

Reconsidering the Prospects of Japan's Long-term Interest Rates

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Why Are Japan and Greece Different?

- Interesting question why Japan has not seen a rise in interest rates.
 - Author says investors fear inflation but not default
 - But in Greece fear seems to be default
 - Fixed exchange rate would seem to provide an anchor not present for Japan
 - In part, Japan debt is not that high if focus on net. Large volume of financial assets through postal saving system.
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Why Are Japan and Greece Different?

- Most of Japan's debt is domestically held, while Greek debt is held by Germany and France.
 - Japan has fiscal room
 - Smaller government sector
 - Room to raise taxes, but
 - Greece has room to cut expenditures
 - Is it culture?
 - Default explanation for everything
 - Less populism
 - Better economic management
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Role of Inflation

- Always adjust interest rate for inflation expectations
 - General puzzle is why Japanese real interest rate is so low given high debt levels.
 - Does inflation-interest rate relationship differ for Japan?
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Interwar Germany

- Keynes was right that Germany could not pay the reparations, but for the reasons given by Ohlin. Ohlin had right analysis but wrong conclusion
 - Germany could not tax output by a large enough amount to pay the transfer of resources – a political constraint
 - Externally held debt
 - Debt →inflation →high interest rates
 - Interesting case, but not sure of its relevancy to current situation.
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Next steps for Economic Policy

- ❑ Agree that there is no sign of a debt limit at present, but also clear that Japan cannot continue indefinitely with the magnitude of debt growth of the last two decades.
 - ❑ But, also seems apparent that growth cannot be sustained without continued deficits.
 - ❑ Why is growth so weak on a sustained basis.
 - ❑ Small trade surplus.
 - ❑ Consumption about the same share of GDP as in the United States.
 - ❑ Weak private investment combined with high corporate saving.
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Japan Net Saving and Investment by Sector, 1980-2008 (% of Net Income)

Item	1980-89	1990-99	2000-07	2008
Saving	16.6	13.2	6.1	2.6
Corporate	3.6	2.7	9.1	6.9
Household	10.9	8.9	2.7	0.9
Government	2.1	1.6	-5.6	-5.1
Investment	14.1	10.8	2.9	0.9
Corporate	8.3	6.0	2.7	3.1
Household	2.4	1.1	-0.6	-1.4
Government	3.4	3.7	0.9	-0.8
Current account	2.5	2.8	4.1	4.0
Statistical discrepancy	0.0	0.6	1.0	2.4

Next steps for Economic Policy

- Saving investment balance looks like an economy in decline or perhaps stagnation
 - Investment rate in line with zero growth rate,
 - But corporate profits and retained earnings are high
 - How much is earned abroad?
 - Cannot justify export expansion
 - Need to create a reason to expand domestic investment
 - A focus on growth first, not deficit reduction
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