessively and failed to produce sufficient results (the yield on Japanese banking assets, even over the last two years is below those of European counterparts, themselves considered very low and highly problematic), other reforms were barely attempted or ignored: the labour market, migration policy, excessive bureaucracy, particularly in the area of business, improvement of human capital and technology in SMEs, a far too prominent role for the primary sector lobby, excessively generous tax treatment for undistributed profits, an industrial policy skewed in favour of large conglomerates, poor capacity for shareholders to amend the

²²The difference between gross and net levels of Japanese public debt is also unusually high, implying that there are public institutions, especially the Government Pension Investment Fund (the biggest pension fund in the world, with more than 1.5 billion dollars in assets) holding large sums of the country's public debt. But even the level of net debt, 150% of GDP, exceeds gross in debt in almost every country in the world (Greece being an exception).

decisions of Boards of Directors, etc. The result of this lack of reform is, in this author's view, expressed, more in than any other area, in the spectacular deficit Japan maintains for a variable as critical to understanding the performance of an economy as the productivity of work. Figure 7 and Table 1 illustrate this negative differential, which not only positions Japan at an abysmal difference from countries with which it is often compared, such as the United States and Germany, but even behind Spain, an economy whose productivity issues are well known.

Figure 7. Productivity per hour worked (constant 2015 US\$). Selected economies.



Source: author's own. Data: OECD

Table 1. Explaining the differential in GDP per capita

COUNTRY	GDP per capita	Productivity per hour worked	Hours worked per person	Employment rate
United States	100	100	100	100
Germany	82.4	92.5	79.4	112.1
Spain	62.7	73.3	96.8	88.5
Japan	69.6	65.2	94.4	113.1

Source: author's own. Data: OECD

As we can observe, based on 2019 data, Japan's level of income per capita is 30 points behind that of the United States. The breach in productivity, more than a third lower in Japan, explains more than 100% of this differential, which is compensated to a very small degree by Japan's higher employment rate.²³

Shinzo Abe: the three arrows of the true archer

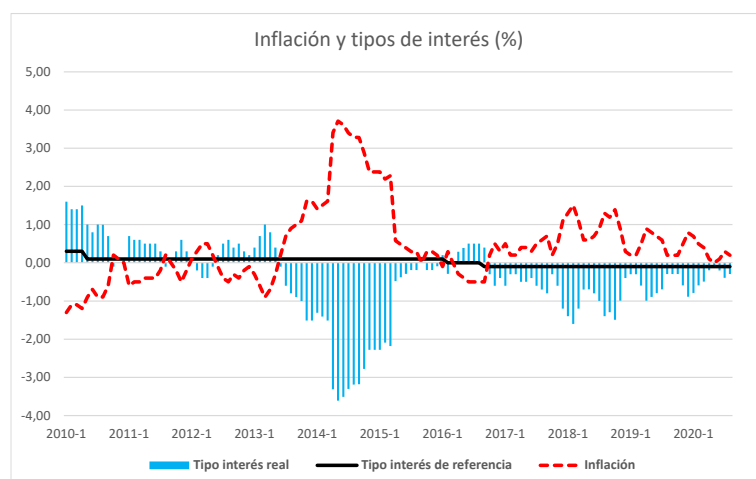
And so, the new Prime Minister, Shinzo Abe took the reins in late 2012 with the challenge of revitalising the country's economic growth. On top of its structural problems, Japan was also still dealing with the aftermath of the Fukushima nuclear accident of March 2011. To achieve his objectives in the economic sphere, Abe identified three lines of action, the "three arrows" that would go on to define Abenomics.

