

Schroders TalkingPoint



Japan earthquake: one year on Shogo Maeda, Head of Japanese Equities March 2012



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In March 2011 Japan was struck by a devastating earthquake, the fourth largest ever recorded in the world, which claimed more than 16,000 lives and devastated the country's infrastructure, supply chains and exacerbated on-going economic issues. The ensuing tsunami swept across many cities only to further the damage. One year later, Japan has gone through an unprecedented rebuild and is working towards bringing the country back on track. As the first anniversary of the quake approaches, the progress of the country is commendable.

One of the notable by-products of the earthquake was the Fukushima nuclear crisis. The World Bank estimated the cost of the crisis to be \$235bn – one of the world's most expensive disasters. However, authorities worked hard to fight the radiation leak and levels continue to reduce as time passes by. TEPCO (Tokyo Electric Power Company), the operators of the Fukushima plant and the largest electric power company in Japan, announced precipitous losses. One year on, we see positive developments around TEPCO including the stabilisation of nuclear reactors and a gradually changing outlook for government support. Yoshihiko Noda, the Japanese Prime Minister, has been pragmatic in his approach to the nuclear power issue and the earthquake has resulted in a review of how nuclear power – which prior to the quake was close to a third of electricity generation – should be consumed.

Japanese consumers and companies are now proactively reviewing their energy usage. Energy consumption has reduced by 10 to 20% and there is no doubt that energy efficient products will be the focus of consumer-goods producers. Interestingly, one of the leading house builders, Sekisui Chemical, expects the ratio of its houses equipped with solar panels to rise to 90% in the second half of the current fiscal year, which ends in March 2012 – the ratio was 77% a year earlier. Therefore, as a result of the disaster and higher energy costs, Japan will become even more energy efficient.



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Immediately after the earthquake struck, the Japanese government set up emergency headquarters as a central hub to liaise with government bodies and local governments, and to facilitate search and rescue efforts. In June, the Act of Reconstruction was created in order to promote a smooth and prompt redevelopment process. While the country still faces budget constraints, the government has allocated its government spending for reconstruction effectively and enforced three supplementary budgets to date. This has been mildly positive for the equity market and is helping the economy to recover. Nevertheless the government has been widely criticised by the media for poor coordination and lack of urgency. No politician would envy Mr Noda's position as he is struggling to repair the country's financial health by proposing tax hikes, while managing reconstruction efforts. It is encouraging that the many people in the affected areas, whose perseverance impressed us so much last year, are focused on rebuilding back their normal lives rather than waiting for government assistance.

When the earthquake hit, the longer-term worry for both the equity market and the economy was that earnings power



of Japanese companies had been severely damaged – however, this has not happened. Corporate earnings have shown, and are further expected to show, a significant recovery during the year. Corporate Japan continues to advance as historically high levels of free cash flow continue to be generated and returns have bounced back following the disaster.

Prior to the earthquake, the rising costs of energy, persistent strength of the yen and higher taxes resulted in a steady shift of production abroad. As a result of the disaster this trend has been accelerated and we believe manufacturing jobs in Japan will continue to shrink. Toyota, Honda and Nissan are expected to produce over 70% of their cars outside Japan in two years. We do not believe that the concept of 'just-in-time' (the inventory strategy which improves return on investment by reducing in-process inventory and carrying costs) has been made obsolete by the disasters including the floods in Thailand, which gave another blow to Japanese manufacturing companies. However, companies will have more inventories than before, and will diversify sources of suppliers and production geographically. This will initially result in increased costs, but over the long term, efficiency gains will offset this.

The disaster has done little to change our belief that the Japanese market remains attractively valued relative to history and other regions. Growth, although slow, has resumed over recent months; wages are beginning to recover and consumer sentiment is improving. While there is evidence of a global slow down, Japan is continuing to show resilience and is being boosted by the recovery efforts post earthquake. It is clear to see that the Japanese market is regaining its upward trajectory so long as the global backdrop does not deteriorate significantly from here.

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