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The Japanese Economy under the COVID Crisis

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Near-term macroeconomic performances, of course, depend on the way the Japanese authority handles the COVID-19 crisis. According to the Lowy Institute COVID Performance Index, Japan ranks 45th with the score 50.1, lagging behind New Zealand (1st with 94.4), Vietnam (2nd with 90.8), Taiwan (3rd with 86.4), South Korea (20th with 69.4) and Sweden (37th with 55.5) but coming before Switzerland (53rd with 48.4), Germany (55th with 45.8) and Canada (61st with 39.5), not to mention the UK (66th) and the US (94th).

It is important to remark, however, that while the UK, the US or Israel (62nd) do not have high scores in the handling of the pandemic so far, these three countries are the front runners in the field of the vaccination drive. In my view, these contrasting facts underline the social situations of these three countries. Confronting the COVID challenges, the day-to-day operations of these countries' systems are plagued by the political and societal divisions so that their responses are clumsy. Yet they are capable of producing paradigm changes, such as rapid development and deployment of new vaccines, to overcome the challenges. Another important point is that the Asian countries which performed better than Japan in fighting the pandemic have strong national security systems. Speaking truth, I am not very optimistic about the country's ability to roll out vaccination for the entire population quickly and effectively.

Speaking about the economic recovery from the COVID crisis, an alarming aspect is the less than bullish investor sentiment in Japan. Whereas in elsewhere, particularly in the US stock markets, investors are confident that when herd immunity of the population is attained with the help of vaccines the crisis will be over and a new phase of expansion will start, Japanese companies are not very sanguine about the future prospects. There is a pervading feeling in the society that just as the collapse of the real estate bubbles in the early 1990s has plunged the economy for a long-running deflation, this crisis will plunge the country into a long-run malaise. In order to avoid this drag-on effects, I urged at the Council of Economic and Fiscal Policy last year that the Japanese employers should not set the course of wage determinations based on the companies' performances in 2020. They should instead base it on the prospective performances in 2021, the year in which with the help of the vaccines the country will escape from the COVID crisis for good and the consumption will recover unhampered by the COVID-induced lockdowns.

Longer-term challenges facing Japan

In the remaining part of my discussion, I will deal with the country's longer-term challenges. We should separate the challenges into those that our big cities are facing and those our regions are facing. In my view, this dichotomy is important. We have to create internationally competitive big cities. Tokyo must compete with New York, Shanghai or London for innovativeness. It must be a hub for internationally competitive firms, including digital and financial companies. On the other hand, our regions must be the sources of the social stability. It should absorb employments. It should provide color to the anonymous culture of global hubs. In both fronts the country has to confront major challenges.

In the big-city front, the major challenges are digitalization and the scaling up of the role of financial sector to allocate the resources. The challenges that this country has to confront are epitomized in the following quote of Risto Siilasmaa, the former CEO of Nokia.

> *"A key source of sustainable competitive advantage in this industry has moved from the "who has device" toward "which device is most suitable to consume digital content" and "which device has access to the largest selection of most desirable contents."*
> *"This poses a huge challenge to Nokia as we have moved beyond the time when the creation of a hero device would have been a quick fix to Nokia's dilemma."*
> Risto Siilasmaa in *Transforming Nokia*

The above statement is about the existential challenge that the Finnish company Nokia faced in the mid-2010s. But our country is facing a similar challenge. In other words, the weakness of our country in the fields of digital industry resides in the weakness of developing a platform model. We are good at, or at least had been good at, producing high quality products. But the idea of providing platforms to which outside parties upload products never took hold in our business culture.

Americans, or the British for that matter, are good at it. They have probably developed the required know-how through the experiences of fostering financial markets. Market itself is not producing and selling. Market is a platform, a device, to which outside players upload their contents, i.e. financial products. And as Siilasmaa states “which device has access to the largest selection of most desirable contents” is the key question.

Lacking experiences in this field, our country must rely on foreign talents – Indians, Israelis, or Chinese perhaps – to foster competitiveness in the field. One encouraging development is that Toyota Motor Corporation placed James Kuffner to a key position of Chief Data Officer (CDO) to convert the company into a digital platform company.

Japanese regions’ main challenges

The main challenge facing the Japanese regions, on the other hand, is how to transform regional banks and regional SMEs into ones more suitable business model under the secular low interest rate environments. In the current low interest rate environment, Japanese regional banks suffer from dwindling interest revenues and may face existential threats possibly in near future. One added problem is that many aging SME leaders cannot find successors of their business.

Facing tough challenges, the Financial Services Agency relaxed the regulations setting the limits of the percentage of shares that banks can hold for non-financial companies. Now banks will be able to hold 100 % of shares in certain cases. Banks, however, have to sell these shares in a time limit – five years currently. That implies that banks should convert a typical SME into a salable company. In effect, banks must perform the tasks usually performed by private equities. The crucial question then is whether banks, especially regional banks, have requisite know-hows. Apparently, they do not. That is the main reason why tagging investment banks with regional banks to promote M&A activities is currently in vogue in the policy discussion. Prime Minister Suga seems to have an interest in the activities of SBI, in particular, in promoting the activities.

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