

Growth strategy launched to solve future social and economic challenges

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- ▶ The Growth Strategy and the Framework Policy, which has become the customary annual growth policy pledge by the Japanese government, was approved by the Cabinet in June. This year's policy has two distinctive features, one being a response to the global trend of economic and national security, green focus area and digitalization, and the other being prioritization of economic recovery over fiscal consolidation.
- ▶ The Ministry of Economy, Trade and Industry (METI) has urged the need for a state-led comprehensive industrial policy to address future social and economic challenges. And there is a growing movement among some politicians to support this by forming parliamentary groups and actively considering strategic areas of goods and services to be prioritised.
- ▶ Raising the potential growth rate has become the most pressing issue in Japan, where the birth rate is low and the population is aging. We believe that investing in technological innovation and talent development that will create economic value-add is the solution for the problems and economic growth.

In the post pandemic world the need to reduce physical contact has become paramount in order to prevent the spread of infection. This has forced major changes in everything from business activities to social life, including a rise in remote working and online activities. It has also shed light on problems that had not been addressed in Japan despite the fact that the need for this had been recognised for some time. For example: (1) the risk of foreign dependency latent within supply chains structured with production offshored and reliance on imports from overseas due to cost competitiveness; and (2) the need to promote digitalization in the midst of a declining workforce due to the falling birthrate and ageing population.

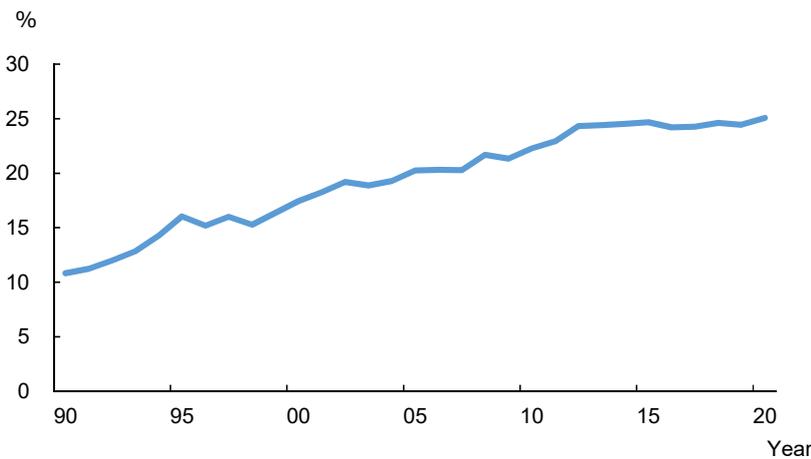
In pursuit of better cost competitiveness, Japanese companies have been shifting production overseas, building complexed, cross border supply chains in the process. However, given the rise of geopolitical disputes, the recent struggle for hegemony between the U.S. and China in particular, as well as natural disasters, experts have been pointing out risks within interdependent supply chains built across borders and regions. These risks manifested when the global pandemic hit our society, causing widespread disruption to companies in terms of production and inhibiting the supply chains of many aspects essential to our daily lives such as daily necessities, products and parts, as well as industrial activities. This has raised awareness of the danger of a high level of dependence on imports. The ratio of imports in Japan's industrial supply chain has climbed to around 25% (Figure 1: the Import Penetration Ratio) and reaches almost 70% in some specific industries such as the information and communications machinery industry and the textile industry.

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Economist

**“Japan's challenges revealed
by the Covid-19 pandemic”**

On the digital front, it is worth pointing out the fact that it took a very long time for the pandemic response cash handouts to reach individuals and companies in Japan in absence of appropriate databases and systems. Before the pandemic, we anticipated the significant progress in digitalisation would only occur after 2025 as the baby-boomer generation retires and the workforce population declines. However, the pandemic has changed the whole picture such that we now anticipate progress to be made a few years earlier.

Figure 1 : Import Penetration Ratio



Period: From 1990 to 2019 (Annual)

NOTE : Import Penetration Ratio = (import index × import weight)/(total supply index × total supply weight) × 100

Source: The Ministry of Economy, Trade and Industry

On 18 June 2021, the Cabinet approved the Growth Strategy Action Plan ,which sets out the government's policy for economic growth, and the Basic Policy for Economic and Fiscal Management and Reform 2021 (the Framework Policy), which sets out future policies and the budget for the next fiscal year.

“Features of the new Growth Strategy”

This year's strategy is characterized by (1) responses to international trends and (2) fiscal policy. In the past, the Growth Strategy has focused on domestic policies such as deregulation. This time, however, the Strategy includes such issues as economic and national security in relation to international economic supply networks, green focus areas as an international trend, and responses to the accelerating global trend of digitalization. With regard to the public finances, the new policy clearly states that economic growth should be prioritised over fiscal consolidation, based on the principle that public finances should be financed by the economy, although the target for fiscal consolidation remains intact.

In the green focus areas of the Growth Strategy, the government sets out to encourage companies to innovate towards carbon neutrality in 2050, earmarking a ¥2 trillion fund and taxation system considerations aimed at promoting investment. In the area of economic and national security, Japan's priorities include semiconductors, pharmaceuticals, batteries, and critical minerals including rare earths. In particular, with regard to semiconductors, the report points out the following problems: 64.2% of Japan's demand for semiconductors is dependent on imports; Japan is highly dependent on Taiwan and China as import destinations; and although there are a large number of semiconductor plants in Japan, the majority of them produce low-end semiconductors. The government aims to support the design and development of advanced semiconductors to support the digital society with its research and development fund, and promote building factories of such semiconductors in Japan in order to build a reliable supply chain network.

