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

Discussant: Barry Bosworth
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.
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
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?
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.
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.
## Japan Net Saving and Investment by Sector, 1980-2008 (% of Net Income)

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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