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# **Wirtschaftsbericht / Economic Report Japan**

Dezember 2019

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## Zusammenfassung (Executive Summary)

- Am diesjährigen WEF in Davos erklärte der japanische Premierminister Shinzo Abe den Pessimismus zu Japan als besiegt («*Defeatism about Japan is now defeated*»). Tatsächlich hat die drittgrösste Volkswirtschaft seit 2012 – der Rückkehr von Abe an die Macht und der Lancierung seines *Abenomics*-Programms – ein beachtlich konstantes Wachstum gezeigt.
- Im Frühjahr 2019 wurde – nach offizieller japanischer Betrachtungsweise, die über das BIP hinausgeht – gar die längste Expansionsphase der Nachkriegszeit erreicht. Das Wirtschaftswachstum Japans *pro Kopf* beträgt seit 2012 im Jahresschnitt 1.5% – ungefähr gleich viel wie das der USA.
- Japan erbringt sein Wirtschaftswachstum nämlich mit einer schrumpfenden Bevölkerung. Ungefähr 300'000 Einwohnerinnen und Einwohner verliert das Land derzeit jährlich. Gleichzeitig verschiebt sich die Alterspyramide laufend: Bereits sind etwa gleich viele Japanerinnen und Japaner über 65 wie im ordentlichen Erwerbsalter.
- Damit ist Japan Vorreiter unter den alternden, schrumpfenden Ländern. Politik, Wirtschaft und Gesellschaft stehen vor neuartigen, grossen Herausforderungen. Gesundheitswesen, Altersvorsorge und Arbeitsmarkt sind nur ein paar der besonders betroffenen Bereiche.
- Auf dem japanischen Arbeitsmarkt wird der Nachfragedruck durch gestiegene Erwerbsquoten von Frauen und Menschen im Pensionsalter vorläufig noch gedämpft. Bei einer rekordtiefen Arbeitslosigkeit von 2.2% zeigen sich jedoch in verschiedenen Sektoren bereits deutliche Engpässe, die Anpassungen und Reformen erforderlich machen.
- Einen historischen Paradigmenwechsel vollzog das japanische Parlament im Dezember 2018: Erstmals können nämlich «gewöhnliche» Arbeitskräfte aus dem Ausland rekrutiert werden. Dies war bisher nur für Hochqualifizierte der Fall. Zwar sind die jährlichen Zielwerte (etwa 70'000) bescheiden und auf Sektoren mit überdurchschnittlichem Mangel begrenzt. Die Türe zu einer allmählich etwas gemischteren Gesellschaft ist jedoch geöffnet.
- Der «japanische Defätismus» – ein Ergebnis zweier Deflations-Jahrzehnte (1992-2012) – scheint auch atmosphärisch überwunden, jedenfalls was die florierenden urbanen Zentren betrifft. Neben politischer und gesellschaftlicher Stabilität, positivem Wirtschaftsgang und Vollbeschäftigung tragen dazu Grossereignisse mit globaler Aufmerksamkeit wie die G20-Präsidentschaft und der Kaiserwechsel mit neuer Zeitrechnung (*Reiwa* = schöne Harmonie) 2019 sowie die Olympischen Sommerspiele 2020 bei.
- Unterlegt wird die Erholung von einem fiskal- und geldpolitischen Experiment ohne Präzedenzfall. Als Vermächtnis der Deflationsjahre sitzt Japan weiterhin auf einem Schuldenberg von rund 240% des BIP. Gleichzeitig betreibt die Zentralbank seit Jahren eine ultra-expansive Geldpolitik. Inzwischen stehen 56% der japanischen Regierungsanleihen und 5% der *Exchange Traded Funds* in den Büchern der *Bank of Japan*. Ein Exit ist noch nicht in Sicht, ebenso wenig wie eine immanente Schuldenkrise
- Eine Anhebung der Konsumsteuer von 8 auf 10% im Oktober 2019 – zuvor zweimal verschoben – ist im Budget mit grosszügigen Stossdämpfern versehen worden. Zusätzlich hat die Regierung im Dezember 2019 ein wirtschaftliches Impulsprogramm beschlossen, das einen Abschwung verhindern soll.
- Wie das Jahr 2019 einmal mehr gezeigt hat, ist Japan Naturkatastrophen in besonders hohem Masse ausgesetzt. Daneben gehen derzeit vor allem von weltwirtschaftlichen Spannungen grössere Risiken aus. Im Konflikt zwischen den USA und China – Japans grössten Wirtschaftspartnern – ist das Land stark exponiert. Neue Abkommen mit den TPP-11-Staaten und der EU vermögen etwas Gegensteuer zu geben. Auch ein begrenzter Vertrag mit den USA hat zumindest vorläufig Druck aus dem bilateralen Verhältnis genommen. Schliesslich ist davon auszugehen, dass auch das im November 2019 auf politischer Ebene abgeschlossene RCEP (Regional Comprehensive Economic Partnership) gewisse positive Impulse auslösen wird, mit oder ohne Teilnahme Indiens.
- Für die Schweiz bleibt Japan ein bedeutender Wirtschaftspartner, der zweitgrösste in Asien und der sechste weltweit (die EU als Einheit gezählt). Handel und Investitionen entwickeln sich grundsätzlich positiv, mit einem deutlichen Handelsüberschuss zugunsten der Schweiz. Mit 126 Millionen teils sehr kaufkräftigen Einwohnern bietet der anspruchsvolle japanische Markt vor allem für Unternehmen interessante Möglichkeiten, die zu einem längerfristigen Engagement bereit sind. Ob das bilaterale Freihandelsabkommen nach dem Besuch von Bundesrat Parmelin im Juli 2019 in näherer Zukunft modernisiert werden kann, bleibt zu sehen.

