Perspectives on the Use of Household Financial Assets in Japan
– Benefits from Transfers Originating in the Bubble Era –

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I. Household financial assets reach fiscal year-end record high

1. Recent trends in household financial assets

Financial assets owned by Japan's household sector totaled ¥1,536 trillion at end-FY2006. Although down slightly from the record-high achieved in December 2006, this represents a ¥16 trillion (1%) increase over end-FY2005 and the highest total ever at fiscal year-end. Although for the past 10 years the largest category of financial assets held by households remains cash & deposits and insurance & pensions, there have been changes in the composition of those assets (Figure 1).

Data on quarterly fund movements show a continued inflow of funds into investment trusts (Figure 2). Consequently, investment trusts as a percentage of household financial assets has more than doubled over the past 10 years, from 2.0% to 4.5%. Meanwhile, there has been nearly a constant outflow of funds from time deposits. With deposits having offered less attractive returns as a consequence of ultra-low interest rates, the weakening yen and rising share prices have solidified the position of investment trusts as the financial product of choice for investors seeking return. In addition, commissions on the sale of investment trusts are attractive to the banks, which have increased their retail sale of investment trusts to the point where they now account for roughly half of the amount of investment trusts sold.

The breakdown of financial assets held by households in terms of savings versus investment indicates that the percentage of those assets held in investments has grown substantially over the past 10 years, from 14.1% to 20.3% (Figure 3). We are thus already seeing a shift in the financial asset preference of households from savings to investment.

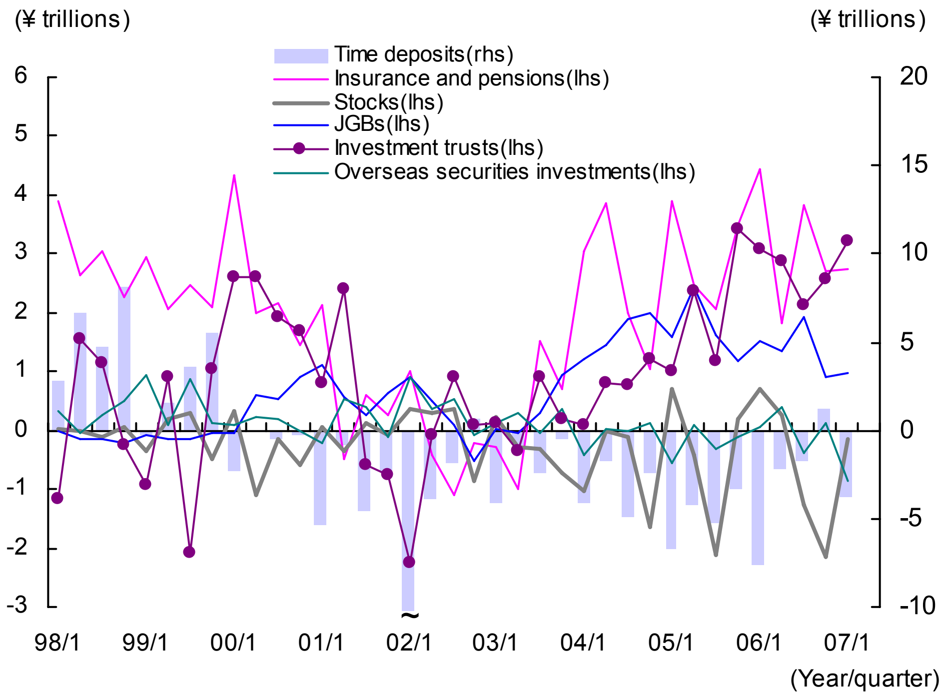
Figure 1: Household financial assets by type

(¥ trillions)

	FY1997		FY2006		FY1997 to FY2006	
	Amount	Share	Amount	Share	Change in amount	Change in share
Currency & deposits	696	54.1%	770	50.1%	74	-4.0%pt
Liquid deposits	103	8.0%	226	14.7%	123	6.7%pt
Time & savings deposits	562	43.7%	497	32.4%	-65	-11.4%pt
Foreign currency deposits	1	0.1%	4	0.3%	3	0.2%pt
Insurance and pension reserves	344	26.8%	402	26.2%	58	-0.6%pt
Insurance	232	18.0%	229	14.9%	-3	-3.1%pt
Pensions	112	8.7%	173	11.3%	61	2.5%pt
Securities	175	13.6%	299	19.5%	124	5.8%pt
Stocks	60	4.6%	111	7.2%	52	2.6%pt
JGBs	8	0.6%	33	2.2%	25	1.5%pt
Investment Trusts	25	2.0%	68	4.5%	43	2.5%pt
Overseas securities investments	5	0.4%	9	0.6%	4	0.2%pt
Other	65	5.1%	56	3.7%	-9	-1.4%pt
Total financial assets	1285	100.0%	1536	100.0%	251	0.0%pt

