LETTER FROM
TOKYO

Is Japan Back?

The Funabashi-Sakakibara debate.

By Barry D. Wood

In December 2022, there were two significant developments in Japan. First, the government released a security analysis to justify an unprecedented 50 percent increase in defense spending over the next five years. With two new aircraft carriers and a strengthened security compact with the United States, Japan is responding to the strategic threat posed by China.

Second, on December 20 the Bank of Japan took its foot off a key interest rate, modifying its control of the yield curve allowing the rate on a ten-year Japanese government bond to double to a still ridiculously low 50 basis points. The result was a rally in the yen which rose into the ¥130 range to the dollar. That was a big jump from the thirty-two-year low of 150 touched in October. Because the Bank of Japan kept loosening while other major central banks tightened, the yen registered a 20 percent decline in 2022.

Concerning security, the government of Prime Minister Fumio Kishida felt compelled to respond to Chinese saber rattling in the South China Sea, particularly the escalating threat to Taiwan. Asserting that Japan faces its most severe security environment since the end of World War II—and with clear reference to China—the white paper condemns countries "seeking to unilaterally change the status quo by force." Bear in mind that Okinawa, Japan's southern-most prefecture, is geographically much closer to Taipei than Tokyo.

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On monetary policy, Bank of Japan chief Haruhiko Kuroda quickly denied that a policy shift was underway. He made clear that the bank's accommodative monetary expansion would continue despite the adjustment in yield curve control.

Prime Minister Kishida in February chose former Tokyo University economics professor Kazuo Ueda to replace Kuroda, whose term expires in April. Ueda, seventy-one, was a classmate of Ben Bernanke at Massachusetts Institute of Technology, and like the former Fed chief his Ph.D. thesis was supervised by the legendary Stanley Fischer. The choice of Ueda was a surprise, the first time government has reached beyond the Bank of Japan or Ministry of Finance for a central bank chief. While Ueda has supported Kuroda's aggressive easing, there are expectations that the Bank of Japan under Ueda will make some early move towards interest rate normalization.

During a challenging decade at the Bank of Japan, Kuroda tenaciously held interest rates exceedingly low in order to stoke inflation and boost wages. He succeeded on the former but failed on the latter. Inflation has risen to a four-decade high of 4 percent but real incomes are down 3.8 percent and have fallen for eight consecutive months.

In Tokyo, I met long-time acquaintance Eisuke Sakakibara, Mr.

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Yen. As always, the University of Michigan Ph.D., now eighty-two, was relaxed about the Japanese economy. "People are satisfied," he repeated several times, "concerned but not stressed" by Japan's shrinking population and diminished living standards. Japan's population shrank by half a million last year, meaning that per capita income figures are higher than they otherwise would be. Japan has been steadily losing population since 2008.

Sakakibara, vice-minister of finance in the 1990s, correctly predicted the yen's 2022 depreciation as Bank of Japan and Federal Reserve interest rate policies worked at cross purposes. Now he is predicting the yen is likely to trade in the ¥120 range this year.

I pressed Sakakibara on his benign assessment of the Japanese economy but he was adamant. "We're a mature economy now," he protested, "people have what they need. One percent annual growth is quite okay. We're not in the 1960s when we were still recovering from the war with annual GDP growth averaging more than 10 percent."

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Economics aside, I'm convinced that a far-reaching geopolitical shift is underway in east Asia. China's attempt to drive a wedge between the United States and Japan is failing. Japan is determined to block China's drive to dominate. Michael Green, until recently the Japan analyst at Washington's Center for Strategic and International Studies, argues that Japan's post-war priority has been "not to lose." Green, now a professor at the University of Sydney, believes Japan will not to be coerced and will not lose to China.

Japan's strategy for winning is to draw even closer to the United States, a priority fully endorsed by the Americans. Hoover Institution historian Niall Ferguson believes the United States and China are well into "cold war II," with the United States seeking to stymie China's technological advance. The Americans are restricting high-tech exports to China—chip-making equipment, computing-related technologies, microelectronics, quantum information systems, and artificial intelligence. The Japanese have signed on to these limitations.

The United States and Japan are boosting high-tech collaboration, a move applauded by respected columnist Yoichi Funabashi, who argues that "science and technology are the foundations of national power."

In my conversation with Sakakibara, I shared a perspective voiced by a respected foreign correspondent who had been posted to Japan. "Japan," he asserted, "is a spent force because they've concluded they can't compete with a China with ten times the population and a much larger GDP. He concluded, "Japan has made the decision to gracefully withdraw from the world stage."

Sakakibara listened patiently to this dreary prognosis before replying calmly, "It isn't true." On this I agree with Sakakibara. How can Japan be retreating when it is the world's third-biggest economy with brands like Toyota, Honda, Sony, Panasonic, and Nintendo—companies that lead not just in Japan but globally?

Japan does face myriad problems. It's essentially monoethnic and resists inward migration despite an exploding elderly population and not enough workers to take care of them. Only recently has Japan brought more women into the workforce. Japanese consumers prefer cash to credit and resist sharing personal data with government entities. Share prices are still below their pre-deflation 1989 peak. The Japanese are inward looking, but is BlackRock's Larry Fink right when he says "Japan missed fifty years of the technology revolution?" No.

Whether we're in cold war II or not, both the United States and Japan must walk a tightrope—balancing mutually advantageous trade links while standing up to Chinese bullying. China is Japan's biggest trading partner, while for the United States, China is number three behind Canada and Mexico.

Back in 2013, then-Prime Minister Shinzo Abe confidently declared that after two decades of stagnation, "Japan Is Back." That assessment was premature. But ten years later, Abe's ill-timed phrase is beginning to ring true. ◆


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