Much Ado About Heisei - What Has Really Changed?

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The Heisei Era can superficially be seen as a time of unrelieved decline and disappointment for the Japanese nation. From the lost decade of the 1990s to the sluggishness of the first decade of the 21st century, it seems on the surface to be a tale of almost continual stagnation. But that is only on the surface of things. There are two ways in which to probe for the truth. First, we must look beyond the surface at what really happened in Japan's economy and business culture to understand what, if anything, changed over this two decade period and what has remained relatively stable. And second, we must be honest enough to compare the Japanese situation to what happened in the rest of the G7 leading economies to get a better sense of whether we should mourn Japan's unique fall, or rather see it as just one example of a global phenomenon. I maintain that Heisei has a Janus-like two-faced nature, coming in like a wounded lamb and exiting like – well – a lion cub.

Heisei Exposed

The real estate bust at the beginning of the1990s set the tone for Japan's slip from its place as the feared super-competitor in the global marketplace. Like air seeping slowly out of a balloon, property values in Japan declined steadily over the decade, creating an atmosphere of increasing pessimism, risk aversion and shrinking growth rates. In fact, this environment was so all-pervasive that many businesses in Japan were not initially focused on a new post-industrial revolution that would put them at an even greater disadvantage once the new millennium began.

Japan's great companies were masters at competing in what we now know as the final stage of the electro-mechanical age, before we all were captivated by digital inventions and technologies that fundamentally changed – and are still changing – the way we do business and conduct our lives. So, in fact, "Japan Incorporated" did not just have to deal with the shrinking value of its assets and price destruction at home, but also with the real danger that it was simultaneously falling behind in the race to invent new products such as those coming out of Silicon Valley and, a decade later, from our own Silicon Wadi here in Israel. Add to this the ongoing fear of being overtaken by the Chinese behemoth in their neighborhood, and it would not be far-fetched to conclude that Japan lost its verve (not to mention its nerve) during the Heisei Era.

Let us, however, take another look at what happened and see if it was really all that much worse than similar things happening in the Euro zone and the US, and what Heisei signifies in Japan's economic evolution.

Lehman Shocks

All countries, save perhaps Israel and China, were humbled by the Great Recession that followed the Lehman Shock banking crisis and stock market crash of 2008. Japan was less vulnerable than the American and Eurozone economies because the mountain of debt in the country was largely held domestically by mostly Japanese citizens and corporations. In a situation not unlike the children's tale of the emperor's new clothes, if nobody says he is naked then he can still strut down the boulevard without fear or embarrassment. Japan had already lived through a decade of what was a new and dangerous situation for the United States, with subprime lending causing massive destruction of equity and bankruptcy for many financial institutions. Japan's bubble had burst long before Lehman crashed, and while the global financial crisis was not good for them, it was not the calamity in Japan that it turned out to be elsewhere in the world.

Deflation and Wage Stagnation

Deflation is, of course, not good for Japan's wage earners, who were penalized continuously by this chronic economic condition because their annual compensation leaned so heavily on semi-annual bonuses. But – and this is a big but – underemployment rather than unemployment, that curse of Western economies, is ubiquitous. Underemployment is not a great thing to brag about, but it has the advantage of utilizing the labor force more than in the case of total joblessness.

Prime Minister Abe's attempts to reflate the economy did not at first work well, but there is no such thing as a magic bullet in economics. Consumers cannot just be persuaded to spend more if their pocketbooks and their personal evaluations of their finances do not coincide with the government's exhortations to spend. What took place during most of the Heisei Era was a steady, toxic drip of lowered expectations on the part of the Japanese about their economic future. But is this that different from what happened in the US and on the continent as well during the Great Recession? I think not. And is it still the same dismal prospect as it was 5 years ago? Again, I think not. What is different is how the Japanese reacted to this reality - with a resigned acceptance unlike the overt or covert resentment we observe in Western countries.

