Spotlight on Japan
Understanding the Japanese Consumer

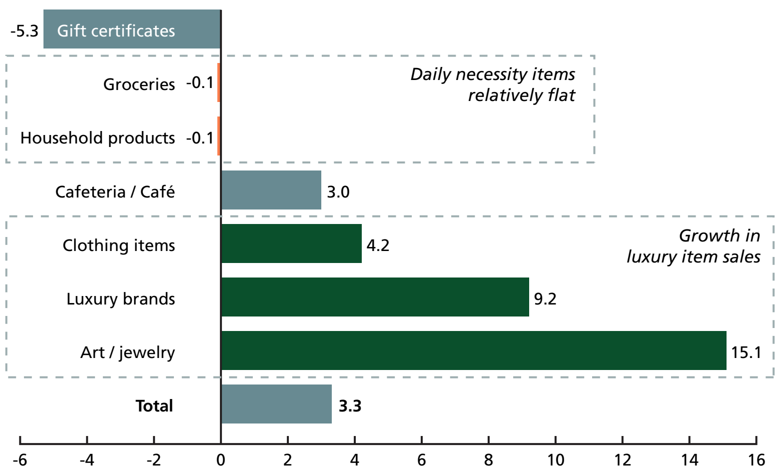
The single most important development for Japanese consumers over the last year has been the introduction of Abenomics, the popularized term for Prime Minister Shinzo Abe's aggressive economic initiatives introduced after his election in December 2012. With aggressive monetary easing and fiscal stimulus, the world's third-largest economy has reemerged as a major influencer of the global recovery.

While the long-term sustainability of Abenomics is debated, the impact on Japan's economy in 2013 was dramatic. The Nikkei 225 stock index gained 57% in the calendar year and corporate profits increased dramatically due to the newly weakened yen.

Given the speed of the market response, the effects of Abenomics on consumer spending vary notably depending on consumer socioeconomics; a clear wealth effect has emerged. Older and more affluent Japanese consumers increased their spending in 2013. For example, in the 12 months ending November 2013, spending in households headed by 65 to 69-year-olds rose by 8.3% compared to an increase of 2.1% among the population as a whole. These older, wealthier consumers have tended to favor one-off, discretionary and luxury items—categories that are experiencing relatively high growth. Department store sales of high-end items such as jewelry, art, watches and clothing have grown strongly over previous years while spending on travel and recreation have also increased (see Figure 1).

Figure 1

Department store sales growth (Mar 2012 vs. Mar 2013)



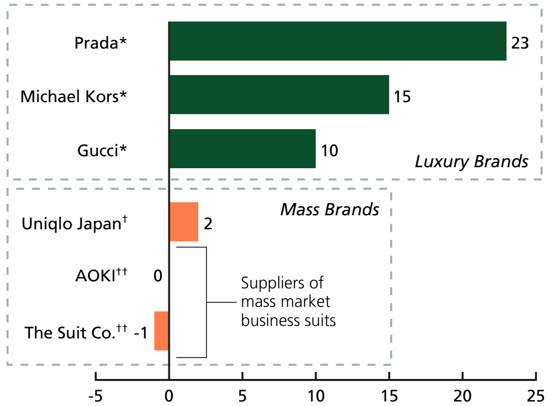
Source: American Express Inc., Cabinet Office, Bank of Japan, Nikkei Business, Japan Department Stores Association, L.E.K. analysis

Older Japanese consumers retain a high proportion of the country's financial assets, including stock ownership. They have both the money and the inclination to spend, particularly on luxuries and conveniences for themselves and their families. These consumers appear to have taken a cue from the anti-deflationary aspects of Abenomics, anticipating that the period of falling prices may be coming to an end and that now is the time to buy. As Hajime Takata of the Mizuho Research Institute observed, "In a deflationary environment, delaying spending was wise. Now, people are starting to think that things will no longer get cheaper." (A note of caution: Recent spending growth has been attributed not only to Abenomics, but also to the anticipation of a 3% increase in the consumption tax in April 2014—discerning clear trends in spending patterns can be challenging due to this confluence of factors).

The Japanese middle class has yet to respond to the effects of Abenomics in a significant way and their spending growth has been muted. Consumption of general, daily items like food and basic clothing has increased only slightly. The consumption of longer-term, bigger-ticket items has remained soft. Illustrating this point, sales of mass-market business suits targeting Japan's working level "salarymen" were flat to slightly declining year-over-year even as luxury brands experienced strong growth (see Figure 2).

