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Capturing Value WorldwideSM



Country Profile: Japan

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It has never been more important for you to understand what is occurring in the world beyond your country's borders. Whether you realize it or not, we are now all fellow citizens...Global Citizens.

The Thomas White organization was founded in 1992 with the goal of bringing the benefits of globalization to investors around the world. We believed that once investors understood that globalization was a positive force, they would also see the advantages of adding international equities to their portfolios. It only makes common sense that professional investors would begin searching the globe for the most attractive opportunities. Researching a wider universe of companies should improve long-term performance. Moreover, broad diversification typically lowers return volatility. Multinational corporations have been using this global strategy for years; why shouldn't investors do the same?

Now nearly two decades later, our firm growth and strong subsequent portfolio performance has confirmed our investment premise. Currently, Thomas White professionals are performing research and managing over one billion dollars in close to 50 countries. We believe one reason for our success is that the nationalities of these analysts are as globally diverse as our portfolios.

A handwritten signature in dark ink, reading "Grant S. White, Jr." in a cursive style.

Japan: A Spirit to Excel



Located in the Pacific Ocean, Japan comprises over 3000 islands, with the largest four accounting for 97% of the total land area.

This archipelago, nestled serenely in the Pacific Ocean towards the Far-East, has a history, culture, and an economy that belies its diminutive footprint. Emerging from the embers of World War II, Japan levitated to the enviable position of the world's second-largest economy in the world during the late 60's and held that position continuously for more than four decades. Although China raced past Japan to become the world's second largest economy in 2011, it was Japan that set the precedent for growth in Asia, way back in the 1950's, by adopting an exported-based economic model. Japan still accounts for nearly 9% of the world's GDP. Barely the size of California, Japan ranks tenth globally according to headcount with a population density over ten times that of the U.S. Japan is also the home to 10% of the world's active volcanoes. Frequently tormented by earthquakes, the latest occurred in March 2011 causing damage of epic proportion. Yet the current earthquake is all but a page in Japan's long history of war, destruction and crusades. Its capital, Tokyo, is the largest metropolitan area in the world with over 30 million residents. True to its national name *Nippon*, which means "the land of the rising sun", Japan has overcome a host of chinks in its armor to ascend to a gloriously incandescent yet arduous stature in the modern-day global vista.

Japan's imperial history often laced with conflict

Feudal regime: Since times immemorial, the sun has been the all pervasive symbol of power, inspiration, sincerity and passion in this oriental country. Ancient legend believes the emperors of Japan to have descended from the sun goddess. Even the Japanese flag, known as *Hinomaru*, or sun disc, sports a center red disc epitomizing "the circle of the sun". Recorded history in Japan can be traced back to over 1600 years, when disparate clans and gentry families vied for power in the country for several centuries. During this time, some celebrated warrior clans, popularly

Japan and the World	
Nominal GDP (\$)	4.9 trillion
GDP Rank	2/192
Per Capita GNI	37,870
Per Capita GNI Rank	32/213
Population Rank	10/224
Geographical Area Rank	61/249
Global Competitiveness Rank	6/139
Economic Freedom Index Rank	19/179
Human Development Index Rank	10/182
Major Industries	Automobiles, Consumer electronics, Semiconductors, Electrical machinery, General machinery

known as *Samurai*, gained recognition, and successive *Shoguns* or military dictators from these clans ruled in Japan up until the middle of the 19th century.

The feudal regime of the *Shoguns* was brought to an end when the Meiji era commenced in Japan in 1867. The Meiji era, which means “enlightened rule”, lasted for the next 45 years and proved to be a catalyst in catapulting Japan from its primeval status to a modernized world power. While the Meiji emperor was the symbolic leader of the Meiji restoration, during his regime, power was wielded by the *Genro*- an oligarchy comprised of the most influential people of Japan from the military, political, and economic spheres. Within a generation, the country came into its own and was acknowledged as a global power to reckon with.