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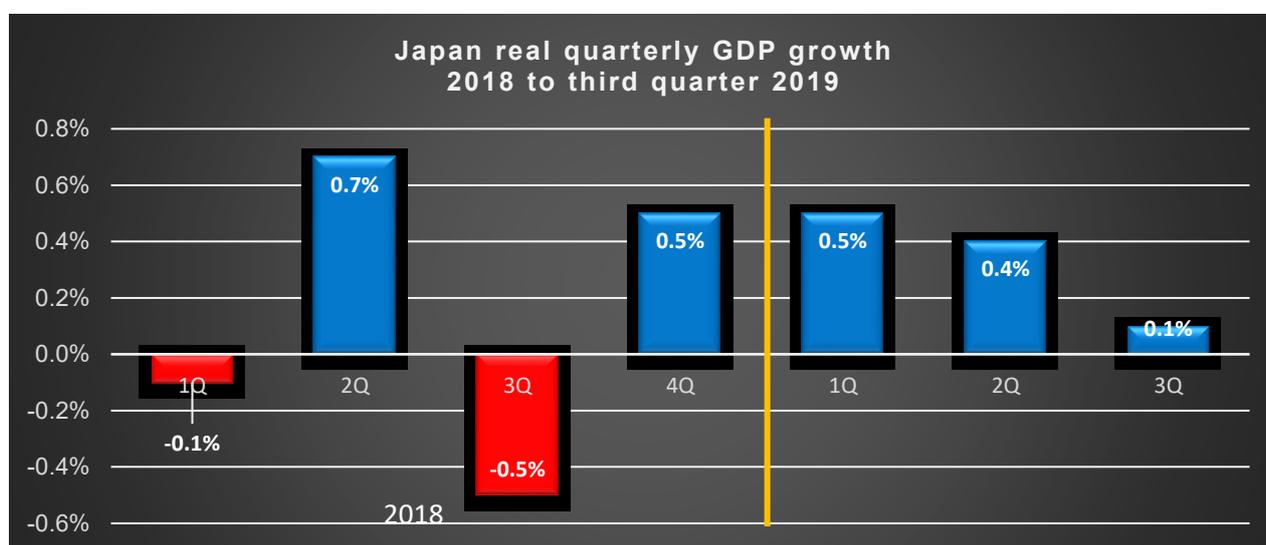
# Economic developments and main challenges

## Selected economic indicators

With a nominal gross domestic product (GDP) of 549,000 billion yen in 2018 (ca. 4950 billion CHF), Japan is the **world's third largest economy**, after the U.S. and China and ahead of Germany.<sup>1</sup> Per capita income is close to those of the United Kingdom and France.<sup>2</sup>

In 2018, Japan's economy experienced **uneven growth**. The first and third quarters saw some decline, while moderate GDP increases were recorded in the second and fourth quarters. **Capital investments** ran almost in parallel with GDP growth. Meanwhile, **consumption** once again remained **largely stagnant** within a +/- 1% range. Overall, **real GDP (seasonally adjusted) increased by 0.7%**, down from 1.9% in 2017.

Based on provisional data, **2019 saw a positive development** through the end of September, driven by private consumption and capital investment. The most severe setback in 2019 came from a typhoon – the strongest in decades – that crossed the main island in October. Furthermore, a consumption tax hike from 8 to 10% and declining exports showed a downward impact on GDP. The last quarter 2019 may therefore well result in a negative growth outcome.



Source: Cabinet Office (CAO)

According to a government panel assessing economic growth under a broad set of indicators, Japan's economic cycle in early 2019 reached its **longest expansion phase since World War II**. Starting in December 2012, when Prime Minister Shinzo Abe returned to power and launched his *Abenomics* reforms, this phase has now outpaced the two previous record periods (1965-1970 and 2002-2008).

In its latest forecast<sup>3</sup>, the IMF projects GDP in Japan to expand in 2019 by 0.8% in spite of increasing downside risks. For 2020, the outlook has been revised downward to 0.5%. However, the Japanese government has since adopted a stimulus program which is expected to boost growth by 1.4% in 2020 to 2021.

As an indicator for the gradual recovery of the Japanese economy from two decades of deflation (1992-2012), average residential **land prices have stabilized** after a long decline. The stock market benefited from record-high corporate profits before reacting to downside risks towards the end of 2018. Since the beginning of 2019, the Nikkei has again been on an overall positive trend.

In early 2019, Japan's **jobless rate** reached a **new record low of 2.2%**, staying at that level since then. Meanwhile, **real wages rose a mere 0.2%** in 2018, as businesses remained cautious on improving pay

<sup>1</sup> Source: Quarterly Estimates of GDP, Cabinet Office: December 2019

<sup>2</sup> Sources: IMF, World Bank.

<sup>3</sup> November 2019.

packages, particularly for employees on so-called “regular” long-term contracts. These account for about 62% of Japan’s workforce while “non-regular” employees on short-term contracts make up for the rest. Typically, “regular” and “non-regular” employees work alongside each other, with the latter being constraint by distinctly less attractive conditions. Upon reaching the statutory retirement age of 60, many previously “regular” Japanese workers are re-hired as “non-regulars”.