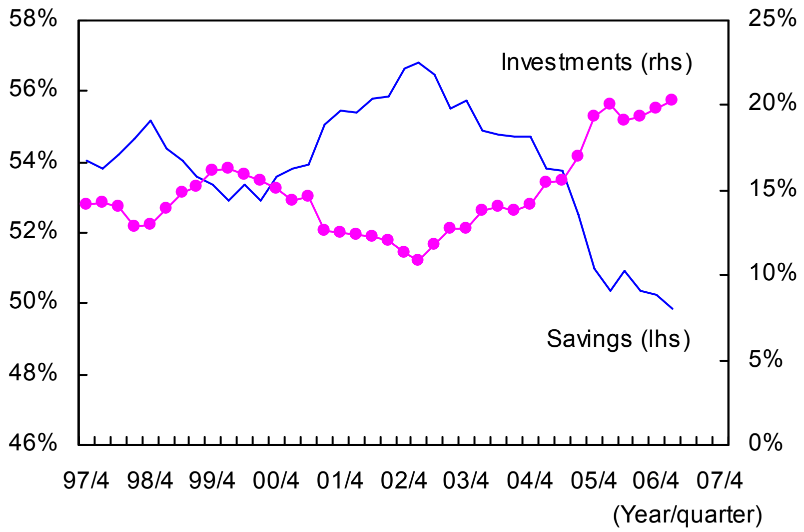
Source: Nomura Institute of Capital Markets Research, based on the Bank of Japan's Flow of Funds Account Statistics.

Figure 2: Primary fund trends in the household sector



Note: In Q1 2002 there was a funds outflow of ¥21 trillion.
Source: The Bank of Japan's Flow of Funds Account Statistics

Figure 3: Shift from savings to investments



Note: Savings are defined as cash & deposits excluding foreign currency deposits, and investments are defined as foreign currency deposits, securities, financial derivatives, and overseas securities investments.

Source: Nomura Institute of Capital Markets Research, based on the Bank of Japan's Flow of Funds Account Statistics

2. Points to consider regarding household financial assets

We see the following three factors as bringing substantial change to household's financial assets in the future. First is the increase in, and compositional shift of, assets held by the household sector in conjunction with baby boomer retirements; second is the increase in intergenerational transfers of wealth from inheritances; and third is the changing content of bequests and the impact of that change. We consider the impact that each of these factors may have in the following section.

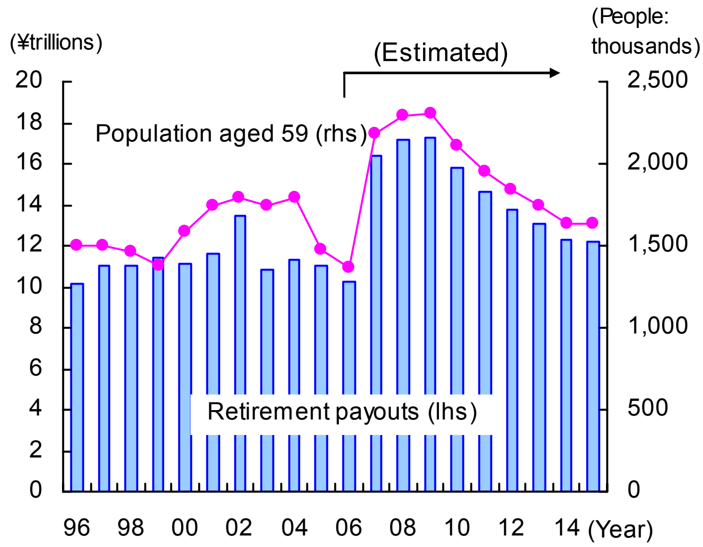
II. Increase in, and compositional shift of, assets in conjunction with baby boomer retirements

The retirement of Japan's baby boomers (those born from 1947 until 1949) will primarily occur from 2007 until 2009. Potential impacts from baby boomer retirements on household financial assets include (1) an increase in retirement payouts available to the household sector owing to the large number of people retiring and (2) the major change in the composition of household assets and liabilities that normally occurs around the time of retirement.