Japanese aggression and role in the World Wars: During the first half of the 20th century, Japan embarked upon an ambitious strategy of aggressive militarization and an expansion of its empire. The country was engaged in



A UNESCO World Heritage Site, the Hiroshima Building was the only structure to withstand the nuclear attack in 1945. Japan narrowly averted a nuclear accident in 2011 when a tsunami hit a nuclear power plant in Fukushima.

military conflicts with [China](#), [Russia](#), and also consolidated its territorial holdings by gaining control over [Taiwan](#) and [Korea](#). The suffering and distress caused by these acts of aggression in Japanese occupied territories received widespread condemnation from around the world. This also prompted the U.S. to impose an oil embargo on Japan. The subsequent Japanese bombing of the U.S. naval base at Pearl Harbor in December 1941 brought the [U.S.](#) into World War II. Japan's imperial pursuits culminated with the cessation of the world war and the U.S. bombing of the Japanese cities of Hiroshima and Nagasaki in August 1945. Ultimately, Japan's absolute monarchy system was replaced by a liberal democratic set-up and the country transitioned to a constitutional monarchy with a parliamentary form of government. The Emperor of Japan today is a symbolic head of state with limited powers restricted to diplomatic occasions. Power is primarily held by the prime minister and other elected members. Emperor Akihito is the reigning emperor of Japan, and Prime Minister [Naoto Kan](#) is the current head of the government. Kan took over as the Prime Minister after Yukio Hatoyama was forced to resign. Kan, Japan's fifth prime minister in four years, is the head of the Democratic Party of Japan (DPJ). The DPJ came to power in 2009, overthrowing the Liberal Democratic Party, which had reigned virtually uninterrupted in the seat of power since World War II.

Japan's rich cultural heritage continues to beguile

Japan boasts of a rich cultural heritage which finds expression in a spectrum of art, crafts, cuisine, and traditions. It has evolved considerably from the original Jomon culture (14,000 BC -400 BC) to the contemporary *mélange* which incorporates influences from Asia, Europe, and North America, and yet retains a distinct flavor of its own. Whether it is craft forms like *ikebana*, *origami*, and *ukiyo-e*, performances like *kabuki* and *noh*, or a distinctly aesthetic style of gardens, architecture or paintings, the contributions of this culturally diverse country are admired the world over. The country has also been a fertile ground for various forms of martial arts like *sumo*, *judo*, *karate*, and *kendo*. *Sushi* and *sashimi* are epicurean examples of Japanese sophistication and refinement in cuisine.

Japanese geisha: The much famed and celebrated *Geisha*, a traditional female Japanese entertainer, is deep-rooted in age-old Japanese culture. The *Geishas* belong to an elegant and elite cultural class, skilled in long-established and venerable



A *Maiko*, or apprentice *Geisha* in a traditional Japanese *kimono*. A young girl may become a *Maiko* at 16, and then must undergo five years of training to become a full-fledged *Geisha*.

Japanese performing arts like classical music and dance, as well as customary practices, such as tea ceremonies. However, with interest in classical Japanese arts gradually fading in contemporary times, and the strains of a slowing economy taking their toll, the *Geisha* culture in Japan is paling into oblivion in the modern world. Buddhism and Shintoism are the primary religions practiced by the 84% of the Japanese, and their teachings are deeply interwoven into the everyday life of the people. The Japanese are also deeply influenced by Confucianism, an ancient Chinese ethical and philosophical system, which entails the practice of proper forms of conduct, especially in social and familial relationships.

Rise of a behemoth in the world economy

The Japanese miracle: For a country that had been ravaged by war, and was plagued with the animosity of most of the leading countries worldwide, Japan has indeed traversed a daunting path to emerge as a global economic force. With an economy in 1951 barely 5% that of the U.S. and a gross domestic product (GDP) half the size of West Germany, Japan has scaled astronomical heights and until recently was the second largest economy in the world. China, of course, overtook Japan as the world's second largest economy in 2010. Currently, the Japanese economy is 33% of the U.S. economy, 1.5 times that of [Germany](#) and 1.8 times the size of the [U.K.](#) economy. Japanese industry and infrastructure, which were virtually destroyed during the World War II, were systematically rebuilt to transform the country into a global economic leader by the mid 1960s.



Literally rebuilt from the ruins of World War II, Tokyo stands tall, symbolizing its status as one of the largest economies in the world.

