Sujet: Est-ce que la Japon est le prochain Grèce ? / Is Japan the next Greece ?

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JAPAN ECONOMICS UPDATE

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Is Japan the next Greece?

- **Japan should be able to avoid the sort of crisis that has hit Greece so hard. Government debt may be even larger in Japan, but the country is in a much stronger position in almost every other respect.**
- It is not surprising that Japan is often mentioned in the same context as Greece. **Japan's government deficit is likely to be around 10% of GDP this year, similar to what we expect for Greece, but the accumulated debt will be nearly twice as high.** Japan's gross government debt will be close to 230% of GDP this year, compared to 120% or so in Greece.
- Nonetheless, Japan's prospects are still far brighter. For a start, **the underlying financial position is not as bad as the headline numbers suggest.** Japan's *gross* debt numbers are high, but this has to be balanced against the country's very large assets. *Net* government debt is a less alarming 105% of GDP, similar to the level in Greece (or Italy). Japan's external asset position is also very strong, reflecting years of current account surpluses, in contrast to the huge external deficits run by the likes of Greece.
- What's more, the sheer size and diversity of Japan's economy is an important advantage. As it happens, foreign participation in Japan's bond market is relatively low, reducing the potential impact of an overseas buying strike. But it is much easier for foreign investors to decide to drop a peripheral market like Greece than a core one such as Japan. **The yen is also a global reserve currency, whereas Greece no longer has its own currency at all.** Investors wanting to hold the euro do not need to hold Greek assets. Nor can Greece depreciate its currency to boost economic growth or ease deflationary pressure.
- **The economic recovery in Japan is also relatively strong and broad-based.** Consumer spending is likely to slow in the first half of this year as the support from government measures fades, but the release of pent-up investment demand should avert a double-dip. (See our *Japan Economics Focus*, "Investment to drive the next stage of the recovery", published on 10th February.)
- This is important for two reasons. Firstly, the deficit will start to fall sooner than it would otherwise have done, and probably faster than in many other major economies too. Secondly, a stronger economic recovery will make it easier for the Japanese government to gain support for the long-term programme of fiscal tightening required to bring debt back under control.
- Admittedly, **the scale of the necessary fiscal tightening is frightening.** The IMF, for example, has estimated that Japan would need to turn the projected underlying deficit of 6.9% of GDP in 2010 (defined as the structural budget balance excluding interest payments) into a *surplus* of 6.5% by 2020, simply to stabilise the net debt/GDP ratio at 80%. However, **several countries achieved similar adjustments in the 1980s and 1990s, including Ireland, Sweden, Canada – and even Greece.**
- The next major hurdle is the publication of the government's medium-term fiscal plan, due by the middle of the year. S&P has already put Japan's sovereign credit rating on watch for possible downgrade if the pace of tightening is deemed to be too slow. Nonetheless, even the one notch downgrade S&P appears to have in mind would still leave the sovereign rating in the AA category (albeit at AA- rather than the current AA). This would imply "a very strong capacity to meet financial commitments". We would add that **S&P rated Japan as AA- between April 2002 and April 2007, so the country's financial markets and economy have *already* survived five years at the lower rating.** (Greece is now rated BBB+.)
- In the meantime, **Japanese bond yields will continue to be determined primarily by the outlook for short-term interest rates and inflation.** In this respect at least, the prospect of a long period of *mild* deflation is not all bad news for the fiscal position, since it will encourage the Bank of Japan to keep interest rates near zero. We also suspect that the Bank will be willing to step up its outright purchases of Japanese government bonds once the government has set out its fiscal plan. (See our *Japan Economics Update*, "Governor Shirakawa's caution is not the last word", published on 18th February.)
- Overall, huge challenges undoubtedly lie ahead and it is hard to see any solution for Japan that does not involve a significantly weaker yen (our end-2010 forecast is 100 to the dollar, and 110 at end-2011). **But those who see a fiscal meltdown and surge in bond yields as inevitable are simply wrong.**

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