1. Increase in total retirement payouts received by the household sector

We estimate that the household sector will receive total retirement payouts of ¥50 trillion (Figure 4) from 2007 until 2009. Workers received retirement funds totaling ¥11 trillion in 2005, and our estimate of future retirement payouts based on the number of workers in each age cohort is ¥16 trillion in 2007 and ¥17 trillion in 2008. In rough terms, this represents an additional inflow of funds into the household sector relative to before of approximately ¥5 trillion. In view of the trend toward delaying retirement beyond age 60, however, it is conceivable that the immediate change in retirement payouts will wind up being more moderate than this estimate.

Figure 4: Retirement payouts



Note: Figures are before tax.
Source: Nomura Institute of Capital Markets Research, based on the Cabinet Office's SNA data and on the 2005 Population Census from the Ministry of Internal Affairs and Communications.

2. Composition of household assets undergoes major change around time of retirement

There is normally a major change in the composition of household assets and liabilities around the time of retirement (Figures 5 and 6). The point at which the quantitative composition of assets and debt begins to change is when the head of household moves from the 55-59 to the 60-64 age bracket, while the point at which the ownership share changes is the move from the 50-54 to the 55-59 age bracket. The percent of households that have debt declines at age 60 from 52% to 34%, going from a majority to a minority. Apparently a large number of households are able to completely pay off their debt, primarily home loans, with retirement payouts.

Thus (1) we look for an annual increase of roughly ¥5 trillion relative to before in total retirement payouts to households, and (2) there should be a major change in the composition of household financial assets around the time of retirement. Consequently, we expect the impact to extend to the asset composition for the entire household sector, and look for a substantial increase in the amount of funds flowing into financial markets. Another reason to focus on baby boomer money is that survey results suggest a tendency for the baby boomers to put a greater emphasis on returns, even at the cost of some risk.

Figure 5: The composition of household assets changes around time of retirement

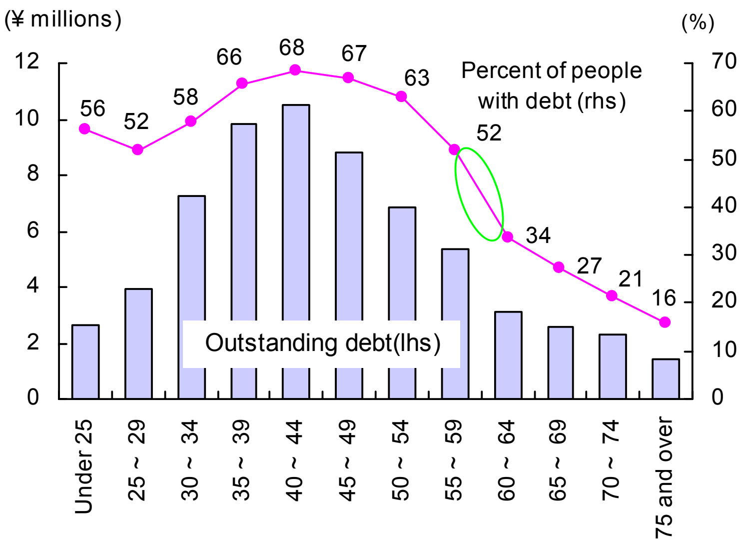
(%)

	Average	Age 50-54	Age 55-59	Age 60-64	Age 65-69
[Share]					
Savings	100	100	100	100	100
Current deposits	15	14	14	16	14
Time & savings deposits	46	44	45	47	48
Life insurance	26	32	29	24	22
Securities	11	7	10	12	15
Stocks and equity investment trusts	7	5	6	8	9
Bonds and bond investment trusts	3	2	2	3	4
Debt	38	48	29	14	12
[Percent who have]					
Savings	99	98	99	99	99
Current deposits	87	86	87	90	88
Time & savings deposits	83	84	86	87	87
Life insurance	77	81	81	80	78
Securities	24	22	27	33	32
Stocks and equity investment trusts	19	17	21	27	25
Bonds and bond investment trusts	9	7	9	12	13
Debt	49	63	52	34	27

Note: Covers all households with at least two people. Shaded area denotes above-average figures.