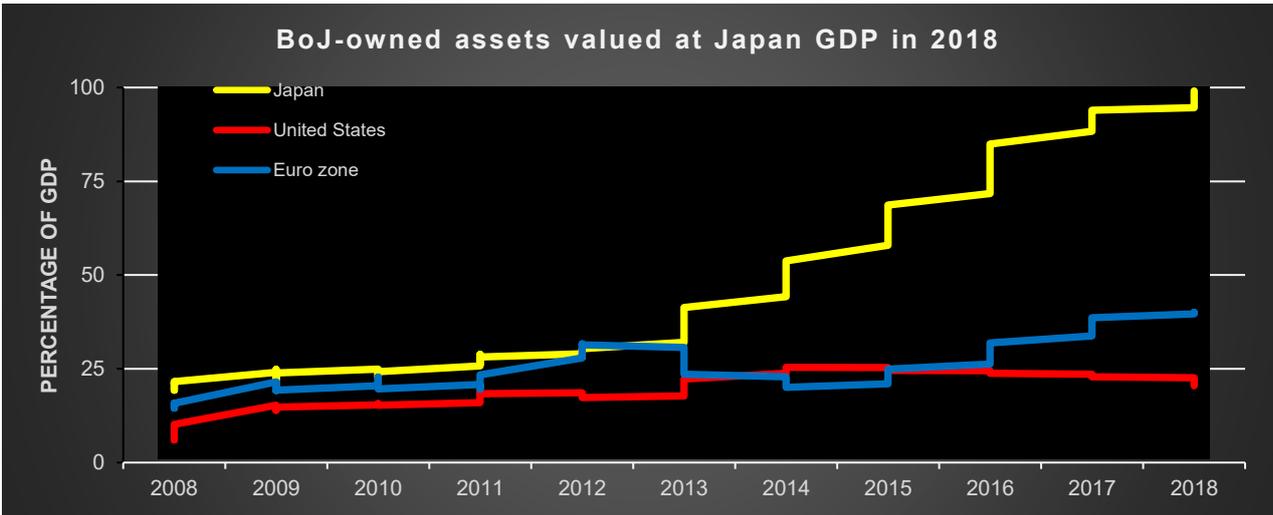
In 2018, inflation slightly outpaced GDP growth. The **consumer price index** (CPI; all items) **rose 1.0%** from the year before, double the 0.5% price gain in 2017. Core inflation – which excludes fresh food and energy – was +0.4%, after a 0.1% increase the previous year.

**Monetary policy**

In March 2018, the Japanese parliament confirmed Bank of Japan (BOJ) governor Haruhiko Kuroda for a second consecutive term, a first in almost 60 years. Under Kuroda’s chairmanship, the **BOJ did not change course on key policies in 2018 and 2019**, which include negative interest rates, extensive bond buying, and a 2% inflation target. In April 2018, however, Kuroda announced that the BOJ would no longer pledge a specific date by which the inflation target should be reached. Since 2013, such target dates had been pushed back six times.

Pursuing an extremely expansive “qualitative and quantitative easing” policy, the BOJ in 2018 became the **second central bank** (after that of Switzerland) whose **balance sheet exceeds the country’s GDP**. The BOJ finished 2018 with assets totaling 552 trillion yen. Around 85% of that figure consists of Japanese government bonds (JGBs). By means of equities held through exchange-traded funds (ETFs; ca. 5% of BOJ’s assets), the central bank now also is one of the largest shareholders of Japanese listed companies.<sup>4</sup>

**Side-effects of BOJ’s monetary policy** relate, in particular, to distortions of the bond and equity markets as well as margin pressure on, and increased risk taking by, banks and other financial sector actors. Nevertheless, there continues to be broad support – both domestically and among international organizations, such as the IMF and OECD – for **Japan’s monetary policy to remain highly accommodative** in the foreseeable future. As repeatedly indicated by BOJ governor Kuroda, an even more aggressive easing stance could be adopted if the economy were at risk to fall back into deflation. Conversely, an exit from Japan’s expansive monetary policy continues to be a distant prospect.



Source: OECD

<sup>4</sup> OECD Economic Survey Japan, April 2019.

## Fiscal policy

Largely as a legacy of two deflationary decades between 1992 and 2012, Japan has **one of the world's highest public debt ratios**. In 2018, gross public debt amounted to **236% of GDP**, while net debt stood at 153%.

During three years from 2014 to 2016, initial progress was achieved towards budgetary consolidation. However, that trend was reversed by **primary deficits** of 2.7% in fiscal 2017 and of **3.8% in 2018**. For the financial year 2019 (April 2019 to March 2020), a similar deficit figure is anticipated, in spite of a **consumption tax hike from 8 to 10% scheduled to take effect this October**.

Against this background, the government has pushed back the **target date for achieving a primary budgetary surplus from 2020 to 2025** – a projection that still relies on optimistic economic growth assumptions. In order to stabilize, or even reduce, government debt in the future, new measures to limit government spending will have to be accompanied by higher revenues which currently stand at a comparatively modest 35% of GDP.<sup>5</sup>

In March 2018, Japan's parliament approved a **98 trillion yen budget (ca. 865 billion CHF)** for the fiscal year starting in April. About 60% were to be covered by tax revenues which for the first time have recovered to 1991 levels – the year the Japanese bubble economy collapsed. The budget also called for 34 trillion yen (ca. 300 billion CHF) in new bonds, thereby pursuing a gradual decrease of the issuance.

The **2019 budget for the first time exceeded the 100 trillion yen mark**. Half of the additional revenue coming from a **consumption tax rise from 8 to 10% in October 2019** has been set aside for social spending, while additional measures are aimed at mitigating negative impacts on the economy.