Post-World War II, the seven-year U.S. occupation of Japan proved to be a blessing in disguise as the Japanese received \$2 billion in aid from the U.S. in the form of food, fertilizers, petroleum products and industrial materials. The country was also saved from spending on defense, adhering to the World War Peace Clause that asserted that Japan would not maintain its own military forces, and the U.S. would provide it military protection, if necessary. Moreover, Japanese families saved extensively between 1950 and 1960, with funds channeled through the banking system to finance business and investment in the economy at relatively low

rates of interest.

Entry into the OECD: Japan's position in the league of the world's most affluent nations was cemented with its Organization of Economic Co-operation and Development (OECD) membership coming through in 1964. The same year, Tokyo hosted the Olympic Games signifying a fundamental shift in how the world perceived Japan, now a high-income OECD country. This was the first time that the Olympic Games were held in a non-western Asian country and the world was gradually acknowledging Japan as a key player in the global landscape. Astonishingly, the erstwhile war torn country had firmly launched itself into a growth trajectory of over 10% in the decade spanning the 1960s, a feat commonly called the "Japanese miracle."

Japan's economic growth

It is a matter of pride for Japan that it houses one of the most educated, skilled and healthy human populations in the world. Boasting the highest life expectancy in the world, the country successfully offset the disadvantages of having limited natural resources and arable land. While the unparalleled economic recovery of Japan after World War II was propelled by the manufacturing sector, primarily by the automobile and the consumer electronics industry, the economy progressively became more broad-based, shifting to a services-centered economy. Exports have always been one of the critical drivers of the Japanese economy. Not surprisingly, this robust trade performance enabled Japan to have the second largest stock of foreign exchange reserves in the world, after China. However, Japan's external demand is still driven by manufacturing, as over 65% of its exports are comprised of transport equipment, electrical machinery, and general machinery.



A global leader in innovation and quality, Japan has made ground-breaking contributions in automotive technology and design.

Japan also emerged as a global financial center, with the Tokyo Stock Exchange becoming one of the most important stock exchanges in the world

Stumbling blocks slacken economy's pace

Economic growth drops: Until the mid-1980s, Japan's economy enjoyed favorable conditions and stable growth, with low inflation and a low unemployment rate. However, the yen's appreciation in 1985 rendered the export sector uncompetitive, causing a moderation in growth from 4.4% in 1985 to 2.9% in 1986. The government tried to provide a stimulus with a drastic easing of the monetary policy through deep rate cuts. This action boosted investment as well as corporate profits, and these conducive conditions caused excessive funds to flow into the stock market and the real estate sector, thereby causing abnormally inflated increases in asset values. The government, in order to tackle this financial bubble, changed tack with a more stringent monetary policy and increased rates. Following the rate hikes, stock prices plummeted in 1990, followed by sharp declines in real estate prices. GDP stagnated in the 1990s, turning negative in 1998. By 2000, the unemployment rate rose from 2.1% in 1991 to 4.7%. The financial system of the country also witnessed an unprecedented collapse - huge bad debts were created in the loan portfolios of financial institutions as corporate borrowers suffered serious losses due to declining stocks and real estate prices.



The rapidly aging population in Japan remains a challenge for future growth.

To revive the sagging economy, the government initiated fiscal stimulus packages or spending programs totaling over 100 trillion yen (\$947 billion) in the 1990s, resulting in skyrocketing gross public debt. To foster economic recovery, Japan also followed an easing of its monetary policy, with short-term rates reduced to 0 between 2001 and 2005. After bottoming out in 2002, the Japanese economy staged an export-led recovery, with GDP growing by 2.6% in 2005 and 2.2% in 2006, and marginally slowing to 2% in 2007. It is a testimony to Japan's resilience that its economy had weathered this prolonged deceleration, although the worst was yet to come

World financial crisis: The subprime crisis, which originated in the U.S. in 2006, and the subsequent weakening of the global economy, both intensely affected Japan, which was highly leveraged by its external sector, its Achilles heel. Just as the country emerged from a prolonged deflationary and recessionary environment, it was thrust into another more debilitating crisis in the form of the global economic recession. Unlike the U.S., or even countries in the European Union, Japan's financial sector was not unduly exposed to the subprime sector, but a decline in its crucial export sector and a dip in business investment hurtled the country into recessionary depths. GDP plunged 5% in 2009 in inflation adjusted terms. However, along with other Asian economies, aided by a loose monetary policy, and extensive stimulus measures from the Japanese government, which at one stage included cash handouts, the Japanese economy appeared to recover. Its strong export sector also benefited from reviving

demand in major emerging economies like China and India. Although these factors helped the economy for a few quarters, inflationary pressures have weighed on the gains that Japan had made from the fiscal stimulus.