Source: Nomura Institute of Capital Markets Research, based on the 2004 National Survey of Family Income and Expenditure from the Ministry of Internal Affairs and Communications.

Figure 6: Indebtedness by age



Note: Covers all households with at least two people.

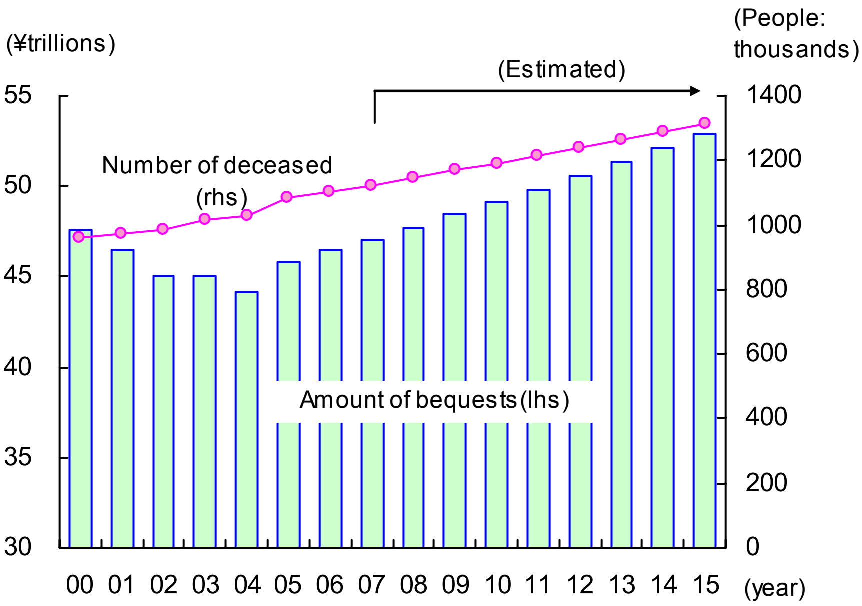
Source: Nomura Institute of Capital Markets Research, based on the 2004 National Survey of Family Income and Expenditure from the Ministry of Internal Affairs and Communications.

III. Increase in intergenerational transfers of wealth from inheritances

1. Amount of bequests continues to grow

It appears that intergenerational transfers of wealth related to inheritance will have an even larger impact on household assets than retirement payouts. This is because the amount of bequests, which is now roughly 3 times the size of the amount of retirement payouts, is expected to continue growing, whereas the amount of retirement payouts available to households should turn to a declining trend from 2010 (Figure 7).

Figure 7: Bequests



Note: Estimates based on the number of deceased X per capita assets and on the estimated value of assets subject to inheritance tax. We assume that the amount of assets subject to inheritance tax remains flat from 2006, and we use 2004 data for per capita assets.

Source: Nomura Institute of Capital Markets Research, based on NTA data, the 2004 National Survey of Family Income and Expenditure from the Ministry of Internal Affairs and Communications, and 2006 Vital Statistics from the Ministry of Health, Labor, and Welfare.

2. Bequests becoming increasingly important

Although inheritance already accounts for at least 30 to 40%[1] of household assets, we expect inherited asset to become even more important moving forward, for a number of reasons. First, bequests become relatively more important in the formation of household assets when employment income is stagnant, as it is now. There are two routes toward asset formation in the household sector, the accumulation of funds