Since the October 2019 tax hike, an even **more comprehensive stimulus program has been approved by the Abe government**. Over a 15 months' period starting from January 2020, this program adopted in December 2019 will partly address the consequences of the strongest typhoon hitting Japan in decades in October 2019 and, for the other part, support economic transition towards higher productivity. Overall, about 8% of the state's budget will be designated to provide an extra 1.4% growth effect by 2021.

## New economic policies

In June 2018, the Japanese parliament enacted a **Workstyle Reform** bill. This new legislation aims to limit overtime work – a frequent phenomenon in Japan –, to gradually increase the minimum wage (currently at 900 yen per hour; ca. 8.30 CHF), to establish the principle of equal-pay-for-equal-work, and contains guidelines aimed at shrinking the gap between workers on “regular” and “non-regular” contracts. It remains to be seen to which extent these new regulations will have an impact on Japan's traditional labour practices.

In December 2018, the parliament endorsed a potentially **major policy shift** in revising the Immigration Control and Refugee Act. For the first time, Japan is setting out to **accept significant numbers of foreign workers** with skills in areas such as construction, agriculture and care for the elderly. 14 sectors of the economy with labour shortages have been earmarked to receive up to 345,000 foreign employees with temporary residency status over the next five years.

Since April 2019, employers in designated sectors may apply for work permits for foreign nationals, most of whom are expected to come from Southeast Asia. Applicants need to provide evidence of certain levels of professional and Japanese language skills. However, the **first months under the new scheme have fallen well short of expectations**. Instead of up to 50,000 candidates anticipated to apply by the end of 2019 for the new status, less than 3000 have done so up to now. Most Japanese employers appear to still favor employing so-called technical interns and students from abroad for part-time jobs which do not come with requirements foreseen for the new workers' status.

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<sup>5</sup> I.e. the fourth lowest among OECD countries (OECD Survey 2019).

At the end of 2018, **2.7 million foreign nationals** were living in Japan (**2.1% of the total population**). Of these, 57% came from China, South Korea or Vietnam. 28% of Japan's foreigners had permanent residency status, while another 25% held a student or technical trainee visa which allow for limited employment.<sup>6</sup>

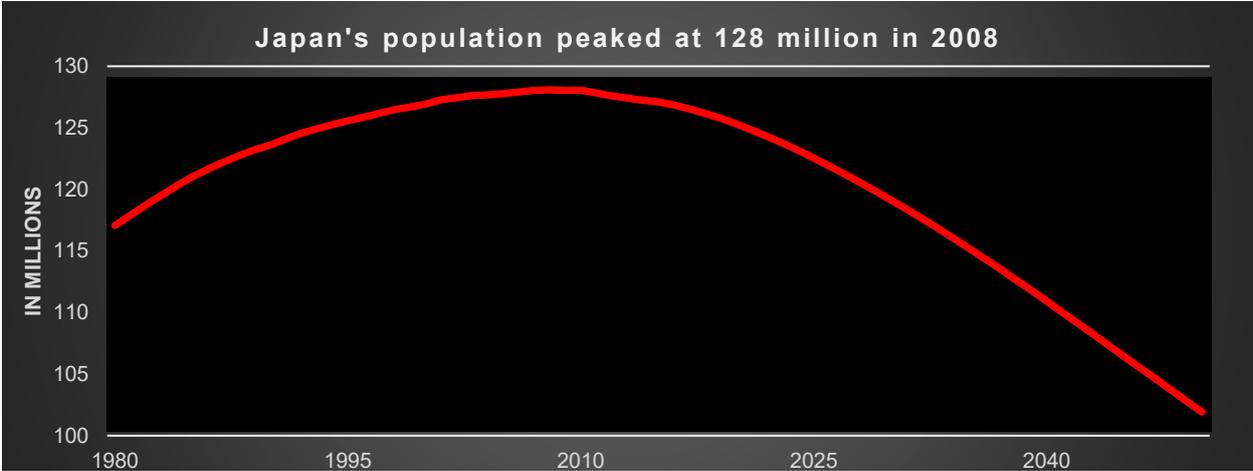
In June 2018, the Abe Cabinet released a strategy committed to a **data-driven revolution in Japan** called **Society 5.0**.<sup>7</sup> The strategy states that Japan's future will depend on whether it will succeed in the global competition for data and for experts in the field. Society 5.0 broadly paints a "super smart society" that makes use of, *inter alia*, automated transportation, unmanned factory production by employing 5G networks, artificial intelligence, robotics and blockchain technology, and distribution of high-quality healthcare even to remote areas. The policy vision calls for public and private sectors to collaborate in planning and executing comprehensive projects in coming years.

### The big demographic challenge

Japan has the **highest life expectancy in the world** (84.2 years), ahead of Switzerland.<sup>8</sup> More than two million of its citizens now are over the age of 90, and 70'000 above 100. Meanwhile, the domestic **fertility rate** has been below the mark of two for nearly 50 years and stood at 1.42% in 2018.

The combination of longer lifespans and fewer births, along with low levels of immigration, exposes Japan to **unprecedented challenges from a rapidly aging and shrinking population**. Deaths have exceeded births since 2007. In 2016, fewer than one million babies were born for the first time since counting began in 1899.

In **2018, the natural decline** of Japan's population hit a **new record of 444,000**,<sup>9</sup> with net immigration of 160'000 offsetting about a third of that decrease. Since the year 2000, the share of Japan's population over 65 has doubled from 26% to roughly 50% of the working-age population and is projected to reach 79% by 2050. By that time, total population is anticipated to fall below 100 million, from 126 at present.



