
MV Capital Management Weekly Market Flash

Japan: Is The Sun Finally Rising?

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Japan's stock market is bringing up the rear this year. The MSCI Japan index is down -7.6%, lowest among the developed economies this index tracks. Selling pressure on Japanese shares was in full throttle during the first half of April; not coincidentally, perhaps, this period also represented the beginning of a rise in Japan's consumption tax on goods and services from 5% to 8%. Long-time Japan watchers could be forgiven for seeing a consumer-dampening tax as the last thing this deflation-challenged economy needs. But there are some indications that prospects in this long-beleaguered economy may be turning brighter.

Green Shoots for Abenomics

One indicator that at least some things are going right is the consumer price index: at 1.4%, Japan's CPI sits squarely between those of Germany (1.2%) and the US (1.6%). For the first time in a very long time, the three major developed economies of the US, Eurozone and Japan are all targeting the same 2% baseline for prices. Arguably, Japan may be closer to reaching that goal than the Eurozone, where sagging prices have turned up the heat on European Central Bank Chairman Mario Draghi to contemplate some additional monetary stimulus.

The labor situation also looks sunnier in Japan than in Europe. The unemployment rate currently stands at 3.7%, which is a far cry from the double digit levels plaguing many Eurozone nations. In Greece, for example, a staggering 60% of the labor force under the age of 30 is unemployed. Beyond the headline number, though, there is mounting evidence that wages are rising: more than 100 of the largest companies in Japan have recently announced wage hikes for their employees, and hourly rates for part-time work are going up as a tightening labor market decreases the number of applicants per part-time work offering.

A Long Way To Go

A sustained economic recovery in Japan could make for a compelling investment story. The Nikkei 225 stock index is currently worth about 35% of its peak value reached 24 years ago, so there is plenty of upside potential. But if Japan is really going to turn the corner on this quarter century of malaise, there will have to be some deep and fundamental changes made to a business culture which over the years has become sclerotic. Overly cautious boardrooms have squandered the opportunity for Japan's enterprises – for many years the most globally competitive anywhere in Asia – to capitalize on growth in China and elsewhere in the region. Ponderous bureaucracies still interfere too much in the day to day workings of key industry sectors. Cultural attitudes still resist opening up to foreign labor, which could provide an energy boost to this ageing population.

Japan has done it before. In the Meiji Restoration of the late 19th century it created a modern industrialized economy literally from scratch. Time will tell if it can pull off a similar feat to be competitive in the 21st century.

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