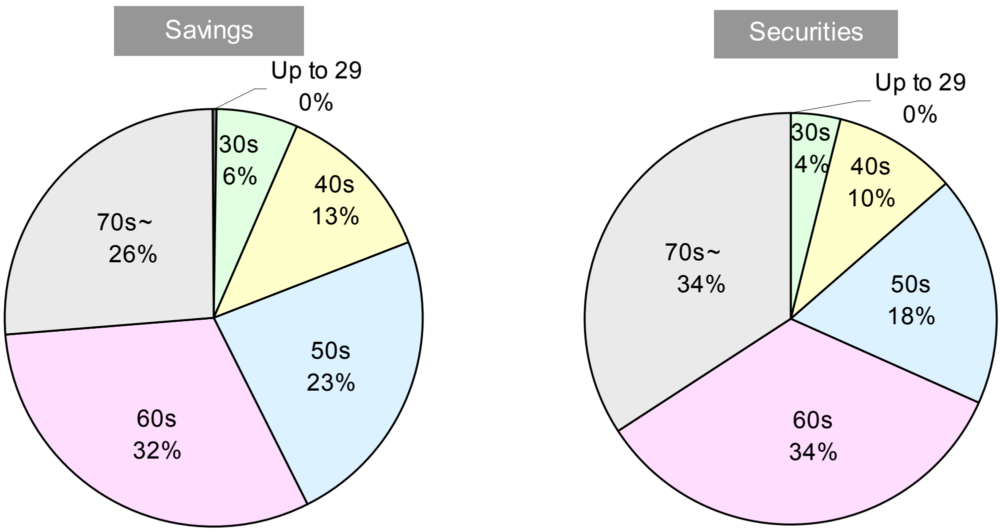
[1] This number is 27.8% to 42.3% in Japan and at least 25% in the US, according to T. Barthold and T. Ito, "Bequest Taxes and Accumulation of Household Wealth: U.S- Japan Comparison," NBER Working Paper No. 3692, 1991.

saved out of annual income and wealth transfers from older generations through inheritance. With the decline in labor's relative share and the breakdown of the seniority-based wage system, average worker income has been stagnant, thereby creating concerns over the "flow" (i.e., employment income) and raising the relative importance of the "stock" (i.e., intergenerational transfers via inheritance).

Second, assets in the household sector are heavily weighted toward households headed by seniors, and these assets are going to be steadily transferred to the next generation (Figure 8). Households headed by a person 60 years and up own 58% of all financial assets, and 69% of all securities, held by the household sector. These percentages have been moving even higher in recent years as a result of the aging of the population.

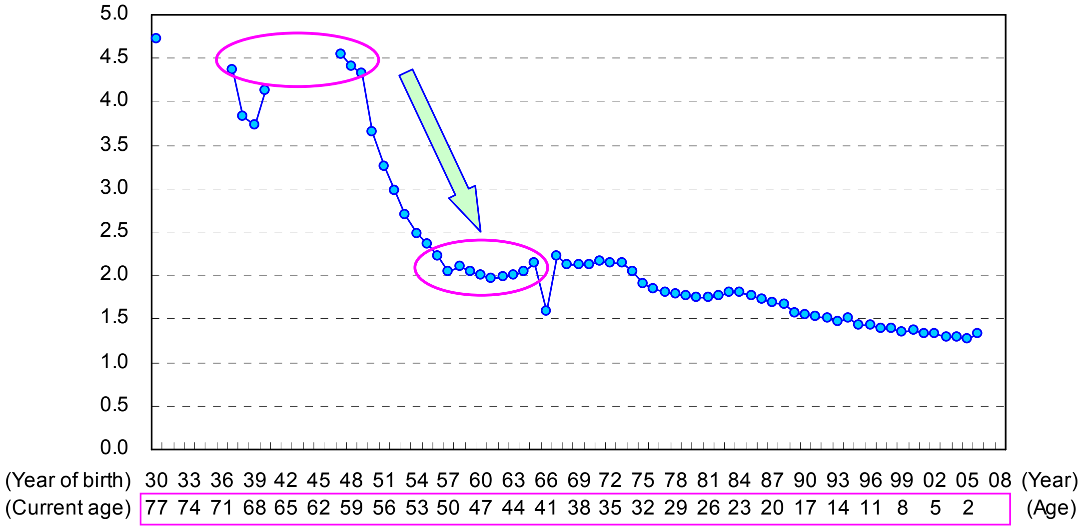
Third, the number of heirs is declining, thereby driving up per capita inheritance (Figure 9). Looking at this from the perspective of the total fertility rate, the generations that have received inheritances thus far have been in families with an average of about four siblings. Those generations in line for future inheritances, however, grew up during a period in which the total fertility rate dropped dramatically from 4 to 2. This smaller number of siblings relative to the generations that have received inheritances thus far translates into an increase in each person's share of inheritance. This increase in the per capita inheritance for the same level of parental assets means the contribution from inheritance to asset formation should increase.