Source: data and projections by OECD

These developments make Japan a global **front-runner in confronting the issues of aging societies**. The Japanese government declared the topic a priority area of work under its G20 presidency in 2019, noting that many other countries will face similar situations in a not too distant future. Among the main challenges that Japan and other aging and shrinking nations will face are a decreasing labour force along with increased spending for pensions, health and long-term care.

<sup>6</sup> Source: Ministry of Justice (2019).

<sup>7</sup> "Investments for the Future Strategy" (Cabinet Office, 2018).

<sup>8</sup> Source: WHO (2018).

<sup>9</sup> 918,397 babies were born, while 1,362,482 people died. Source: Ministry of Health (2019).

## Other reforms

Other **reforms** had **been introduced since the launch of “Abenomics” in 2012**, notably in regard of: corporate taxation (reduction from 37% in 2013 to 29% in 2018); corporate governance (new Code in 2015); women’s participation in the labour market (employment rate up from 60% in 2012 to 69% in 2018); attracting talent from abroad (“Japanese Green Card for Highly Skilled Foreign Professionals” in 2017); and promoting international trade (see below).<sup>10</sup>

Major further reforms will be needed, notably regarding the labour market, the social security system, health insurance and fiscal sustainability. **Prime Minister Abe’s** re-election to the presidency of the ruling Liberal-Democratic Party (LDP) in September 2018, which extends his **time in office by another three years until 2021**, offers an opportunity for further advances. Partial re-elections to the Diet’s Upper House in July once again provided broad public support for the government’s policy direction.

A number of sectors of the Japanese economy are considered to have significant growth prospects in spite of a diminishing working-age population. Particularly **high hopes** are placed in **robotics, artificial intelligence and other new technologies** that not only have the potential to replace workers and raise productivity but also to establish Japan as a world leader in technological solutions for aging societies. From a point of view of regional development, tourism has been a particularly strong contributor to economic development. In any case, Japan’s overall productivity still has considerable development potential, ranking 21th among OECD’s 36 members.

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<sup>10</sup> See overview in OECD Survey (2019).

## Economic agreements

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### Japan's policy and priorities

2018 and 2019 were exceptional years for Japan's trade policy. It first signed and approved the renegotiated "**Comprehensive and Progressive Agreement for Trans-Pacific Partnership**" (CPTTP) and an "**Economic Partnership Agreement**" (EPA) with the EU. It then moved to **concluding a first stage** pact with the U.S. and a **political finalization** of the "**Comprehensive Regional Economic Partnership**" (RCEP) with 15 Asia-Pacific partner countries.

With the **European Union**, a comprehensive deal was signed in July 2018 and came into effect on 1 February 2019. In combination, the two sides have a population of 640 million and represent approximately **30% of global GDP**. The Japan-EU agreement reduces or eliminates most remaining customs duties on goods – with **automobiles, for Japan, and agricultural products, for the EU**, being of particular interest. It brings improvements in the area of non-tariff barriers, reinforces legal security for investments and contains provisions for improved market access in selected services and government procurement sectors.

The signing of the **CPTTP** took place in April 2018. Following the withdrawal by the U.S. from a previously finalized TPP, **Japan had led the adjustment of the pact**, bringing it to a fresh conclusion without some provisions, notably on intellectual property rights. It entered into force on 30 December 2018 among the first six signatory countries (Australia, Canada, Japan, Mexico, New Zealand and Singapore), followed by Vietnam in 2019. Four CPTTP signatory states have yet to ratify the pact (Brunei, Chile, Malaysia and Peru). With about 400 million people in currently seven participating states, the treaty covers about 12% of world GDP. Whether it will be able to attract further countries remains to be seen.

A **limited trade deal with the U.S.** followed in 2019 after very short negotiations. It focuses on reducing or eliminating most **agricultural tariffs** agreed between Japan and the European Union as well as with the CPTTP countries before, in exchange for some liberalization for Japanese industrial exports. This agreement will enter into force on 1 January 2020. Meanwhile, a considerable number of trade-related issues remained unresolved and will be due for further negotiations potentially in a near future.

With the two above "mega-regional" agreements and a "first stage" pact with the U.S. completed, the Japanese government joined other governments in seeking a conclusion of the 16-nation **Regional Comprehensive Economic Partnership (RCEP)**.<sup>11</sup> At a RCEP Summit held in Bangkok in November 2019, all members but India declared the negotiations politically concluded, although some issues remain to be finalized before signing. For the time being, Japan remains committed to supporting India in joining the pact as an original member. However, should India remain outside the pact, it appears unlikely that Japan would remain on the sidelines.

Apart from these major initiatives, Japan is engaged in a **trilateral trade dialogue with the EU and the U.S.** that seeks "to address non market-oriented policies and practices that undermine the proper functioning of international trade". Furthermore, Japan participates in a "Reform and Modernization Initiative" for "middle-ground" WTO members led by Canada.

A long-time project for a **trilateral FTA between Japan, China and South Korea** regained some momentum in 2018 and 2019. At a meeting at prime ministers' level in Tokyo in May 2018, the three sides agreed to speed up the negotiations. A sixteenth round took place in Seoul in November 2019, with the aim of redefining the aim of the initiative following the political conclusion of RCEP..

Finally, Japan pursued **bilateral trade negotiations with Turkey**, with ten rounds held between January 2018 and October 2019. Meanwhile, processes with Canada, Colombia, the GCC and South Korea remained suspended.

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<sup>11</sup> In addition to Japan and the 10 members of ASEAN, Australia, China, India, South Korea and New Zealand participate in the RCEP negotiations.

