Tullett Prebon Research, a blog by Dr Tim Morgan

The Japanese gamble – rising sun or sunset strip?
by Tim Morgan on April 8, 2013

If you're familiar with the thesis set out in Perfect Storm, you'll appreciate two things about our approach to economics. First, there has been an ever-widening divergence between the "real" (energy-based) economy and the "financial" economy of money and debt. Second, the unavoidable reconciliation of the real and the financial economies must involve the degradation of the value of money as an energy claim (and of debt as a future energy claim). Seen through this analytical prism – which must lead us to expect both money-printing and the deliberate stoking-up of inflation – Japan's new economic strategy looks ultra high-risk (well, that's a polite way of putting it).

Of course, I can see where Prime Minister Shinzo Abe and central bank chief Haruhiko Kuroda are coming from. Japan's famous "lost decade" has in fact stretched into twenty years of stagnation characterised by deflation. If stagnation is one problem that the deliberate injection of inflation (through running the printing presses) is designed to solve, the other is Japan's truly frightening level of public debt, now nudging towards 250% of GDP. Inflation, it is hoped, will boost nominal tax revenues and devalue historic debt whilst simultaneously persuading the public to spend (which, understandably, they are reluctant to do if the purchasing power of their money tends to increase over time).

What does not seem to have occurred to the government is that twenty years of comparatively comfortable stagnation might be regarded as something of a "soft landing" after the madness of the 1980s, which saw asset values escalate to such an extent that the paper value of the Imperial palace came to exceed that of the whole of California. The fall-out could have been very, very much worse than stagnation.

Hitherto, Japan has got away with running enormous public (and private) debts because its domestic propensity to save has been very high, but this advantage is eroding fast. As Japan's population ages, the ability to save is declining just as the need to draw on accumulated capital increases. This means that the government can no longer rely on domestic savings to fund its deficits, and this, you might think, is no time to punish savers (which seems to be an unavoidable result of printing money), let alone to increase public spending.

Moreover, the likelihood of a greater reliance upon global capital markets coincides awkwardly with a probable need to import even more energy in the wake of the damage inflicted on Japan's nuclear industry by the Fukushima disaster.

To be sure, the yen has long traded at a premium to its PPP (purchasing power parity) value, but this should not blind policymakers to the fact that competitiveness has already improved markedly, and yet an export boom has not resulted.

In short, Japan looks like a classic case of divergence between the physical and the financial economies, a divergence whose potential consequences are worsened by the overhang of huge accumulated debts. Indigenous resources of energy are minimal, and Japan's welfare needs are rising inexorably as the population ages. Injecting inflation may indeed devalue historic debt, but this will be achieved at a high price if, as a result, market interest rates rise, the willingness of the population to save declines, and energy costs surge.

Japan has been described elsewhere as “a bug in search of a windscreen”. Japanese people must hope that I’m wrong, and that Abe and Kuroda have not turned the economy to face the oncoming traffic.