But one of the biggest obstacles to Japan's economy came in the form of a devastating earthquake. In March 2011, an earthquake measuring 8.9 on the Richter scale off the coast of northeastern Japan unleashed a tsunami that affected 18 of the 47 prefectures in Japan, killing more than 13,000 people. It also knocked off the cooling systems of a series of nuclear reactors in a power plant in Fukushima. Although the meltdown of the reactors was prevented, a large amount of harmful radiation escaped into the atmosphere. The affected nuclear power plant was also shut down. A number of export-based industries such as electronics, autos, and steel making suffered, and output from these industries plummeted. The damage to property from the tsunami is estimated at around \$300 billion. A nascent recovery that was underway in the beginning of 2011 was stalled as a number of local prefectures witnessed a shortfall in output.

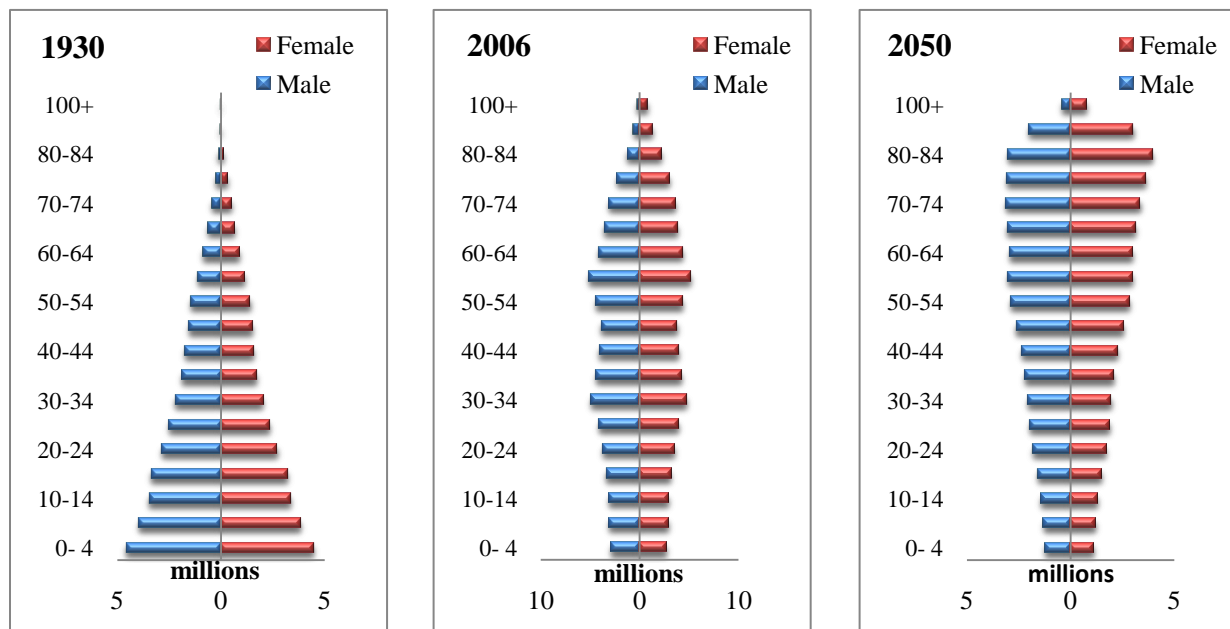
Major hurdles to economic growth

Political Impasse: Japan has been plagued by a dearth of leadership at the highest levels of government since the mid-2000s. Frequent scandals and infighting among ruling parties have often resulted in short tenures for the country's prime ministers, often lasting only a few months. Since 2007, Japan has witnessed the rotation of five prime ministers. In 2009, the Democratic Party of Japan (DPJ) won a landslide election defeating the Liberal Democratic Party of Japan, which had ruled Japan for 50 continuous years. However, the newly-elected DPJ too has been struggling to provide effective leadership for Japan. Constant bickering between the two major parties of Japan (LDP and DPJ) has resulted in a political impasse that has effectively blocked much-needed reforms in the country.