## Implications for Switzerland

**Until 2018**, Japan had 15 preferential trade agreements, including with Switzerland (effective since 2009), covering a **limited part of its international trade agenda**.<sup>12</sup> The **EU EPA, the CPTTP, the U.S. agreement and – potentially – RCEP dramatically changed that picture**.

For **Switzerland**, these new agreements bring about some improvements, notably where Japan commits to aligning with international standards or to improving market access regulations that apply without discrimination. At the same time, Swiss companies' competitive position in Japan is **negatively affected mainly by significant tariff reductions primarily for agricultural products** and by **specific sectoral preferences** in areas such as government procurement.

Against this background, Switzerland has **asked for an update of its bilateral Free Trade and Economic Partnership Agreement** with Japan on several high-level occasions, most recently at a meeting between President Ueli Maurer and Prime Minister Shinzo Abe in June 2019 in Tokyo and during a visit to Japan of Federal Councillor Guy Parmelin in July 2019. At the 4<sup>th</sup> meeting of the joint committee under the bilateral agreement held in November 2018 in Berne, a dialogue had been started focusing, for the time being, on limited improvements that do not require parliamentary approval. Whether that approach can be taken further towards a full review of the FTEPA is a matter for further discussion.

## Foreign trade

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### Development and general outlook

#### Trade in goods

Japanese merchandise exports and imports continued to grow in 2018. **Exports rose 4.0%** to 81.5 trillion yen (ca. 722 billion CHF), with sales of machinery to China among the main drivers. **Imports increased 9.7%**. Here Japan's high dependency on foreign energy – in particular crude oil and LNG – plays a key role. Overall, Japan recorded its **first annual trade deficit since 2015** (1.2 trillion yen; ca. 10.6 billion CHF or 0.2% of GDP), after a 2.9 trillion yen surplus the previous year.

**China overtook the U.S. as Japan's biggest export market** with a 19.5% share, growing 6.8% to 15.9 trillion yen (ca. 141 billion CHF) in 2018. Japanese imports from China edged up 4% to 19 trillion yen (ca. 168 billion CHF), significantly slowing from a 20% increase in 2017.

The **United States** held an 18.9% share of Japanese exports, which increased 2.4% to 15.4 trillion yen (ca. 136 billion CHF). Meanwhile, purchases of U.S. cars, grain and pharmaceuticals contributed to a double-digit growth of imports from the U.S. to 9 trillion yen (ca. 80 billion CHF) – **shrinking Japan's trade surplus with the U.S. by 8%**.

Japan recorded a slight deficit with its **third largest trading partner, the European Union**. Exports grew 6.4% to 9.2 trillion yen (ca. 81 billion CHF) while imports expanded by 11% to 9.7 trillion yen (ca. 86 billion CHF). Germany remained Japan's largest export market and import partner among the EU member states.

**Figures for 2019** point to a considerable **slowdown of export activity from Japan**. Most affected were machines tools for production in China as well as a range of products bound for South Korea on the back of an escalating trade row.

#### Trade in services

With total imports of 22.2 trillion yen (ca. 195 billion CHF) and exports of 21.4 trillion yen (ca. 188 billion CHF), Japan's **services trade deficit** was 806 billion yen (ca. 7 billion CHF) in 2018 – slightly wider than in 2017, when the **lowest deficit on record** had been registered.

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<sup>12</sup> Agreements with: ASEAN (as a group), Australia, Brunei, Chile, India, Indonesia, Malaysia, Mexico, Mongolia, Peru, Philippines, Singapore, Switzerland, Thailand, Vietnam.

Transport, telecommunications and computer services were among those contributing most to the deficit. Meanwhile, **travel services recorded a new record surplus** for the fourth consecutive year, with more than 2.4 trillion yen (ca. 21.3 billion CHF) in positive territory. The government estimates that foreign visitors' consumption totaled 4.5 trillion yen (ca. 40 billion CHF) in a major contribution to economic and regional growth in Japan. After 31 million visiting tourists in 2018, the official goal is to attract 40 million in 2020.

The **U.S. remained Japan's largest services trade partner** (27% share), with estimated imports into Japan of USD 45.4 billion and exports to the U.S. of 34.5 billion in 2018, followed by the European Union (19%) and China (9%).<sup>13</sup>

## Outlook

Further increased **international trade tensions** – particularly between the United States and China – pose a **considerable risk for the Japanese economy**. Additionally, fallout from a bitter dispute with South Korea and consumer retaliation both for trade in goods and services are affecting Japan's economic growth potential.<sup>14</sup>

More generally, Japanese companies are strongly exposed to international value chains, as economic growth has strongly relied on exports in recent years. Apart from unresolved issues in the bilateral relationship with the U.S., Brexit is another worry for Japanese companies, with many having chosen the United Kingdom as a main base for serving the European Union market. Deteriorating *terms of trade*, both globally and in Japan's bilateral exchanges, may thus affect growth prospects for the Japanese economy going forward.

## Bilateral Japan-Switzerland trade

### Trade in goods

In 2018, **Japan was Switzerland's fourth largest trading partner** (after the EU counted as one, the US and China), according to Swiss Customs' business cycle trade statistics which exclude precious metals and stones, works of art and antiques.<sup>15</sup> With 2.5% of Switzerland's total merchandise trade and a value of 11 billion CHF, Japan's share is comparable to those of Spain and the Netherlands. If trade in the above-mentioned items (especially gold) are included, Japan ranks 7<sup>th</sup> among Switzerland's trading partners (preceded also by Hong Kong, India and the United Arab Emirates).