In June of this year, the Ministry of Economy, Trade and Industry (METI) published a document titled "A new axis of economic and industrial policy: the challenge of a new industrial policy" (Figure 2). The document recognises the need for government-wide support for key technological fields, strategically important goods, regulations and systems to solve future social and economic problems, which is a different approach to the past. Citing the industrial policies promoted by China, Europe and the United States, which call for self-reliance in strategic sectors and involve large-scale fiscal measures, the report mentions the importance of industrial policies in Japan that are stated and involve large-scale, long-term and systematic financial mobilisation.

On the political side, too, there is a growing trend within the ruling Liberal Democratic Party to establish parliamentary groups. The Parliamentary Assembly for the Promotion of the Semiconductor Strategy has been established to promote the development of semiconductors, which are indispensable for advanced technology and a strategic asset for economic and national security, and the Parliamentary Assembly for the Promotion of Battery and Other Basic Industries to Create the Society of the Future has been established to promote technological innovation in storage batteries, which are necessary for realising a decarbonised society. It is expected to have an influence on future budget and taxation decisions.

“Political support for the promotion of new industrial policies”

Figure 2 : New Axis of Economic and Industrial Policy

	Traditional Industrial policy	Structural Reforms Approach	New axis of economic and industrial policy
Term	Development of specific export industries (1940s-1960s) Stable Growth and International Friction (1970-1984)	Structural Reforms (1985-2008)	From 2021
Purpose	For a particular industry protection and fostering	Particular emphasis on improving the market environment	Resolving diversifying medium-to long-term social and economic issues ("mission-oriented")
Policy Framework	Microeconomic Policy (Supply side) Public initiative ~Prevention of excessive competition	Microeconomic policy (Supply side) Private initiative ~Promoting Competition ~	Unification of microeconomic and macroeconomic policies (demand and supply) (Wise Spending, productive government expenditure) Full mobilization of policy tools for an achievement for ambitious target setting, industry-government-academia collaboration, regulations and systems, international standardization, guidance of private finance, and the development of an innovative social environment
Technologies Development	Application/Practical use orientation	Basic research orientation	Creating ambitious and dramatic innovations
Positioning of the Manufacturing Industry	Manufacturing industry promotion and protection Focus on final products	Manufacturing industry Lower relative position	Digital transformation of design and production processes Emphasis on supply chains and value chains, including service industry
Public fiscal measures	Medium-scale and medium-term	Small scale, one-time and short term	Large-scale, long-term and systematic

Source: The Cabinet approved the Growth Strategy Action Plan

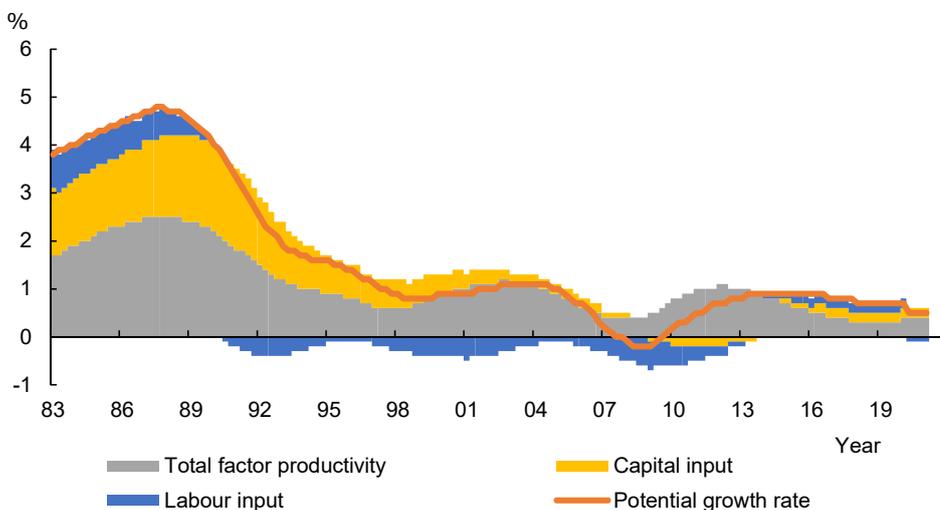
In Japan, where the birthrate is low and the population is aging, experts have been warning that a decline in the potential growth rate is inevitable (Figure 3). This will create a vicious circle for Japan's ageing society through the following channels: (1) constraints on supply capacity will lead to further restrained growth; and (2) the decline in the expected growth rate will suppress consumption and investment activity, and must be avoided at all costs.

“Boosting the potential growth rate”

The social distancing policies imposed in on a society-wide level to combat Covid-19 will continue to have a negative effect on productivity, particularly in the service sector. The traditional business model of low wage labour and low profit margins is no longer viable. We are now at a critical juncture where companies will need to change their work styles and business models to overcome this challenge, for example by becoming more efficient through digitalisation or by adding more value to the products and services they create. During the Covid-19 pandemic, the number of corporate insolvencies has been curbed by government cash handouts and financial support, but the number of closures and dissolutions has increased. One of the reasons for this is due to ageing management teams.

In both the manufacturing and services industries, the labour force will shift to growth industries and companies, and investing in technological innovation and talent will create economic value-add. The Covid-19 pandemic has reaffirmed the social and economic challenges for the future of Japan, and we believe taking appropriate measures to solve them will boost economic growth.

Figure 3 : Potential Growth Rate



Period: From January-March 1983 to January-March 2021 (Quarterly)
 NOTE : Potential growth rate: y/y % chg., others: Contribution
 Source: The Cabinet Office

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