Figure 8: Distribution of financial assets by generation



Source: Nomura Institute of Capital Markets Research, based on the 2006 Survey of Household Economy from the Ministry of Internal Affairs and Communications.

Figure 9: Number of heirs as suggested by the total fertility rate



Source: 2006 Vital Statistics from the Ministry of Health, Labor, and Welfare.

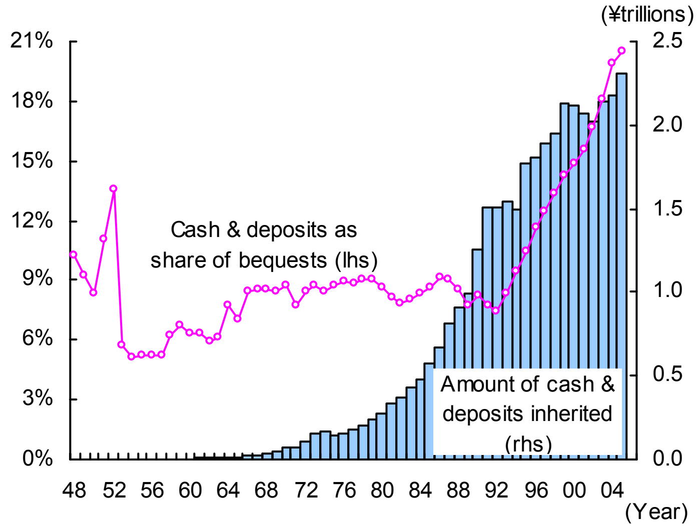
IV. The changing nature of bequests and their impact

1. Cash & deposits account for record-high proportion of bequests

To date, land has accounted for by far the largest share of bequests. One reason for this is that land has numerous advantages over other types of assets under inheritance laws. For example, the land tax assessment value (*rosenka*) used to value land is about 80% of the declared value (*kouji kakau*) and about 50-70% of the market value. In addition, special exceptions for smaller plots of land allow for a 20% reduction in the assessed value of residential land in certain cases, such as when the children take over their parents' business or cohabitate with their parents.

In recent years, however, the breakdown of bequests has changed substantially. After bottoming in 1992, cash & deposits as a percentage of bequests has been climbing rapidly (Figure 10). One reason for this increase in the percentage of cash & deposits is of course shrinkage in the denominator resulting from the collapse in land and other asset prices, but the absolute level of cash & deposits also started rising rapidly at the end of the bubble years, and it has continued increasing to the present. This percentage is now at 21%, and cash & deposits have reached a post-war high both in percentage and absolute terms.

Figure 10: Cash & deposits account for record-high proportion of bequests



Source: Nomura Institute of Capital Markets Research, based on NTA data.

2. The increase in cash & deposits' share of bequests: Source goes back to bubble years

One likely reason why cash & deposits are accounting for a larger share of bequests is that in a deflationary environment, liquid assets are preferred over assets that have downside price risk. One possible source of this cash & deposits is proceeds from the sale of assets held by households during the economic bubble that have been kept in savings accounts since then.

A common impression is that households suffered losses from the bubble economy. The household sector as a whole, however, was quite adept at selling off assets that had appreciated sharply during the bubble years. During the five-year period from 1985 until 1990, for example, the household sector had capital gains on land of ¥948 trillion, 2.3x that of the corporate sector (¥404 trillion), and actually pocketed ¥58 trillion as a result of real estate sales.[2]

To ascertain who within the household sector actually benefited from the bubble, we compare changes in savings per household across generations (Figure 11). The figure shows strikingly rapid growth from 1987 to 1989 in both the savings and net savings (after subtracting debt) held by households headed by a person aged 65 and higher. Furthermore, the bursting of the bubble caused no substantial decline in this group's savings, which actually wound up maintaining a moderate growth path. A breakdown of the type of savings shows that the most impressive growth was of securities during the bubble years and of time deposits after the bubble burst.

