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Special points of interest:

- Annual growth figures lowered to +1.3%
- Japanese firms make an increasing use of M&A, helped by a changing regulatory and business environment
- Special reports: the Tokyo Michelin guide and the new fingerprinting rule

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Japan's current economic situation

¥ per $ (2007)
Source: Bank of Japan

The announcement, on Dec. 19, that real GDP is expected to grow by only 1.3% in the fiscal year to March 2008 instead of the previously projected 2.1% led Prime Minister Fukuda to state that the government "should reflect on and regret the fact that [the new rules] had a negative impact on the economy." The tighter building regulations introduced earlier this year, which led to a sharp drop in housing starts, are expected to wipe 0.6 percentage points off growth.

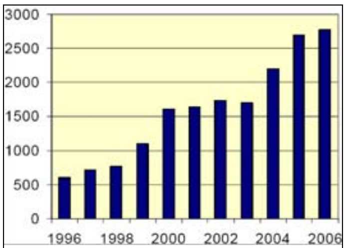
Meanwhile, figures for the July-September quarter have also been revised, with the quarter-to-quarter +0.6% and the annualized +2.6% figures being lowered to 0.4% and 1.5% respectively.

Although the possibility that Japan may fall into recession should not be dismissed, strong export figures suggest that it remains rather unlikely. Furthermore, after having hit a two-and-a-half year high against the dollar - at ¥107.17 - on Nov. 28, the yen has since gone down to around ¥113, easing the pressure on exporters and the export-driven growth.

However, strong export and profit figures are only enjoyed by big companies: profits at mid-sized companies fell by 17% in the third quarter, leading to the first fall in five years in Japan's aggregate corporate earnings. Usually, profits at big companies trickle through the economy, but this has not happened of late. Wages are still stagnant, and its combination with increasing prices led consumer confidence indicators to their lowest level in four years.

As a result of this dull prospect, the BoJ decided - unanimously for the first time since June - to keep interest rates on hold at 0.5%.

M&A makes its way into Japan



Number of M&A deals in Japan
Source: RIETI

On Dec. 10, Eisai, Japan's fourth largest drug maker, announced that it would buy US biotech firm MGI Pharma for $3.9bn, making it the largest foreign acquisition this year by a Japanese company, and the largest ever by a Japanese drug maker.

This deal highlights the growing need for Japanese companies to seek growth in overseas markets, as the ageing and shrinking population

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M&A makes its way into Japan

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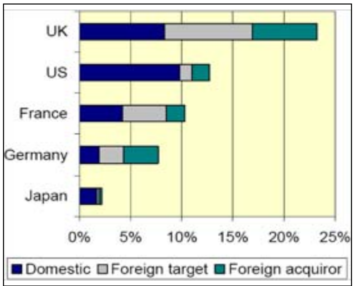
implies that prospects for growth in the domestic market look rather dull.

As a result, Japanese firms are increasingly making use of mergers and acquisitions: the value of deals involving Japanese companies acquiring foreign assets climbed from a meager $8bn in 2004 to $17bn the following year and $44 in 2006. Meanwhile, the total number of M&A deals involving Japanese companies reached 2,775 in 2006, more than four times the level of a decade ago.

In fact, Japan already had a history of strong activity in foreign acquisitions during the "bubble years", in the late 1980s and early 1990s, albeit in a very different context. That was the golden age of Japanese business and firms mainly made trophy acquisitions, mostly in the US. The acquisition by Mitsubishi Estate of the Rockefeller Center in New York is one famous example. However, these expansions were often overambitious, lacked synergies and were characterized by naïve financial strategies, so that most ended in shambles.

With the glorious days long past, the context has now changed. Many businesses see foreign expansion as a necessity, and the Japanese government is aware that the limitation of the domestic market is an issue that cannot be ignored, introducing a set of regulatory changes that brings the whole business system closer to that of its Western, and mainly Anglo-Saxon counterparts (see Geneva Bulletin, November 2007). These aim at taking the Japanese system toward a more open, transparent and market-friendly style with increased emphasis on shareholder value, with a view to creating an efficient market for corporate control. For instance, a law covering triangular mergers was implemented last May, allowing foreign firms to buy Japanese firms through local subsidiaries. Overall, regulatory change regarding M&A has been huge in the last ten years.



M&A as a percentage of GDP (1998-2005)
Source: RIETI

... regulatory change regarding M&A has been huge in the last ten years

Globalization has taken its toll on the traditional system too. The proportion of Japanese shares held by foreign investors has increased hugely, from 5% in 1990 to 28% now. These are traditionally more vocal and demanding than Japanese shareholders, and in order to satisfy them, Japanese companies have to take shareholder value into consideration, something they were not used to.

Other notable features of the Japanese business system seem to be unwinding as well. Cross-shareholdings are on a downward trend, and so is the influence of main banks. Lifetime employment is no longer assured, and the number of part-time workers has rapidly increased. These evolutions make for a larger market for corporate control where a more fragmented ownership means that it is easier to buy shares from other shareholders, and where firms are less reluctant to fire staff following an M&A deal.

