Japan. An Inflection Point.

Picture this story on the front page of the New York Times or the Wall Street Journal:


Hat Tip to Jeff Uscher of Japan Insider for the catch. Jeff notes that “As of September 2016, 27% of the Japanese population was aged 65 or older but ‘only’ 13% are aged 75 or older.” Jeff reminds us that “the standard of being considered elderly was raised from 60 to 65 back in 1956.” That change was driven by a United Nations ruling. In 1956 the average life expectancy of a Japanese man was about 64 years. Today it is about 81 years. For women, life expectancy was about 68 years then and is 87 years now.

Translate this approach to payments for workers and retirees. Take the working age to 75 and the pre-elderly age to 65, and the entire payments structure of benefits shifts dramatically. This change occurs at a time when Japan’s aging population is working longer and the labor market in Japan has tightened. Remember, Japan has very strict limits on immigration. In Japan, the ratio of job openings to job applicants has tightened to the level it was 20 years ago.

Does this measure portend the end of deflation in Japan? Will we finally see changes in incomes and movement away from the two-decade malaise of no inflation, limited growth, and continuously rising savings rates as people worked longer and accumulated more money in order to protect themselves in their old age?

We just might be at an inflection point. The Bank of Japan estimates that the “labor output gap” is now positive, which means that the country has run out of surplus workers (source: BCA Research).
In Japan, there is a growing evidence of petty crimes among the elderly. They are motivated by the need to support themselves. Will raising these age categories and permitting and encouraging work at later ages alter this socially negative outcome?

For investors, this strategic change is bullish for Japan. The Bank of Japan is unlikely to move away from the zero interest rate level for some time. Thus the real interest rate can fall as labor income rises and the government continues to expand its defense expenditures while being able to finance its deficits at near-zero interest rates. Lower real interest rates often lead to higher growth rates.

Japan, its economy, and its stock market could be the major source of surprise and of gains in 2017. At Cumberland, we favor Japan in our international ETF strategies. We use combinations of ETFs, some of which include currency hedges.

For comparison, readers may note that the US population over age 65 is about 14%. Our aging demographic is smaller, percentage-wise, than Japan’s, and our immigration policy may be under political attack but it is not as closed. Our system defines us as elderly at ages which start at 62 for a lower Social Security benefit and 67 for a full benefit. Our system mandatorily imposes taxation-driven rules on retirement payments at age 70½. And our system has many pension systems that are grossly underfunded (by trillions) because of promises based on retirement ages that are much lower than current life expectancies.

Does this situation portend a change in the American view of the elderly and pre-elderly, too? We cannot say, because the political fight would be fierce. In Japan, the society had to be forced to make this change out of absolute necessity. My best guess is that America is likewise incapable of being proactive, which means it will be a retirement funding crisis here that ultimately compels us to update and match benefits
with life expectancies.