

Rethinking Japan: an opportunity for Australian business

Japan has been working hard to turn around their economic fortunes. And whilst they have had some success, there is still plenty to do. Leading thinkers met recently with PwC and Asialink Business to discuss the state of Japan's economy and what it means for Australian business. Here are some of their insights.

Japan's need to lift FDI is an opportunity for Australian businesses

Japan has the lowest ratio of Foreign Direct Investment (FDI) as a proportion of GDP among OECD member countries. As Japan struggles to address fiscal imbalance and low growth, it will need to look at ways to lift the flow of capital investment into the country.

So why is FDI in Japan so low? Some suggest it's a result of capital outflows on the back of a depreciating Yen, as well as the sluggish business environment.

But for others the problems are deeper. A major one is the challenge of labour – foreign firms face a tough fight for talent in Japan due to the declining population and the fact there are few women in the workforce. Another is corporate governance, an area that is proving politically difficult for Prime Minister Abe to reform. A more prosaic reason for low FDI may simply be the fact that Japan does a poor job at selling itself as a preferred destination for foreign capital, particularly compared to China, Korea and Singapore.

Whilst the low level of FDI is a challenge for Japan, there is a strongly held view that it presents a largely untapped investment opportunity for Australian businesses.

Information a challenge, particularly in Japan's dynamic SME sector

Australian companies historically are under-invested in Asia; only 9% are currently doing any business there at all. A reason commonly given is that Asia, including Japan, is simply 'too hard'.



Whilst this perception is generally over-stated, it is not without some merit. For example, Australian businesses have reported great difficulty in getting information in English about Japan's market opportunities and business regulations.



This appears to be particularly true for the SME sector, a sector that in fact represents one of the most promising opportunities for Australian business. Many of the companies at the forefront of high tech breakthroughs in Japan are SMEs and are looking to take their companies to the next level.



Both Australian and Japanese players in various sectors, such as the high tech SME space, could benefit from greater effort to break down information barriers and explore investment opportunities.

Outlook for Japan-Australia business relationship hinges on reforms and inter-regional trade

The future of the Japan-Australian business relationship depends to a large extent on the success of Japan's reform agenda; without reform Japan's economy will struggle to grow (see breakout box, left) and attract FDI from countries like Australia.

But in addition to internal reforms, Japan also needs to increase its share of trade in the booming inter-Asia markets. Intra-Asian trade was \$3 trillion in 2013 and is predicted to exceed intra-Europe flows to become the world's largest trading network by 2016. With the JAEPA and TPP agreement now in place, both Japan and Australia can work together to not only increase trade and investment with each other, but also with the growing markets of Asia and Pacific Rim countries.

Turnbull Government keen to engage with Japan

New Australian Prime Minister Malcolm Turnbull has put relations with Japan high on his agenda with a plan to meet Prime Minister Abe before the end of the year. Discussions are likely to focus on investment and the new trade agreement, as well as defense matters including Australia's contract to build a new fleet of submarines.

Mr Turnbull needs to reassure Japan that he is as supportive of the relationship as the previous Prime Minister Tony Abbott was. This will bode well for Japan-Australia relations, both politically and economically.

Japan and Australia can both benefit in Asia by looking towards the future

Australia is struggling with its engagement with Asia at the same time that Japan is struggling to reform its own economy. A deepening of relations and focus between Australia and Japan – at the business, government and university level – might just be what both countries need to become stronger players in the region. The unanimous view is to embrace a sense of urgency.

Economic snapshot: better, but room for improvement

Deflation largely under control

Japan's economy has improved considerably under the last 2 years of Abenomics, which has brought an end to the crippling, decades-long period of deflation. Inflation, while still low, is expected to rise over the medium term. Threats include slowdowns in China and the EU, and US concerns over the low Yen.

Fiscal and structural reform needed to lift economy

The key challenge now for the economy, and the Government, is continued reform, both fiscal and structural. Abe's ability to drive these much-needed changes depends largely on his political capital, which tends to rise and fall with the success or otherwise of Abenomics. He is acutely aware of former US President Clinton's words: "It's the economy, stupid".

Taxes must rise and spending must fall

Whilst there are divergent views about the precise quantum and consequence of Japan's large Government debt, most economists and businesses agree it needs to be brought under control. Without tax increases and spending cuts the fiscal situation will only worsen. Some pundits believe it is likely that there will be an increase in consumption tax to around 16% VAT in the near term.

Workforce and other structural reforms key to arresting impact of ageing population

Japan's ageing population is a major drag on growth and a spur to deflation. Reviving the economy will require increasing workforce participation and productivity.

One option is to increase immigration; another is to remove the barriers preventing women from working more. Other important areas for structural reform are trade, particularly in the growing inter-Asian region, and agriculture.

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