Sluggish Consumption

Japan suffered from deflation and from sluggish consumption with an economy limping along at very low growth rates for much of the Heisei Era. Chinese imports also contributed to Japanese price destruction as evidenced by the proliferation of 100-yen shops during the late 1990s and early 2000s. If you were to currently enter one of the 100-yen stores that remain – and there are many fewer of them than there were 10 years ago – you will not find the same quality of merchandise that had made them a wonder of the Japanese consumer market, nor will the products for sale all come from mainland China as was once the case. Personally, I lament the absence of the wonderful 100-yen CDs with great songs from the 1950s whose copyrights had expired. But these 100-yen shops were one more testament among many to how Japan's consumer economy had become price-conscious and constrained.

After the Lehman Shocks occurred (in 2009), I created a concept which I call "indulgent parsimony" that I perceived as typifying the syndrome that first emerged in Japan and then everywhere else after the Great Recession hit. The Indulgent Parsimony concept consists of both practical and emotional elements that jointly influence a buyer's purchasing decision, and it is this dual appeal that makes it so powerful. Furthermore, the important thing about Indulgent Parsimony is that it must appeal to both the practical/rational and the emotional needs of the consumer simultaneously if it is to be truly effective.

The anemic consumer atmosphere in Japan despite Abe's '3 arrows' strategy resembles what is happening in the West. Japan's famously aging population seems resolved to practice parsimony, indulgent or otherwise. In this respect, an American economic observer recently commented that "…efforts to generate growth through fiscal stimulus and tax cuts will prove futile because the working-age population in the US is declining. As such, consumption—which makes up 70% of the US GDP —will continue to fall." (MARK YUSKO: 'The US is going to have a crash and it will be massive', Stephen McBride, Mauldin Economics, May 29, 2017).

An important question thus arises: are we perhaps attributing too much uniqueness to the malaise that enveloped Japan during the Heisei Era?

The Olympic Boost

The upcoming Olympics does present an opportunity unique to Japan, however, in several areas. Aside from large scale construction and infrastructure projects related to the upcoming 2020 Tokyo Games, there has also been a spillover effect to other areas of the Japanese economy. This was admittedly not across all sectors, but it was better than a few years ago. For one thing, real estate is less depressed than it was in mid-decade, with this pump now being primed largely by Chinese money. Chinese investment substitutes for that of Japanese millennials, who, like millennials in the rest of the developed world, have come to view home and car ownership as less than indispensable trappings of their lifestyle. This attitude stems partly from the fact that they are having trouble saving enough for the down payments needed for such large purchases, and partly because millennial consumers are famously more enamored of experiences they can enjoy with their disposable income rather than the material things that baby boomers craved. With this in mind, the Olympic bounce may yet bring other benefits to the country's economy.

What Has Really Changed?

Now that the Heisei Era is ending we can look back and see what has really changed during this period.

1. Japan is now a slow-growth affluent society with expensive tastes –much like the rest of the G7. Even with price destruction brought about by the double punch of the 1990s real estate bubble and the Lehman meltdown, it is still a fairly pricey place to live, especially in the large cities. And pay scales did not keep pace across the board, leaving many younger Japanese with declining expectations. Declining expectations beget caution, which in turn leads to sluggish consumption, which sets in motion a vicious cycle that stymies economic growth. Nevertheless, Morgan Stanley noted that

   "[Although] it is not making headlines yet….wages in Japan are rising the fastest in decades in a shift that is poised to divide the nation's companies – and their stocks – into winners and losers.". Morgan Stanley also expects wage growth to accelerate to 2.8 per cent by the end of 2018, with higher hourly earnings cancelling out fewer working hours and slower employment growth. While wage reflation means companies have to pay more in salaries, it also leads to stronger demand and revenue gains.

