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CASH: THE LIFEBLOOD OF JAPAN'S ZOMBIE ECONOMY

Just like any other country, Japan's economy has many problems. Most notably is their bond market that has been nationalised after decades of quantitative easing. In the past commentators often referenced "zombies" when speaking about Japan and the companies that inhabit its borders. However, after a growth spurt that lead to multiple expansionary quarters, this is not necessarily accurate anymore.

The funny thing about economic growth is that no one really, fully understands where it comes from, because many things that add to "growth" is not captured by economic theory. A good example is the benefit or value of using Google, YouTube and Facebook. Yes, we can capture the added value of these companies, but not the productivity increases gained by individuals who use this software. In the not so distant past, if you had a pertinent question you had to waste time driving to a library, look for a book on a specific topic, and probably read pages and pages to find an answer. Now, you can simply "Google" it, and within seconds you have an answer. Another good example about the limitations of growth theory, is that replacing a broken window adds to GDP, but breaking it in the first place doesn't subtract from GDP. We, like some other deep thinkers believe that because technologies, like free software, aren't accounted for in standard growth economics, economies are probably larger than we give them credit for.

We don't fully understand the growth story of Japan's economy. We also can't understand why Japan is arguably the most technologically advanced economy in the world but all this technological advancement, tied with the prudent, cost-cutting culture of the Japanese have led to a stockpile of corporate cash. In fact, Japan's corporate cash recently reached an all-time high of $4.8 trillion (R73 trillion). To put this into some perspective, if the cash pile up of Japan's corporates were an economy, it would have been the 4th largest economy in the world. Japan's cash would replace Germany who is currently in 4th place with a GDP of $4.4 trillion. Of course, that's not how it works, but it gives some perspective.

Large cash pile ups aren't such a good thing if you're an investor, you would want these companies to re-invest all the cash to generate more future income, or you would want a dividend pay-out, so that you could spend it. Also, cash pile ups aren't a good thing for the leaders of countries where it happens. Ideally, you want companies to circulate the cash back into the system to boost economic growth. For this reason, Japan's prime minister, Shinzo Abe, has been fighting with corporates since 2013 to distribute cash. Since then Japanese firms have started to distribute cash instead of retaining 70% of the free cashflow that is generated by the firm, they now only keep about 40%. Japanese firms have also started to buy back more shares. Although buy-backs have increased to $60 billion, it still falls short of the $800 billion buy-backs US firms made over the last year. The problem is that Japanese firms are just too profitable, they can't seem to get rid of the cash fast enough, or as fast as their historically ingrained culture of saving will allow for.

However, cash is king! What all this cash does for Japanese firms is that it allows them to buck-up against the expected headwinds of a global slowdown. A quick trip around the world of manufacturing purchasing manager's indexes (PMIs), a proxy for future growth, supports their fears of an ensuing slowdown. India's PMI's have fallen to its lowest levels in over a year, Indonesia's PMI is at its lowest level since 2017. China's official PMI fell to 49.5, below the expansionary levels of 50. In the US, the Philippines, and even Myanmar, PMIs are slipping. So, when a recession eventually pops up somewhere, or when markets start to falter, Japanese firms will be able to make strategic acquisitions at a fraction of the cost.