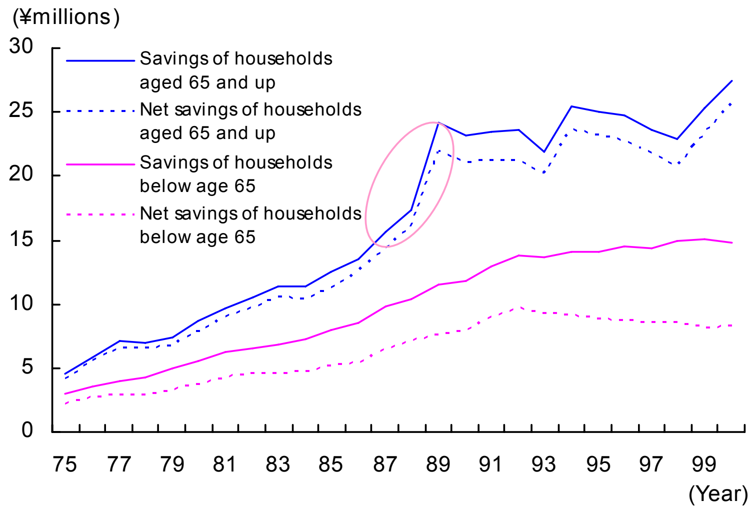
Figure 12 shows changes in the level of savings for households aged 65 and up across different savings levels, and indicates a notable increase in the savings of

2 For details, see Sachiko Miyamoto, "The Bubble Era and the Lost Decade" Nomura Securities Co Ltd, Tokyo Economic Research Paper, 5 July 2006. The capital gains on stocks recorded by the household sector in 1985-89 totaled ¥76 trillion.

households above the ninth decile (the top 10% of households) in terms of savings. During the two years of impressive growth from 1987 until 1989, savings per household in that group increased by ¥19 million, and then continued growing after the bubble's collapse.

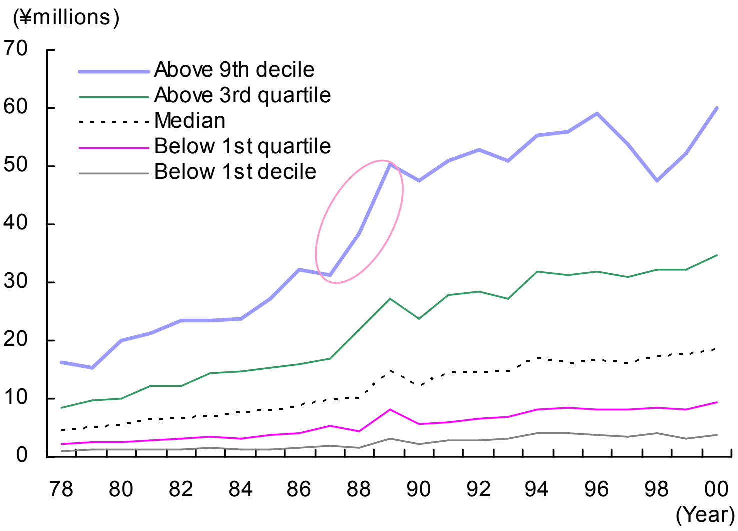
Based on this, it appears that the segment within the household sector that was able to benefit by selling the assets it held during the bubble years was that of households headed by a person aged 65 years and up with high savings. Because the sales proceeds were retained as savings, they have resulted in recent years in an increase in the amount of cash & deposits within bequests.

Figure 11: Savings and net savings per household



Source: Nomura Institute of Capital Markets Research, based on the Family Saving Survey (now part of the Family Income and Expenditure Survey) from the Ministry of Internal Affairs and Communications.

Figure 12: Savings for households headed by a person aged 65 and up



Source: Family Saving Survey (now part of the Family Income and Expenditure Survey) from the Ministry of Internal Affairs and Communications

3. What the increase in cash & deposits as a proportion of bequests suggests

The increase in cash & deposits to a record-high proportion of bequests may suggest the following.

First, from the perspective of the person receiving the inheritance, it means greater freedom regarding how the bequests are used. Compared with inheriting real estate and other assets that are difficult to sell, inheriting cash & deposits and other highly liquid assets makes use of the inheritance much easier. Consequently, the funds are more likely to be used for things that are a priority at the heir's stage of life.

People have been living longer in recent years, and thus the age at which inheritance takes place has generally been rising.[3] In the past inheritances were often received at a stage in life when heirs had substantial fixed costs, including a mortgage and education costs, but in recent years it is estimated that the oldest child is in the 46-50 age bracket when the father dies and 66 year or older when the mother dies (Figure 13). Consequently, most children are already retired when they finally receive their inheritance from both parents (normally from their mother), a completely different stage of an individual's life cycle than when fixed costs are high.