Figure 2

YoY sales growth by brand (2012-13)
Percent change yr-over-yr



Note: *Q3 YoY; **Q2 YoY; †Comp sales Sept-Nov ; ††Comp sales Apr-Dec
Source: Company reports, Reuters, Seeking Alpha

Middle-class spending remains weak despite a rebound in traditional twice-yearly bonuses in 2013, especially for employees in the manufacturing sector. Many in Japan's middle class have yet to see any increases in their base salaries, which has stalled consumer confidence and hurt their ability to grow their savings. In addition, the majority of working class savings are in cash or cash equivalents. Consequently, these consumers have neither the disposable income levels nor the Nikkei-boosted savings of their elders.

Prime Minister Abe has been pressuring companies to hike wages before April when the consumption tax increase will take effect. Many companies, however, are hesitant to raise salaries before it is clear Japan has exited its deflationary cycle, defending their recalcitrance by claiming that once raised, salaries can't be cut without sacrificing morale. The combination of rising prices and limited income growth actually caused overall consumer sentiment to drop over the final two quarters of 2013. (see Figure 3).

Looking ahead, the aggressive monetary easing and fiscal stimulus of Abenomics is expected to continue, and we expect these economic initiatives to prop up Japan's economy over the next year. The success of Abe's broader structural reforms aimed at longer-term success remains in question, however (see sidebar). The sustainability of Abenomics depends largely on whether companies will begin spending more on wages and corporate investment.

For retailers operating in Japan, growth in wages will be a key indicator of whether the 2% inflationary target of the Bank of Japan can be achieved and sustained; success will help unlock Japan's considerable consumer spending. Some are skeptical that wages will increase after prolonged declines over the last 20 years. Others argue that Japan's corporate sector is sitting on large

What is Abenomics?

ACCORDING TO THE WORLD BANK, Japan's GDP was $5.96 trillion in 2012 and her population was 127.6 million. Since its heyday in the late 1980s, Japanese household income has steadily declined and the country has been plagued by deflationary pressures. The purpose of "Abenomics" is to break that torpor and ensure long-term sustainable growth.

Abe's policy measures center around "three arrows." The goal of the first arrow is to combat deflation and drive corporate investment by pressing the Bank of Japan (BOJ) to conduct aggressive monetary easing. In support of that goal, the BOJ more than doubled its monetary base in 2013, driving a 21% decline in the value of the yen against the US dollar. The goal of the second arrow is to spur long-term economic growth via fiscal stimulus. In January 2013, Abe announced a 10.3 trillion yen ($101 billion) spending package and then added another 5.5 trillion yen ($54 billion) package in December.

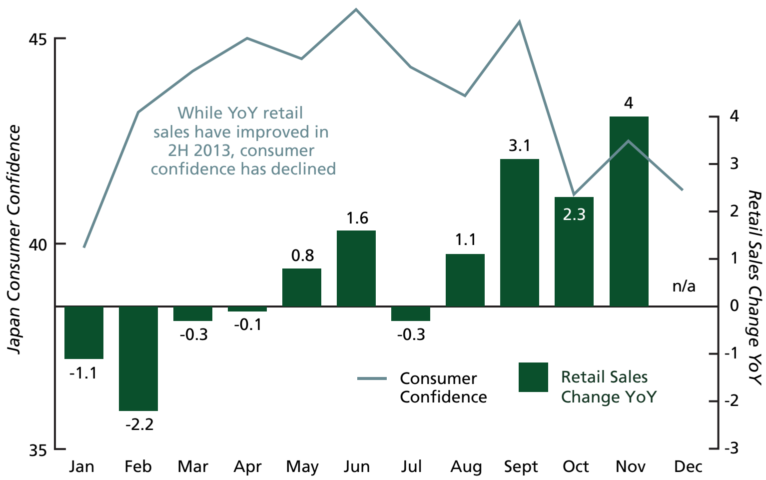
The third arrow is more challenging and has only been addressed in limited fashion thus far. Its goal is to create longer-term growth and improve corporate competitiveness via structural reforms. It includes addressing politically sensitive issues such as increasing worker mobility, reducing the corporate tax rate, as well as structural reform of key sectors, including agriculture exports, healthcare and energy. Questions remain about how ambitiously and how rapidly the Abe administration will push for these reforms.

cash reserves and earning significantly higher profits and, therefore, will start raising wages as confidence in the Japanese economy improves.

The 2014 calendar year will likely reveal whether Japan's economy has turned the corner. In the short-term, a key challenge for retailers will be finding the balance in retail and channel pricing that will support consumer demand in an uncertain environment, while accommodating growth in supply costs and transfer prices due to the weakened yen. As the longer-term effects of Abenomics are uncertain, retailers will need to monitor Japan's economic policies and their impact on consumer behavior to see how Abe's high-stakes reforms unfold.

Figure 3

Japan 2013 consumer confidence and retail sales



Source: Trading Economics

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