Lack of reforms: Important economic reforms have been few in coming – the privatization of the government-run mail service Japan Post began in 2007, but last year, the current government halted any future sales of Japan Post shares. The onslaught of globalization and greater integration in the global economy has also posed many challenges for Japan. While Japan has long been the undisputed leader in the manufacturing domain, the forces of liberalization and lowering of trade barriers across the globe have resulted in an intensely competitive environment constituted largely by emerging economies the world over.

Demographic Deficit: Of all the problems that Japan faces, perhaps none is as pressing as the rapid aging of its population. Japan has been facing an unprecedented shrinking of its working-age population over the last decade. The problems for Japan are many fold in this regard as the decline in working age population of the country will continue unabated over the next four decades. As Japan entered the Meiji period in late 1860's, the country threw away its inward-looking feudal system and adopted a more open society.

Japan's Population by age-group since 1930



It opened its borders and began industrializing the nation. For the next seven decades, until the 1940's, Japan's population grew at a steady pace. However, in the 1950's as economic opportunities grew for Japan's masses, the country's fertility began to decline as more women joined the workforce. By the 1980's Japan's fertility had fallen to around 1.5. Currently, Japan's fertility is 1.2 children per women. This means most women in Japan give birth to no more than one child in their life time. On the other hand longevity of Japan's people has risen to such a great level that average life expectancy in Japan has touched 83 years. This means trouble for the country from both the ends of the demographic spectrum. While there are more elderly people, there are fewer young ones to support them. Japan's working age population, which rose to a high of 87 million in 1995 from 50 million in the 1950's, has since started falling. The country's current working age population is around 80 million. This figure is expected to fall to 50 million in 2050 and will equal the number of working age population a hundred years ago in 1950. By 2030, over 30% of the country's population is expected to be over 65.

Fiscal health: Japan's fiscal health continues to cause concern. An alarming public debt, the largest among developed countries, forced Naoto Kan to propose several fiscal austerity measures, which include a rise in sales tax (a hugely unpopular move), and a plan to restrict bond sales. The International Monetary Fund (IMF) estimates the country's public debt at around 215% of its GDP.

Lack of diversification: Japanese firms, which have been global leaders in manufacturing, will also need to actively diversify their operations, especially into services; or alternatively, outsource certain business operations to retain cost competitiveness in the world markets.

Weak domestic spending: Domestic consumption has been anemic, and trying to force the notoriously thrifty Japanese to spend during an uncertain economic period will be a task for Naoto Kan's government.

Financial crisis: Lingering effects of the financial crisis continue to hover, especially in southern Europe and there is uncertainty about the extent of the economic recovery in the U.S. Given that scenario, Japan remains heavily dependent on Asian economies for future economic growth.

Labor woes: The OECD also recommends that Japan increase growth in the services sector by enhancing labor productivity. Labor productivity in Japan, the organization estimates, is 30% below the U.S. level.

Can the Japanese sun rise again?

Japan is a resilient country, with an undying spirit to excel. With renewed vigor, the nation has ascended to glorious heights after each setback that it has encountered. While the first half of the 20th century was a witness to its emergence as a contemporary global power, as well as its subsequent virtual destruction, the latter half saw the country's spectacular ascent yet again, scaling the global economic landscape.

The onset of the 21st century saw the country battle a protracted recession. Bigger challenges also await Japan as the country will come to terms with the

demographic issues it faces. The earthquake of 2011 has also setback Japan's economy by a few quarters. These are turbulent times for Japan. Perhaps the country's most challenging time ever, economically. But the country, despite all its travails remains a colossal economic force thanks to the material wealth it accumulated over the centuries. If there ever was a country known to weather storms, it is Japan. Yet, only time will tell if the Japanese sun can rise again from the ashes of its latest economic challenges. 🌍



An icon of the Japanese spirit to excel, the *Shinkansen* or the Bullet train, is the world's first high-speed train, introduced in Japan in 1964. It is an inter-city train that runs at an average speed of over 160 miles per hour.

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