Because of this, recently a large portion of bequests have been savings and investment funds held by seniors, which tend to flow into capital markets, and this has raised the importance of bequests to those markets.

Second, from the perspective of the person leaving the inheritance, the decision in old age to hold most assets as cash & deposits is probably not just because such liquid instruments are more attractive investments within a deflationary environment, but also because of the need to prepare for the various risks of old age. Uncertainty over pensions, health care and other social infrastructure has risen since the bubble's collapse, and it appears that a growing number of households are trying to put together their own defensive measures in preparation for their lives as seniors. The rising proportion of cash & deposits under these conditions also seems to point anew to the lack of financial products geared toward the various risks of old age.

Figure 13: Later timing of inheritances

(Age)

	Age of parent's death (mode)		Age of oldest child	
	Father	Mother	When father dies	When mother dies
1970	70-74	75-79	41-45	51-55
1980	75-79	80-84	46-50	56-60
1990	75-79	80-84	46-50	56-60
2000	70-74	85-89	41-45	61-65
2004	75-79	90 and up	46-50	66 and up

Note: Age of eldest child at time of parent's death calculated using the husband-wife age difference and the mother's age when first giving birth.

Source: Nomura Institute of Capital Markets Research, based on Vital Statistics from the Ministry of Health, Labor, and Welfare.

3 For details, see Sachiko Miyamoto, "Bequests and Households Assets," Nomura Capital Market Review, Winter 2006, Vol.9, No.4.

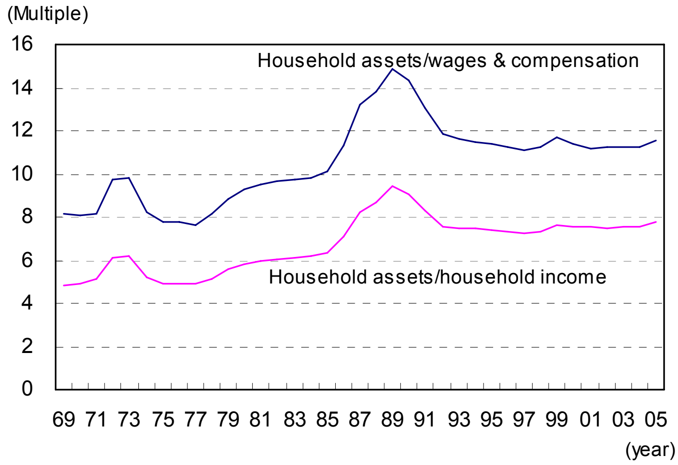
In recent years, it has become more difficult to count on support from other family members, which has traditionally served as a buffer against these risks, with the result being that the direct risks of old age are greater than they used to be. This is an urgent issue for Japan, where the population began aging at an accelerated rate earlier than the other developed countries.

V. Conclusion

When considering Japan's standing within the global community from a long-term perspective, as its population ages and the number of its workers declines, Japan's GDP is expected to be superseded by that of China and India. Nevertheless, although Japan may soon lag other countries in the size of its GDP, a measure of "flow," it is unlikely to lose its edge anytime soon in total wealth accumulated, which is a "stock" concept.

A critical question for Japan is how it should deal with its household financial assets, which rank it number two globally. The ratio of stock to flow in the household sector, after rising sharply during the bubble years, has been fairly flat for more than a decade (Figure 14). Nevertheless, with Japan's exit from deflation and the accompanying turnaround in real estate and other asset prices to positive growth, stock is becoming relatively more important, and this makes it likely that the long-term upward trend in prices will gain momentum. The intergenerational wealth transfers seen recently have emerged over time out of the gains generated by households from selling assets that had sharply appreciated during the bubble years. In order to develop mechanisms and policies to ensure the effective use of household assets, it is imperative that we look closely not only at the amount and composition of those assets at a particular time, but also at the entire long-term flow, including the process of asset accumulation. We expect household assets to become an increasingly important factor within Japan's capital markets.

Figure 14: Stock versus flow in the household sector



Note: Household sector includes single proprietors. Figures from 1969 to 1995 are calculated using link coefficients.
Source: Nomura Institute of Capital Markets Research, based on Cabinet Office data.