   Inflation, spurred by wages, will be "the last piece of the jigsaw puzzle to fall into place for Japan's economy," as noted by Jonathan Garner, who is Morgan Stanley Asia's chief Asia and emerging market equity strategist. Compensation levels are already climbing, with a broad gauge showing a 2.2 per cent jump last year that followed two years of near 2 per cent gains – the strongest trend since the 1990s. However, hourly pay rates have yet to show that strength, as seen in a 0.4 per cent drop in March of this year. In this respect, Garner and his colleagues published a study last month (April 2017) on how wage increases will shake out across corporate Japan, and concluded that there will be more winners than losers. ("Japan's Real Estate Sector Poised to Thrive as Nation's Wages Expected to Accelerate," Nippon Tradings International, 11 May, 2017)

2. One of the things most affected by the pessimistic economic outlook is population growth. I think that Japan is not dealing with population decline like the other G7 nations in that it does not want to flood the country with young immigrants to make up for a labor deficit. Instead, it has become a society obsessed with robots, but in a different way than the West, where self-driving cars and bots of all sorts are seen as functional devices. In Japan, robots are viewed emotionally as well as functionally. Japanese want their robots to be polite and exude *omotenashi* in the same way that Japanese humans do. The thinning of the social fabric and the way interpersonal relations are seen as *mendokusai* by young people who should be out actively dating and coupling, means that the Japanese are in the process of becoming more emotionally attached to user-friendly intelligent machines than to their fellow Japanese.

The decline in working age population also puts the labor force in a bind. "A declining workforce is already crimping the construction and service industries. The Tokyo Olympics will choke private-sector investment instead of stoking economic growth," predicts Ryutaro Kono, chief Japan economist at BNP Paribas, in a report he released in March of this year (2017). Kono also stated that an acute labor shortage will make it hard for businesses to invest in plants and facilities. Even if the unemployment rate, which has just fallen below 3%, declines further to around 2%, and people who are able to work but are not currently looking for jobs return to the workforce, the maximum number of workers who will become available in the coming years will be 990,000, which is half the number of jobs Kono expects to be created due to the economic effects of the Olympics. Kono further warned that if work and jobs related to the Olympic spurt are given priority, then the operations and investments of other industries and businesses will be seriously hampered — in effect, clipping economic growth. Stuck in a bind, there is no way for Japan to prevent the looming labor crunch other than opening its doors to unskilled foreign workers. But Japan will most likely not do that for cultural and nationalistic reasons.

Japan's working population, the number of people aged 15-64, has shrunk by 10 million since it peaked two decades ago, and has slid down to 77.28 million. It will fall by another 3 million by the time the capital hosts the Summer Games according to an estimate by the National Institute of Population and Social Security Research.

("Japan Grapples with Labor Shortage Amidst Surging Condo Construction,"

28 Apr, 2017 – *Nippon Tradings International*)

3. Simultaneous with declining population is the <u>shrinking of household size to just above single-person units.</u> This has implications for consumption, marketing, housing, healthcare and all manner of societal concerns.

   If ever there was a "lonely crowd" – to borrow American sociologist David Reisman's famous concept – it is emerging in Japan's single-portion sized urban population. There is plenty of money to be made by marketers who target isolated Japanese glued to their digital devices as if by an umbilical cord, buying single-portion meals at *combini*, and living in what has been called rabbit hutch mini-housing, and (when they can afford it) splurging online for lifestyle items that may or may not be real bargains.

4. The Olympic lift will indeed have a salutary impact on Japan's economy. No country ever made money from hosting the Olympic games, but in the runup to 2020 the anticipation of hosting the Games for the first time in more than 50 years will certainly, if selectively, stimulate consumption and help real estate sales and firms involved in foreign tourism to Japan.

   The government's declared goal of doubling direct incoming foreign investment by 2020 seems to be well on track. With an expectation that Tokyo's property prices will rise even further after the 2020 Olympics, foreign investors are in a buying frenzy. In this respect, "Overseas investors, high net-worth families and foreign companies more than doubled Japanese property purchases in 2014. An increasing number of companies are setting up local branches to gain access to local financing and obtain a higher market share. By the end of 2014, inbound investment rocketed to its highest level since 2009, up by 181 percent, with property investment being one of the main drivers.” (27 Oct, 2015- P. Donnelly – Manager, Sales & Marketing @ Nippon Tradings International)

This trend will likely continue undiminished until at least 2020.

Conclusion

To sum up, the Heisei Era really is over, and while the picture is not all bright and promising, some economic stirrings hold the promise that Japan will get a second wind from the Olympic stimulus combined with Abenomics policies. Indeed, Japan may well end up by being one of the luckier, more stable (but aging) societies on the planet.