**Swiss merchandise exports to Japan rose 4.3% in 2018 to 7.6 billion CHF** (share of total exports: 3.3%), while **imports dropped 5.5% to 3.4 billion** (down 22% if precious metals etc. are taken into account, after a surge of 52% the previous year). As a result, Switzerland recorded a bilateral trade surplus with Japan of 4.2 billion CHF, the third highest - after those with the U.S. and Hong Kong (6<sup>th</sup> highest when precious metals etc. are included).

Leaving precious metals aside, **pharmaceutical products**, with a share of 44% once again were the **leading Swiss export to Japan** in 2018. Their value remained virtually unchanged at 3.1 billion CHF. Exports of watches increased by 9% to 1.34 billion, representing 19% of the total. Medical devices (up 3%), machinery (up 11%) and agricultural products (up 13%) also enjoyed solid export growth, while chemicals (-2%) declined slightly. Prospects for Swiss exporters remain positive, particularly in high-quality branded and niche segments.

Among **Switzerland's imports from Japan, automobiles held the top spot with 678 million CHF**, a share of 23% (-14%), ahead of machinery (up 9%), pharmaceuticals (-12%, after an increase of 54% in 2017) and chemicals (up 5%).

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<sup>13</sup> Sources: USTR (2019), WTO (2019).

<sup>14</sup> An equal share of about 20% of Japan's merchandise exports go to the US and to China. Among Japan's imports, about 25% are from China and 11% from the US, whereas South Korea stands at 7.1% behind the EU at a combined 11.3%.

<sup>15</sup> Source: Federal Customs Administration (2019)

## Trade in services

In 2017, **Japan ran a services trade deficit of 70 billion yen** (ca. 610 million CHF) **with Switzerland**.<sup>16</sup> Its exports to Switzerland fell by 4% to 450 billion yen, while services imports from Switzerland saw an increase of 14% to 520 billion yen. Sectors that contributed to the increase in Swiss services exports include telecommunication and computers, insurance and pension services, as well as construction.

Growth in Japan services exports to Switzerland was most prominent in fees from usage intellectual property, which more than doubled.

## Direct investments

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### Development and general outlook

**Japan's inward foreign direct investment (FDI) stock** was worth 30.7 trillion yen (278 billion USD) at the end of 2018, an increase of 5% year on year.<sup>17</sup> By country, the US continues to be Japan's largest foreign investor (59 billion USD), accounting for 21% of total inward FDI, followed by the Netherlands (15%) and France (12%).

However, Japan's level of inward direct investment remains **very low among developed countries**. As a percentage of GDP, FDI stocks in Japan accounted for 4.3% in 2018, compared to 67% in the UK, 37% in the US and 23% for Germany<sup>18</sup>. In spite of efforts by the Abe government to attract more foreign businesses to Japan, *inter alia* through a corporate tax rate cut to below 30%, a long way still lies ahead in view of catching up with other nations. As a new development in 2018, Japan's parliament adopted legislation that will for the first time allow foreign-invested "integrated resorts" to set up casino facilities in the country.

Meanwhile, Japan's **outward FDI remained robust**, expanding by 4.4% to another record high of 181 trillion yen (1,645 billion USD) at the end of 2018. By country, the U.S. is Japan's top destination, accounting for 30% of overall outward FDI stocks. The UK came second, with a share of 9%, followed by the Netherlands (8%). According to UNCTAD data, the value of Japan's outward FDI stood at 33.5% of GDP in 2016, compared with 14.6% in 2010. Still, this ratio remains below the average of 44.8% for developed economies.

### Bilateral investment

**Switzerland is the seventh largest foreign investor in Japan**, with FDI stocks worth 1.4 trillion yen (12.4 billion CHF) in 2018, up 16% from the previous year. This represents 4.7% of total inward direct investment.<sup>19</sup> In new statistics based on an "ultimate beneficial owner basis" released by the Bank of Japan in mid-2018, Switzerland even ranks fourth investor in Japan, after the US, France and the Netherlands. Around 200 Swiss companies have set up business establishments in Japan.

A breakdown by industry<sup>20</sup> shows that Swiss FDI in the manufacturing sector amounted to about 75.2 billion yen (666 million CHF) in 2018, with **pharmaceuticals and chemicals** accounting for a **majority share** (46.9 billion yen; 415.3 million CHF). Unlike in 2017, **electrical machinery** made a sizable contribution with 24 billion yen (212.5 million CHF).

On the other hand, the non-manufacturing sector registered a negative figure in 2018, one attributable factor being developments in the wholesale and retail sectors. Finance and insurance companies remained the main Swiss services investors in this category.

**Japanese direct investment in Switzerland grew by 12% in 2018** to reach a stock of about 1.6 trillion yen (ca. 14.2 billion CHF). Around 150 Japanese companies are established in Switzerland, some with

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<sup>16</sup> Source: MoF

<sup>17</sup> Source: MoF

<sup>18</sup> Source: UNCTAD World Investment Report 2019.

<sup>19</sup> Source: MoF and BoJ

<sup>20</sup> Figures for direct investment by industry are compiled according to the Direct Principle. Thus, the figures are different from those of direct investments in the Balance of Payments which are compiled according to the Asset and Liability Principle on a gross basis.

their global headquarters. The largest investments include wholesale and retail trade and construction businesses. At the end of 2018, Hitachi announced that it would acquire an 80% stake in ABB's power grid business for about 714 billion yen (ca 6.3 billion CHF), the largest purchase in the Japanese company's 108-year history.