The first would allow him to apply the old adage that this journey didn't need so many saddlebags: just more, much more, monetary expansion. The appointment in 2013 of Haruhiko Kuroda as the new Governor of the Bank of Japan (BoJ), and the appointment of other like-minded members to the Policy Board of the Bank (gradually removing those in favour of a more orthodox monetary policy), would, if you forgive me the analogy, put in place a committed archer to shoot the first arrow. Over the intervening seven years, Kuroda has reduced the reference interest rate even further, to a sub-zero level (Figure 8), generating almost continuously negative interest rates; has increased the BoJ balance, even before the pandemic, to over 100% of GDP (Figure 9); has acquired public and private assets of all manner and condition, including a significant volume of shares in Japan's major companies; and has the delimited not only short-term rates but long-term rates, particularly those corresponding to ten-year public debt. What's more, in the first

²³From 2013, the average American employee began to work more hours than their Japanese counterpart, as reflected in Table 1, constituting an historic change.

phase of his mandate, he intervened in currency market to devalue the yen.

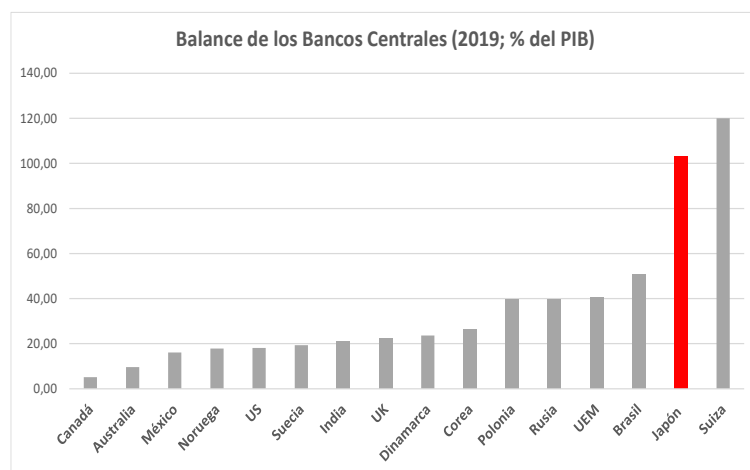
Figure 8. Inflation and central bank reference interest rates (%)



Source: author's own. Data: BIS

Note: Real interest rate calculates as the difference between the reference rate and inflation.

Figure 9. Size of central bank balance sheets (% of GDP) Selected economies.

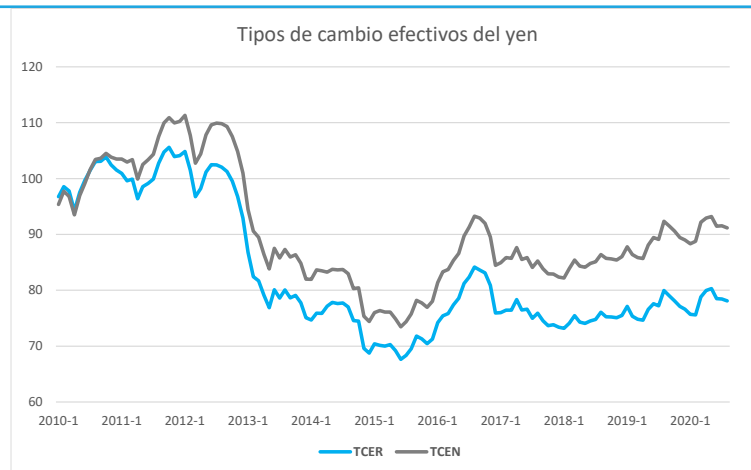


Source: author's own. Data: IMF

If the reader expected to encounter a significant spike in growth and/or inflation thanks to this massive monetary expansion, I invite them to review Figures 2 and 7 to abandon all hope.²⁴ The solution to Japan's problems does not lie in the expansion of monetary policy to infinity. This would be the first lesson on Abenomics, although it does have a corollary; if monetary expansion is capable of serially depreciating the currency, it fosters growth. This is what happened in Japan in the early months of Abenomics, when severe depreciation of the yen's exchange rate (Figure 10) stimulated exports and, with that, growth. But again, through external demand, with limited effects over time and with the risk of similar action on the part of trading partners.