Nonetheless, traditional attributes of the Japanese business system are still prevalent. The labor market is still rather inflexible, and some still view selling a firm as an admission of failure. In July, an appeals court upheld the anti-takeover defense set up by Bull-Dog Sauce, a food firm, against an American investment fund, Steel Partners, ruling that it was an "abusive acquirer".

Thus, M&A as a proportion of GDP is still much lower in Japan (around 3%) than it is in the US or UK (see figure), although it is much higher than in 1991, when it was just at 0.4%.

In fact, the Japanese market for corporate control now looks to be pretty much where the US was twenty years ago. Although many obstacles remain, things are beginning to move. Older businessmen still cherish the traditional business model, but younger managers are implementing the changes, and so is the government.

M&A in Japan is still in a developing phase, but if the country truly embraces M&A, the potential for growth is huge.

Stable shareholder ratio (%) (value of shares owned by stable shareholders (banks, insurance firms and non-financial firms) / total firm market value)
Source: RIETI

Tokyo named world's culinary capital

When, on Nov. 19, Michelin released the Tokyo version of its famous restaurant guides, some could just not believe it: Tokyo was awarded a record-breaking total of 191 stars, a huge number compared to Paris's 64 and New York's 42.

The truth is, Jean-Luc Naret, director of Michelin guides, knew that the launch of this guide – the first outside Europe and the US – would upset some. After all, it almost seems like stars have been attributed as if they were devalued, a sharp contrast with its traditional status that led some French chefs to commit suicide because they lost a star.

However, Mr. Naret defends his guide by claiming that "anyone who complains about this has never traveled to Tokyo, because if they do, they can see for themselves the fantastic quality of restaurants here". Moreover, Tokyo has an estimated 160,000 restaurants, compared with 20,000 in Paris and 23,000 in New York, which helps. Paris, meanwhile, can still console itself by retaining the lead in terms of three-star restaurants, with 10, two more than Tokyo.

Although some may have choked when hearing the news, it does not come too much as a surprise. Indeed, since the early 1990s, Tokyo has become a culinary destination that can no longer be ignored. Joel Robuchon, Alain Ducasse, Gordon Ramsay... The list of foreign stars that have come to open a restaurant is endless. All have been attracted by Japanese people's love for food and great curiosity, coupled of course with a strong purchasing power.

In addition to Western cuisine, the rich offer of exquisite Japanese food is also striking – 89 of the 191 stars went to Japanese restaurants.

It thus seems that Michelin was spot-on by attributing so many stars to Tokyo restaurants. 191: Surely a record that will be very hard to break...

Three of the eight Tokyo restaurants that got three stars are sushi bars

New fingerprinting rule introduced for foreigners

In a move that caused the ire of Japan's foreign community, the government recently introduced a rule obliging all foreigners entering Japan – residents as well as tourists and visiting businessmen - to have their photograph and digital fingerprints taken. Words such as "discriminatory" and "insult" have come forth, and Amnesty International has even called it "a violation of basic human rights".

This measure is all the more regrettable that it is intended to prevent international terrorist activities on Japanese soil. Not only is it a highly questionable tool for alleviating terrorism – had the perpetrators of 9/11 been fingerprinted on arrival in the US, they would not have been stopped: they entered legally - it also seems to be inappropriate in a country where terrorism has only ever been carried out by Japanese nationals – most notably in 1995, when Aum Shinrikyo, a religious cult, made a sarin gas attack in Tokyo's subway, killing 12.

The business community has also expressed concern on the impact this could have on the state of affairs, particularly at a time when Tokyo is ambitioning to become a major financial center. The tourism industry might also be affected.

Moreover, this law was imposed by the justice minister without any form of debate, and as thus highlights the inability of Japan's different ministers to act coherently. This policy should never have been introduced, not only because it is highly controversial, but also because it threatens to undermine the promotion effort of Japan's marketplace.

Japan is the second country after the US to introduce such a measure.

This policy [...] threatens to undermine the promotion effort of Japan's marketplace

JETRO
Japan External Trade Organization

JETRO is a government-related organization that works to promote mutual trade and investment between Japan and the rest of the world. Originally established in 1958 to promote Japanese exports abroad, JETRO's core focus in the 21st century has shifted toward promoting foreign direct investment into Japan and helping small to medium size Japanese firms maximize their global export potential.

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JETRO Website updates

Some new documents have been added to the JETRO website!

- The '2008 Economic Outlook for East Asia', released by JETRO's Institute for Developing Economies (IDE)
- A press release on the increasing presence of auto-related companies in Japan

They can be viewed on:
http://www.jetro.go.jp/en/news/releases/2007/

Furthermore, two sections have been added to the JETRO Switzerland website:

- 'Economic Information', which provides information on both the Swiss and Japanese economies
- 'Switzerland-Japan Relations', which focuses on trade, FDI and the Economic Partnership Agreement that is currently being negotiated between the two countries.

Please have a look at:
http://www.jetro.go.jp/switzerland/

We at JETRO Geneva wish you a Happy New Year!

We hope that you were satisfied with our services in 2007 and remain at your service for the coming year.

We look forward to hearing from you again in 2008.