## Trade, investment and tourism promotion

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### Export promotion

As a network partner of the government-sponsored agency “Switzerland Global Enterprise”, the **Swiss Business Hub in Japan** (SBHJ) is integrated in the Embassy of Switzerland in Tokyo with a staff of six members. Its export promotion section **offers customized consulting services for Swiss- and Liechtenstein-based companies interested in expanding in the Japanese market**. These services include market research and analysis, support for identification of qualified business partners and organization of trade fair participation in Japan.

Most projects are conducted in cooperation with trusted external experts. With Japan’s External Trade and Investment Organization (JETRO), the Swiss Business Hub has a Memorandum of Understanding on Cooperation, concluded in 2014. It also interacts closely with other institutions and stakeholders, such as the Swiss Chamber of Commerce and Industry in Japan. 2018 and the first months of 2019 saw an increase in the number of projects conducted by the SBHJ.

### Investment promotion

The Investment Promotion section of SBHJ opens doors for Japanese companies to Switzerland and the European market. In close cooperation with a range of Swiss partners, **Japanese companies are assisted throughout the process** towards setting up a business in Switzerland. Acting as a “one stop shop”, the SBHJ informs about advantages of Switzerland as a business location for expanding activities in Europe and worldwide. On behalf of the Swiss Cantons (sub-federal entities), it assists in finding the best location, making contact with economic development offices, meeting legal and administrative requirements, entering into partnerships, procuring work and residence permits and learning about legal and tax requirements.

Based on its **comparative strengths** – notably in the areas of innovation, education, productivity, infrastructure, tax, political stability, public sector efficiency and quality of life – Switzerland is, *inter alia*, attractive for Japanese investors for world or regional headquarters and for research and development activities. Sectors that have attracted interest from Japan recently include the Swiss fintech and blockchain industries. Companies active in high-tech areas, such as artificial intelligence, robotics and life sciences, also look to Switzerland as a research and development location. Meanwhile, comparatively high prices and restrictions for residence and work permits for non-EU citizens tend to be seen as challenges by Japanese investors.

### Tourism promotion

**Switzerland Tourism’s** office in Japan, first established in 1976, has been integrated in the Swiss Embassy since 2017. With three staff members, the office promotes Switzerland in Japan as an attractive destination for leisure and business travel, working closely with partners on both sides.

For Japanese travelers, Switzerland continues to be primarily a **summer destination**, with 70% of visits taking place between June and August. Switzerland Tourism Japan aims to increase travel in other seasons by highlighting unique features of the country, notably related to nature. For many years, Switzerland has ranked among the top five “dream destination” countries compiled by Japan Tourism Marketing.

In 2018, the Swiss hotel industry registered 382’585 **overnight stays** by Japanese visitors, **down 6.3%** from the previous year. Tourists from Japan continue to rank **among the highest spenders** in Switzerland at around CHF 300 per day, with a focus on quality. Their annual direct economic impact is estimated to be around CHF 190 million.

At the same time, Switzerland as a tourist destination continues to face **challenges** in the conservative Japanese market. These include the limited holiday entitlements of Japanese employees and the relative strength of the Swiss franc. Tourism in Europe as a whole is experiencing a rebound with increasing numbers of visitors from Japan, after a difficult period due to security concerns. Meanwhile, the boom of inbound tourism in Japan tends to increase airfares also for Japanese visitors to Europe.

## **Swiss-related economic networks in Japan**

### ***Swiss Chamber of Commerce and Industry in Japan (SCCIJ)***

The SCCIJ, founded in 1981, supports Swiss companies in Japan as well as Japanese enterprises interested in conducting business in Switzerland. It is among the most active chambers of commerce in Japan, organizing frequent events with the aim of providing relevant information and facilitating business contacts. The Chamber currently has about 200 members, three quarters of whom are corporates.

The SCCIJ contributes to official visits from Switzerland, such as by President Alain Berset in 2018 and Economy, Education and Research Minister Guy Parmelin in 2019. With the Swiss Embassy and IMD Business School based in Lausanne, the SCCIJ is a co-organizer of the Switzerland-Japan Economic Forum, a major event held for the second time in March 2019 in Tokyo. Together with the Swiss-Japanese Chamber of Commerce headquartered in Zurich, SCCIJ is furthermore sponsoring traineeships in Japan for young professionals from Switzerland.

### ***Japan-Switzerland Economic Council (JSEC)***

JSEC was established in 2014 when Switzerland and Japan celebrated 150 years of diplomatic relations. The Council is committed to connecting Japanese companies with direct investments in Switzerland, providing up-to-date economic information on Switzerland and promoting contacts between Japanese and Swiss stakeholders.

### ***World Economic Forum (WEF) Japan***

Japan has traditionally been strongly represented at WEF's Annual Meeting in Davos. WEF's Japan office, in collaboration with the Embassy of Switzerland, holds regular seminars attended by business, government and academic representatives to discuss key issues from the Annual Meeting in Davos. In March 2019, WEF founder and executive chairman Klaus Schwab delivered a keynote speech at the seminar.

### ***ISC St. Gallen Club Japan***

Established in 2003, the Club promotes the yearly international St. Gallen Symposium for current and future leaders, including by recruiting high-level participants from Japan. Annual meetings of are taking place at the residence of the Swiss Ambassador, its honorary president. As the World Economic Forum, the St. Gallen Symposium will celebrate its 50<sup>st</sup> anniversary in 2020.

### ***Other Swiss-related economic links in Japan***

Several Swiss universities have established alumni associations which regularly meet in different locations in Japan. City and tourism institutions maintain partnerships, such as the one between "Rhätische Bahn" and Hakone Railways.