Figure 9. Effective yen exchange rates (2010=100)

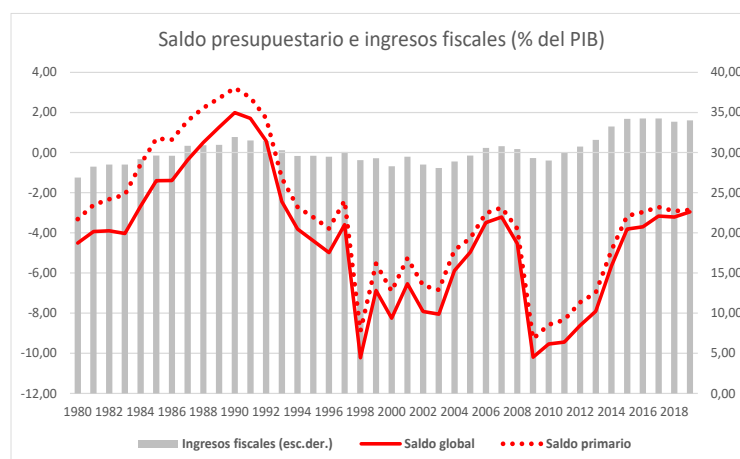
²⁴For the keen-eyed observer, the jump in inflation in 2014 is explained by the short-term impact on prices of the increase in VAT (which, for the very low Japanese rate, meant almost doubling it, rising from 5% to 8%).



Source: author's own. Data: BIS

The second arrow in the quiver, under the direct responsibility of the Abe Government, involved a complex adjustment to fiscal policy. While the general tenor of fiscal policy was aimed at ensuring moderate expansion (but with more efficient spending than in previous decades), the new government perceived the threat of gross debt, already at 230% of GDP. So, while the extraordinary expansion plans for public spending, as a complement to the already approved ordinary budget, became a feature of the Abe Administration, VAT was doubled (the aforementioned increase of 2014, plus another in late 2019 to bring the rate to 10%), increasing the tax revenue, which for the last few years has been around 34% of GDP, an historic maximum. With that (Figure 11), the public deficit has contracted to around 3% of GDP, which must be added to the negligible cost of financing debt (the primary deficit almost coincides with the overall deficit, revealing minimal payment of interest) to understand how the growth in the mountain of public debt has slowed (note that these points apply to the situation before the pandemic) as can be observed in Figure 6. While all together it made for an exercise in fiscal prudence, rather than restriction, it has not served to re-float growth, nor to leave the public accounts in a better state before the possibility of a new crisis that would result in the deterioration of one and the other, as has materialised with the consequences of COVID-19.

Figure 11. Public accounts. Selected variables (% of GDP)

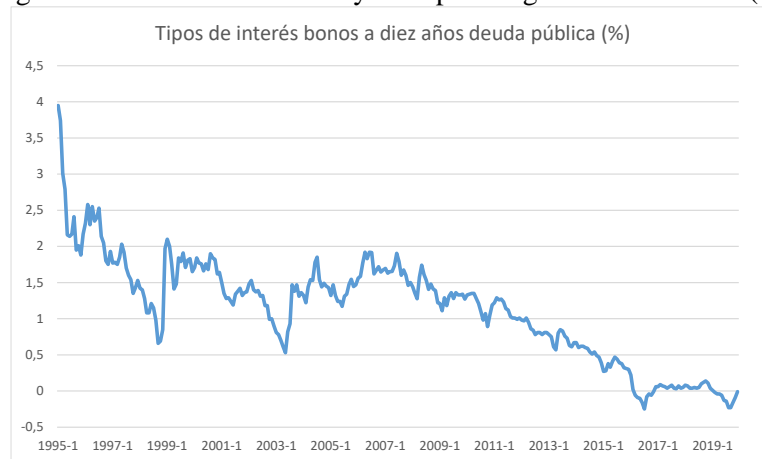


Source: author's own. Data: BIS

Certainly, the possibility of continuing, largely undisrupted, with the management of a country with a level of debt that would be unassumable for practically every other economy (that, is the Japanese Government's extremely high fiscal margin) is due to a number of unique characteristics of the Japanese economy. Firstly, the elevated rate of private savings, with a population used to investing much of these funds in public debt, despite the low return (although not in real terms, considering the null average inflation over the last 25 years as has been indicated). Secondly, the increasingly intense activity of the BoJ not only in the acquisition of debt but in limiting the cost of debt to the Government. Figure 12 shows the extremes this intervention has reached, with ten-year interest rates at negative values. Thirdly, and as a consequence of the above, the Japanese government is little concerned with the possible debts of foreign investors arising from the

debt level, given that 90% of the country's public debt is in the hands of Japanese, an exceptionally high figure.

