Japanese Share Sell-off a Sign of Growing Financial Instability

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The sharp drop in Japan's Nikkei stock market index last Thursday and subsequent global share sell-off have highlighted mounting instability in world financial markets.

The Nikkei went down by 7 percent and then showed considerable volatility on Friday, before ending the day marginally higher. In the United States, markets posted their first weekly loss after a month of record highs. While one of the factors in the Japanese plunge was a fall in manufacturing in China, a key element was fear of a major crisis if the US Federal Reserve Board ceases or significantly cuts back its "quantitative easing" program, which is pumping $85 billion per month into financial markets.

On Wednesday, Federal Reserve chairman Ben Bernanke indicated that if economic conditions in the US improved, the Fed may consider a "step down" in its asset-purchasing program. There was no definite commitment and no date was set, but such is the dependence of financial markets on the injections of cheap money from the Fed and other central banks that the mere suggestion that supplies could be cut back triggered a market slide.

Commenting on the sell-off in the *Financial Times*, HSBC chief economist Stephen King pointed to the widening gap between "financial hope and economic reality." He commented: "At the beginning of the year, there were high hopes that the world economy would be dragged out of its torpor thanks to the copious use of monetary drugs, recovery in the US and strength in China. Monetary drugs, however, appear to have hallucinatory effects."

The turbulence in Japan is particularly significant because the program initiated by Prime Minister Shinzo Abe's government and the Bank of Japan (BoJ)—doubling the country's money supply within the space of two years—represents the most extreme form of "quantitative easing."

It is estimated that since the program started at the beginning of April, the BoJ is buying the equivalent of 70 percent of newly-issued government bonds. The stated aim of the policy is to lower interest rates, stimulate inflation and increase economic activity.

One of its unstated aims is to undermine Japan's trade rivals in Korea, China and beyond, by devaluing the yen against their currencies and thereby boosting Japanese exports. This is fuelling sharp tensions between the major powers, as each power attempts to gain advantage at the others' expense through competitive devaluation. Such tensions aggravate the dangerous strategic situation in East Asia, with the Obama administration encouraging Japan's aggressive posture against China over regional territorial disputes.

The Abe government also aims to utilise its quantitative easing program to help finance and push through economic restructuring plans to attack the working class—such as pension cuts, value-added tax increases, industrial restructuring, and other reactionary measures. This is in line with policies in the US and Europe, where quantitative easing has been combined with deep social cuts, mass layoffs, and deep wage cuts and productivity speed-up.

The immediate impact of the Japanese central bank's program has been a rapid rise in stock prices. This has raised fears that the BoJ's policy, rather than providing a means to revive the Japanese economy, is creating the conditions for a major financial crisis.

One objective of the policy is to increase the price of government bonds through central bank purchases, resulting in lower interest rates. But instead of falling as was expected, bond yields have increased over the past month, indicating that large-scale investors may be trying to reduce their exposure to government debt, fearing a major downturn in the bond market in the future. If this move to the exits increases, then it could spark a major financial crisis.

Japanese government debt, equivalent to around 245 percent of gross domestic product (GDP), has been financed by investment houses and domestic savings. But this may not continue. A government panel's draft report has reportedly warned that there is "absolutely no guarantee" that domestic investors will keep financing government debt.

In a speech to a symposium on Sunday, BoJ governor Haruhiko Kuroda warned that if there was no improvement in economic conditions while interest rates continued to rise because of concerns over the state of government finances, then major financial institutions would suffer losses on their bond holdings. The BoJ has calculated that a rise in interest rates of just 1 percentage point would lead to market losses equivalent to 10 percent of their core capital for the major banks, and 20 percent for the smaller regional banks.

While claiming that banks would be able to cope with rising interest rates once the economy improved, Kuroda's voicing of concerns over government debt had a definite political purpose. Japanese and international finance capital are insisting that debt levels have become unsustainable and the government must start an austerity program directed against the working class.

However, the Abe government's policies have attracted one prominent international supporter. *New York Times* columnist Paul Krugman has hailed the measures as an antidote to the "economic defeatism" that taken over the Western world.

"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," he wrote.

Krugman's enthusiasm for the Abe government's quantitative easing program is a striking demonstration of the utter bankruptcy of the school of liberal Keynesian economics which he represents and which holds that the economic crisis can be resolved if only there is more enlightened government policy.

In the first place, so-called Abenomics cannot be separated from his government's political agenda: an ever-more aggressive foreign policy based on the assertion of the Japanese ruling elite's interests in the region and deepening attacks on the working class at home.

The gyrations on the share markets point to the fact that far from providing a “model” for the United States or the rest of the world, Abenomics is another expression of the deepening crisis of the global capitalist system as a whole.

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