Japan’s Ever More Dangerous Debt
Problem Foreshadows that of the U.S.

[These are my comments to friends on an article in the New York Times (included below) about how Japanese government debt is growing to ever more alarming levels.
–S.H.]

Hi everybody,

Appended below is an article from today’s New York Times about how the huge and rapidly growing national debt in Japan is raising more and more alarm bells.

I’ve been arguing for well over a decade now that what was happening to the Japanese economy (crisis, stagnation, in and out of recessions, massive bouts of Keynesian deficit financing, etc.) foreshadowed what would soon be happening in the U.S. as well (but likely in a more rapid and severe way here once it really took off). I think it is fair to say that the events of the last few years have started to demonstrate that this is actually true.

The massive and rapid growth of the national debt of both countries also bears this out. While the U.S. national debt growth is behind that of Japan in relation to the sizes of their economies, both are rapidly zooming up, and both at an ever faster pace overall. Though the debt growth is always increasing in both countries, it is uneven, with massive spurts from time to time. Still, overall, the rate of debt increase is a ragged form of an exponential curve. And that which cannot possibly continue forever is destined to come to an end. When it does, it will mark the transformation of the long-developing economic crisis into a new, even more serious, stage.

There are a few issues that arise from this article. First, I’ve been arguing that the dollar will be collapsing at some point, and this ever-increasing debt in Japan shows why it is reasonable to think that the yen will also be collapsing at some point. But how can all currencies simultaneously collapse given that they are valued in terms of each other (and no longer in terms of gold)?

Well, firstly, both the dollar and the yen can sink sharply in relation to the other major world currency, the euro. The European Central Bank, and German influence there in particular, are keeping euro area debt from rising anywhere near as fast as national debt is in the U.S. and Japan.

More fundamentally, all the currencies in the world can fall in value simultaneously in relation to the prices of commodities. In other words, they can all be inflated. While bourgeois economists are saying not to worry about this, and point to the current weak levels of inflation, over the longer term there is definitely going to be massive inflation all over the world even in
the midst of recession/depression. It will be somewhat less in Europe, but it will occur everywhere. And inflation rates in the U.S. and Japan in particular will be at least double-digits annually at some point (and maybe much worse).

The article makes the point that even though the Japanese national debt is twice as high as that in the U.S. (in relation to their respective GDPs), the situation in the U.S. is in some important ways much more worrisome. Most of Japan’s national debt is owed internally to Japanese corporations and citizens. (Who else would buy it, at the very low rates of interest it is still offered at?!) Nearly half of the U.S. national debt, by contrast, is owed to foreigners (especially China and Japan), and that makes the U.S. much more vulnerable to an international panic, a run on the dollar, etc.

The next few years will see one major bout of rapid debt increase after the other, in both Japan and the U.S. (with debt also increasing pretty damn fast even in between these special bursts!). The interest rates that these governments will be forced to offer on this debt will be tremendously increasing (even in Japan). And the portions of the government budgets that go to service this debt will rise and rise again. This will continue until the ability of these countries to continue doing this comes at an end—because the rich investors and foreign countries simply refuse to buy any more of it.

At that point the only way left for either country to continue to “stimulate” their economies via Keynesian deficits will be by just printing more and more money. And that will rapidly lead to hyperinflation and the complete collapse of the currencies.

In short, the capitalist countries of the world—and Japan and the U.S. in particular—are very rapidly running out of options to keep the world economy from sinking into a major full-blown depression.

It won’t be too many years now before that happens, and when it happens it will come on fast and hard.

Scott

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Rising Debt a Threat to Japanese Economy

By Hiroko Tabuchi
TOKYO — How much debt can an industrialized country carry before the nation’s economy and its currency bow, then break?

The question looms large in the United States, as a surging budget deficit pushes government debt to nearly 98 percent of the gross domestic product. But it looms even larger in Japan.

Here, years of stimulus spending on expensive dams and roads have inflated the country’s gross public debt to twice the size of its $5 trillion economy — by far the highest debt-to-G.D.P. ratio in recent memory.

Just paying the interest on its debt consumed a fifth of Japan’s budget for 2008, compared with debt payments that compose about a tenth of the United States budget.

Yet, the finance minister, Hirohisa Fujii, suggested Tuesday that the government would sell 50 trillion yen, about $550 billion, in new bonds — or more.

“There’s no mistaking the budget deficit stems from the past year’s global recession. Now is the time to be bold and issue more deficit bonds,” Mr. Fujii told reporters at the National Press Club in Tokyo. “Those who may call this pork-barrel spending — that’s a total lie.”

For jittery investors, Japan’s rising sea of debt is the stuff of nightmares: the possibility of an eventual sovereign debt crisis, where the country would be unable to pay some holders of its bonds, or a destabilizing collapse in the value of the yen.

In the immediate term, Mr. Fujii’s remarks prompted concerns of a supply glut in bond markets, sending prices on 10-year Japanese government bonds down 0.087 yen, to 99.56 yen, and yields to their highest point in six weeks.