Figure 12. Interest rate for ten-year Japanese government bonds (%)



Source: author's own. Data: BoJ

The third arrow, the most innovative, the one Japan really needed, has scarcely been fired. What has happened with structural reform over almost eight years of the Abe administration? Some reforms, although not the principal ones, have been implemented. For example, the influence of the LDP's agricultural lobby has waned, leaving scope to advance on some trade agreements. In this sphere, Japan led the move from the Transpacific Partnership Agreement, the free trade agreement that was going to intensify trade relations between all the important economies in the Pacific region (except China), until it was jettisoned by the Trump Administration, to the unspeakably named Comprehensive and Progressive Agreement for Transpacific Partnership. A display of international cooperation that, with the odd stumbling block, and more gestures than results, was an objective of the Abe government. There is also burgeoning liberalisation of the electricity market and some stimulus to prolong working life. Little else.

Essential reforms, those that could bring about a new economy and increase the country's appalling levels of productivity, have barely been targeted or not at all. There has been no comprehensive reform of the labour market. Nor of the country's bureaucracy, marked out as a priority by the new Prime Minister, Yoshihide Suga. He is also hoping to set about the digitalisation of the public sector, opening a path to greater innovation in the private sector and especially Japan's notably inefficient SME sector. The much called-for demand for fiscal reform to mobilise the undistributed profits of companies so that they reach citizens via dividends has not been seen either. The banking system, with its limited efficiency and atrocious profitability, is also calling out for new measures. The intentions, and even rules, articulated by Abe in favour of real salary growth have been forgotten. Partly because it would be best to increase productivity before salaries. A new migration policy, which would allow for a more dynamic demographic pyramid and labour force, never arose.

And so, there's plenty of homework left to do in the wake of Abenomics, and, until that's resolved, everything points to the continued mild but unrelenting decline of the Japanese economy.

Is this the future for Europe?

Several authors have pointed to a parallel between the evolution of the Japanese economy (and society) from the 1990s on, as described in the previous pages, and what could happen in Europe, and particularly Western Europe, from here going forward. The detail of the European situation should be the subject of its own separate analysis, but to close this Under the Microscope section, Table 2, without intending to be exhaustive, characterises the evolution of the Japanese economy over the last three decades and notes the extent to which each description might apply in the case of the European Union. The similarities are abundantly clear and, as such are concerning, and offer a warning as to the potential future trajectory of Europe.

Table 2. Will Europe be another Japan?

<i>Feature of Japanese economy and society</i>	<i>Is it being reproduced in Europe?</i>
Negative natural growth	YES

Severe limitations on immigration	NO, but likely
Notable ageing demographic	YES
Insufficient structural reform	YES
Growing gap between cutting edge companies and followers	YES
Poor preparation of SMEs for the new economy	YES (varies by country)
Mediocre productivity growth	YES (varies by country)
Bureaucratic and pressure-group obstacles to pro-growth reform	YES (varies by country)
Growth of public debt to unprecedented levels	YES (varies by country)
Minimal short-term interest rates	YES
Minimal long-term interest rates	YES
Unprecedented conventional and unconventional monetary expansion	YES
Increased private savings levels	Limited
Limit profitability of the banking system with structural problems	YES
Increased dependence on overseas demand for growth	YES
Significant trade / current account surplus	YES
Serious costs to a possible extensions of protectionist barriers	YES

Source: author's own.



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Panellists:

