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Japan's Economy Tumbles

M Abe Prepares to Hammer Working People

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"The bankers in Tokyo tell me there is a widespread mindset of panic among institutional holders of Japanese Government Bonds (JGBs) and that can't be a good thing. Panic tends inevitably to lead to crisis, and goodness knows, global financial markets could hardly deal with another crisis without contagion on a massive scale." Reuters commentary

Japanese markets were whipsawed for a second time in three days while the yields on Japan Government Bonds (JGB) inched higher. The benchmark Nikkei Index shed 469 points in Monday's session lopping another 3 percent off Thursday's 7.3 percent plunge. Skittish investors are exiting stocks fearing that Abenomics and the Bank of Japan's (BoJ) efforts to reflate equities prices and boost inflation will fail.

An unexpected selloff in JGBs pushed the yield on 10-year debt to 1 percent last week increasing the likelihood of higher interest rates which will leave bank balance sheets and JGB-heavy pension funds deep in the red. Investor confidence in the BoJ's governor Haruhiko Kuroda has begun to ebb as roiled markets and rising yields add to financial instability and deepening crisis. This is from an article at International Finance Review:

“Extreme volatility in the Japanese government bond market could trigger a sell-off on a par with a market rout in the third quarter of 2003. That was when local banks and foreign investors were forced to dump their JGB holdings after heightened volatility caused the assets to exceed internal value-at-risk limits.

According to analysts at JP Morgan, the threat of a so-called “VaR shock” highlights one of the unintended consequences of quantitative easing, and the situation could be exacerbated this time around.” (“QE raises JGB ‘VaR shock’ fears”, IFR)

Hayman Advisors Kyle Bass summed up the problem facing the BoJ like this:

“Abe and the BOJ face what I call the ‘rational investor paradox. If Japanese Government Bonds (JGB) investors begin to believe that Abenomics will be successful, they will ‘rationally’ sell JGBs to buy foreign bonds or equities.”

In other words, if bondholders believe that Kuroda will hit his inflation target of 2 percent, then they will have to jettison their low-yielding JGBs or suffer losses. The uncertainty surrounding long-term interest rates is what’s causing the gyrations in the stock market and the growing sense of unease. And while the Kuroda is currently purchasing over 70 percent of new issuance, the selloff in the quadrillion dollar JGB market has overwhelmed his efforts to keep rates low.

Last Friday, a clearly-shaken Kuroda tried to placate jittery investors saying that “the BOJ will flexibly conduct operations by adjusting frequency, pace and target.” He added, “It is natural for long-term yields to rise as the economic recovery and inflation picks up.” Market-watchers took this simple statement of fact as a sign that Kuroda was no longer fully-committed to keeping rates low. This is what led to Monday’s stock rout.

Liberal economists in the US have praised Prime Minister Shinzo Abe’s efforts at ending Japan’s two decades of deflation, particularly the BoJ’s unprecedented Quantitative and Qualitative Easing (QQE) program which will double the base money supply in two years and which purchases financial assets (J-REITs, ETFs) other than government debt. Paul Krugman has been particularly impressed with “Abenomics” and devoted a recent column to singing its praises. Here’s a clip from Krugman article titled “Japan the Model”:

“In a sense, the really remarkable thing about “Abenomics” — the sharp turn toward monetary and fiscal stimulus adopted by the government of Prime Minster Shinzo Abe — is that nobody else in the advanced world is trying anything similar. In fact, the Western world seems overtaken by economic defeatism…

So, how is Abenomics working? The safe answer is that it’s too soon to tell. But the early signs are good…, with surprisingly rapid Japanese economic growth in the first quarter of this year…

Meanwhile, Japanese stocks have soared, while the yen has fallen…, very good news for Japan because it makes the country’s export industries more competitive…

So the overall verdict on Japan's effort to turn its economy around is so far, so good. And let's hope that this verdict both stands and strengthens over time. For if Abenomics works, it will serve a dual purpose, giving Japan itself a much-needed boost and the rest of us an even more-needed antidote to policy lethargy." ("Japan the Model", Paul Krugman, New York Times)

While Krugman wisely qualifies his praise for Abe's gigantic stimulus program, it's clear he thinks that Japan is on the right path. One can only wonder if Krugman would change his mind if he knew that Abe is a right-wing militarist whose real objective in using Keynesian theories is to rebuild imperial Japan's war machine while clamping down on working people.

There's been much to-do over Abenomics "three arrows", that is, monetary (QQE), fiscal and structural policies. But the media's main focus has been on monetary policy and the reflationist efforts of the BoJ. In contrast, the fiscal component gets hardly any attention at all, even though Keynes emphasized the ineffectiveness of monetary policy in a liquidity trap. (which he compared to "pushing on a string.")

The reason fiscal policy is downplayed in the media is because Abe's $116 billion fiscal package (aimed at rebuilding aging infrastructure) is a "one shot" deal that will expire in 2014 leaving working people to face impending economic contraction and the same stagnant environment they find themselves today. In other words, Abe is using Keynes ideas in much the same way as Obama, to revive economic activity (temporarily!) while more and more of the nation's wealth is transferred to speculators via the equities markets. Here's a summary of what's really going on under the radar:

"There has been much public discourse among observers who believe Japan's weak consumption may be attributed to cultural issues, suggesting that Japanese consumers are frugal by nature and disinclined to spend. I believe this is simply not true. In my opinion, the frugality of Japanese consumers has resulted from their poor outlook for wage growth. Over the past 20 years, average wages in Japan have not grown; they actually peaked in 1998 and have been on the decline ever since. It's no wonder that Japanese consumers would curb spending if they expected their incomes to continue declining. There is an entire generation of Japanese that have graduated from school and begun careers amid an environment of constantly falling wages. Changing this deflationary mindset will require a sustained period of price increases and wage growth. There is no overnight miracle cure. In fact, the biggest risk may be impatient markets and investors who expect overnight results." ("Is Japan's Star Rising Again?", Morningstar)

Repeat: Wages have been falling for 20 years.

Abe has no intention of increasing wages or improving standards of living. To the contrary, the so-called "reforms" he plans to implement are designed to crush the middle class and further exacerbate inequality. Here's a clip from Bloomberg which explains:

"(Abe's) growth efforts will be "disappointing" if they don't tackle labor laws, the social-security system and energy policy, said Naoki Iizuka, a Citigroup Inc. economist in Tokyo…

Abe said he wants to boost private investment to 70 trillion yen ($683 billion) a year — through deregulation, taxes, spending and equipment-leasing deals. … he's talked about opening the power market to more competition and restarting nuclear plants, supporting targeted industries such as biotechnology and joining the Trans-Pacific Partnership free-trade talks with the U.S. and 10 other Pacific Rim countries.

"To release domestic demand that would stimulate long-term growth, Japan will have to melt the vast regulatory barriers which clog the economy, open the gates to substantial immigration and privatize sectors still in government hands." ("Abe's Resurgent Japan Hurt by Lack of Business Spending", Bloomberg)

Free trade, deregulation, privatization and labor "flexibility". Where have we heard that before? This is just the Shock Doctrine wrapped in a Keynesian bow.

Abe wants to kick-start the economy and win the upper House in July elections so he can advance his neoliberal agenda; pump up stock prices, privatize more publicly-owned assets and industries, deregulate energy and financial sectors, and pass laws that will allow corporations to fire workers without review. Is that why Krugman is so euphoric?

While there may be some short-term improvement from Abenomics (which could as easily be called "Rubenomics"), the long-term battle against deflation will undoubtedly be lost. Monetary easing and the wealth effect are no substitute for a strong, vibrant economy and solid wage gains. As Waseda University finance professor, Yukio Noguchi, told the New York Times, "Without a revival of the real economy, this is all just voodoo economics."