The Obama administration insists that it understands the risks posed by deficits and ever-increasing debt. Its critics are doubtful. But as Washington runs up a trillion-dollar deficit this year, with trillions in debt for years to come, it need look no farther than Tokyo to see how overspending can ravage an economy.

Tokyo’s new government, which won a landslide victory on an ambitious (and expensive) social agenda, is set to issue a record amount of debt, borrowing more in government bonds than it will receive in tax receipts for the first time since the years after World War II.

“Public sector finances are spinning out of control — fast,” said Carl Weinberg, chief economist at High Frequency Economics in a recent note to clients. “We believe a fiscal crisis is imminent.”

One of the lessons of Japan’s experience is that a government saddled with debt can quickly run out of room to maneuver.
“Japan will keep on selling more bonds this year and next, but that won’t work in three to five years,” said Akito Fukunaga, a Tokyo-based fixed-income strategist at Credit Suisse. “If you ask me what Japan can resort to after that, my answer would be ‘not very much.’”

How Japan got into such a deep hole, and kept digging, is a tale of reckless spending.

The country poured hundreds of billions of dollars into civil engineering projects in the postwar era, marbling Japan with highways, dams and ports.

The spending initially fueled Japan’s rapid postwar growth and kept the Liberal Democratic Party in power for most of the last half-century. But after a spectacular asset and stock market boom collapsed in 1990, the country fell into a long economic malaise.

The Democratic Party, which swept to victory in August, promises to rein in public works spending. But the party’s generous welfare agenda — like cash support to families with children and free high schools — could ultimately enlarge budget deficits.

“It’s dangerous for the Democrats to push on with all of their policies when tax revenues are so low,” said Chotaro Morita, head of fixed-income strategy at Barclays Capital Japan. “From a global perspective, Japan’s debt ratio is way off the charts,” he said.

Still, officials insist that Japan is better off than the United States by some measures.

One hugely important difference is that Japan is rich in personal savings and assets, and owes less than 10 percent of its debt to foreigners. By comparison, about 46 percent of America’s debt is held overseas by countries such as China and Japan.

Moreover, half of Japan’s government bonds are held by the public sector, while government regulations encourage long-term investors like banks, pension funds and insurance companies to buy up the rest.

All of this makes a sudden sell-off of government bonds unlikely, officials argue.

“The government is just borrowing from one pocket and putting it in the other,” said Toyoo Gyohten, a former top finance ministry official and a special currency adviser to Mr. Fujii. “Although the numbers appear very fearsome, we have some leeway.”

Many analysts agree that during a recession, Japan, like the United States, should worry less about trying to cut debt. But they say Tokyo should at least concentrate on making sure that spending does not get out of hand.

“The government needs to stabilize the debt, first and foremost. Only then can it start setting other targets,” said Randall Jones, chief economist for Japan and Korea at the Organization for Economic Cooperation and Development.
A credible plan to pare down spending is important “to maintain public confidence in Japan’s fiscal sustainability,” said the O.E.C.D.’s economic survey of Japan for 2009.

In the long run, even Japan’s sizable assets could fall and eventually turn negative. Japan’s rapidly aging population means retirees are starting to dip into their nest eggs — just as government spending increases to cover their rising medical bills and pension payments.

The fall in public and private savings could eventually reverse Japan’s current account surplus, possibly driving up interest rates as the public and private sectors compete for funds. Higher interest rates would increase the cost of servicing the debt, and raise Japan’s risk of default.

In a worst case, Japan’s currency could suffer as more investors switch away from Japan to other assets. And if Japan were to print more money and set off inflation to reduce its debt burden, the supply of yen would shoot up, lowering the currency’s value further.

In recent months, the yen’s surge on major markets as the dollar weakened has sent a false sense of security. The currency recently touched a seven-month high of about 89 yen to the dollar before easing slightly, as near-zero interest rates in the United States prompted investors to take their money elsewhere. Many strategists expect the yen to strengthen further, at least in the short term.

“In 10 or 20 years, Japan’s current-account surplus will fall into deficit, and that will lead to a weaker yen,” said Mr. Morita at Barclays Capital. “But if investors become pessimistic about Japan before that, the yen will weaken earlier than that.”

For all the recent talk of a shift away from the dollar as the reserve currency of choice, it is the yen that is becoming increasingly irrelevant, analysts say. The yen made up 3.08 percent of foreign currency reserves in mid-2009, down from 3.29 percent the same time last year and down from 6.4 percent in 1999. In mid-2009, the dollar still accounted for almost 63 percent of global foreign reserves.

“The yen is set to enter a long decline” in both stature and value as investors lose confidence in Japan, said Hideo Kumano, chief economist at the Dai-Ichi Life Research Institute in Tokyo.

Considering the state of Japan’s finances and economy, Mr. Kumano said, the yen’s recent strength against the dollar “isn’t an affirmation of Japan — it’s the yen’s last hurrah.”