A Paradigm Shift in Japan's Gold Market

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Navigating Transformations

In the annals of Japan's economic history, a noteworthy chapter unfolds in the realm of its gold market. In bygone decades, Japan stood tall as one of the world's major gold importers, with my own professional journey in physical gold trading at a trading house during the 1980s and 1990s marked by the importation of gold from diverse sources such as Australia, Switzerland, London, and South Africa. However, the dynamics of this narrative underwent a gradual but transformative evolution.

The initial catalyst for change emerged with the introduction of a consumption tax, and the trajectory took a more dramatic turn following the bursting of Japan's economic bubble in the 2000s. Astonishingly, Japan, once a significant net importer of gold, underwent a 180-degree pivot, emerging as a net exporter. This seismic shift in our business operations signified not just a change in economic fortunes but a reorientation of the very foundations of gold trade within the country.

During my 14-year tenure at a Tokyo bank branch, a stark reality emerged – we transitioned from importing gold, which occurred only once, to becoming prolific exporters. The catalysts for this transformation were manifold. **The introduction of the consumption tax, initially at 3% in 1989, escalated to 5% in 1997, 8% in 2014, and eventually reached 10% in 2019.** Intriguingly, this tax, ostensibly a financial hurdle, paradoxically held advantages for investors. When purchasing gold in Japan, the consumer must bear this tax burden, but upon selling the gold, the entire tax amount becomes recoverable. In theory, the consumption tax should not pose a deterrent to gold investment; rather, it should be viewed as a mechanism whereby investors could gain an additional 10% over the selling price, irrespective of the tax rate at the time of purchase.

However, the implementation of the consumption tax had far-reaching and unforeseen consequences for the Japanese gold market. The profound impact of this tax only became apparent in the early 2000s. In stark contrast to foreign counterparts like Hong Kong, where gold purchases were not burdened by value-added tax, the ease of bringing gold from such tax-friendly jurisdictions to Japan without customs declaration became an unintended incentive for both individuals and large-scale criminal organizations to engage in extensive smuggling.

The two primary drivers behind Japan's gold exports were long liquidation of gold at higher yen prices and widespread smuggling. The government responded with stringent measures, instructing businesses not to purchase gold lacking proof of officially paid consumption tax. While smuggling persists to some extent, its influence on the Japanese gold market is gradually diminishing.

Presently, gold commands more attention in Japan than ever before. The trajectory from 1971, when US President Nixon severed the dollar's link to gold, to the present, where gold hovers around $1,980 per troy ounce, exemplifies a staggering 57-fold increase in value against the US dollar. The unprecedented rise underscores a natural process – global governments' freely printing fiat money while gold supply remains constrained.

Historically, significant selling and buying patterns in the Japanese gold market were observable. Notably, there were substantial gold sales when the price surged by 500 yen per gram, with long queues of sellers at major retail shops. Conversely, during market declines, queues formed with eager buyers seeking to capitalize on lower prices. This pattern, rooted in the tendency of Japanese investors to hunt for bargains, formed the basis of a simple yet consistently profitable trading strategy during my time at a trading house.

This traditional bargain-hunting inclination of Japanese investors, however, has undergone a paradigm shift in recent years. Even with gold prices in yen reaching unprecedented levels, there is a surprising absence of a surge in selling from gold holders. Notably, retail shops report a well-balanced mix of sales and purchases at their counters. In the realm of gold exchange-traded funds (ETFs), a departure from the trend observed in the US and Europe becomes apparent. While holdings in these regions decrease, Japanese gold ETFs continue to increase their holdings despite historically high prices.

In conclusion, the Japanese gold market is undergoing a profound paradigm shift, characterized by changing investor demographics, heightened concerns about yen depreciation, and the introduction of new investment avenues such as the expanded NISA framework. As gold continues to capture the imagination of a new generation of investors, the narrative of Japan's gold market unfolds as a dynamic and ever-evolving story.

Several factors contribute to this evolving attitude towards gold in Japan:

1. **Generational Shift:**
   The primary buyers of gold in the 1980s and 1990s, the older generations, are exiting the scene and selling their gold. Simultaneously, a younger demographic, largely unaffected by historical gold prices, is entering the market. A significant shift in investor demographics has occurred, with investment seminars that once saw over 90% attendance from older individuals now welcoming a much younger audience.

2. **Continued Yen Depreciation:**
   The Japanese yen, which began the year at 131 yen to the dollar, has depreciated to 150 yen, constituting an approximate 8.7% devaluation against the US dollar. Coupled with inflationary pressures, this depreciation has raised concerns among Japanese investors about holding yen in their bank accounts. While older generations traditionally favoured the safety of bank deposits, the erosion of yen value has prompted a revaluation, with an increasing number of investors viewing gold as a hedge against both inflation and yen depreciation. Despite higher gold prices, investment in gold continues to rise.

3. **Introduction of the New NISA Account:**
   The Nippon Investment Saving Account (NISA), introduced in 2014, mirrors the English ISA model. Individuals utilizing NISA enjoy exemption from the 20.315% tax on trading profits. Originally capped at 1.2 million yen with a five-year duration, the current NISA account is set to conclude this year. The new iteration, effective from 2024, raises the investment limit to 18 million yen per individual with no time constraints. This strategic governmental move aims to redirect funds from dormant bank deposits into investments. The enhanced framework has led to a surge in interest, with more investors opening current NISA accounts and preparing for the expanded framework in 2024. The new NISA will encompass various precious metals, including gold ETFs, reflecting a broader investment landscape. This initiative has sparked a significant shift in investor sentiment and behaviour, contributing to the evolving landscape of the Japanese gold market.