Recession in Japan Sends Shares Tumbling

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Japanese stocks suffered their biggest one-day plunge in more than four months following an announcement that the world's third biggest economy had slipped back into recession. The two consecutive quarters of negative growth were triggered by an increase in the sales tax that was implemented by Prime Minister Shinzo Abe in April. The VAT tax was designed to put more of the costs of running the government on working people who have been forced to reduce their personal spending due to higher taxes, 23 consecutive months of falling wages, steadily shrinking incomes, and a sharp decline in full-time employment. At present, 38 percent of Japan's labor-force work at part-time jobs that pay less than fulltime positions, and that provide no benefits, security or retirement. (Note: the economy contracted at a 1.6 percent annual pace in the July-September quarter, preceded by a 7.1 percent drop the quarter before.)

In Japan, consumer spending accounts for more than 60 percent of GDP. Thus, when the government raises taxes, spending declines, deflationary pressures build, and the economy goes into a slump. Quantitative Easing– which involves the purchasing of government bonds by the Central Bank– has negligible impact on the real economy. The Bank of Japan's (BoJ) extraordinary monetary easing–which includes the buying of ETFs and J-REITs as well as Japanese Government Bonds (JGBs)–has helped to buoy stock prices and lift corporate profits to record highs, but has had a damaging effect on the economy. The weaker yen has lifted import fees on oil and other essentials making it more expensive for working people and retirees to scrape by. Even so, Abe pushed ahead with his tax increase determined to prove his loyalty to his constituency of financial speculators, fatcat corporatists and other wealthy elites, all of who have made out like bandits due to zero rates and QE.

It's worth noting that the BoJ's gigantic liquidity injections have had almost no impact on inflation which is still running below the BoJ's target of 2 percent. That fact holds true in the US too, where a $3.5 trillion increase in the Fed's balance sheet has failed to lift inflation to the Fed's target. The reason for this is easy to understand. While QE adds to base money in the financial system, that money has no where to go without a transmission mechanism. In other words, there must be demand for funds (loans-credit) for borrowers to get their hands on that money and use it for additional consumption. But since the private sector (businesses and consumers) are still net savers in Japan, borrowing is minimal and insufficient to produce robust growth. This is why raising the sales tax from 5 percent to 8 percent was such a bad idea, because credit was already weak when Abe decided to remove even more fiscal stimulus from the economy. Now Japan is back in recession and the options for pulling the economy out of the ditch are limited. (Monetary policy is already at its highest setting.) This is from Bloomberg:

"No part of Japan's economy looks encouraging," said Yoshiki Shinke, chief economist at Dai-ichi Life Research Institute, who had the weakest forecast in a Bloomberg News survey, with a 0.8% growth estimate for real GDP. “Today’s data will leave another traumatic memory for Japanese politicians about sales tax hikes.”

It may be a “traumatic memory” as Shinke says, but that doesn’t mean the politicians are calling for a repeal of the VAT tax. Heck, no. Nor are they demanding higher taxes on corporations, financial institutions, and high-income elites who can afford to pay-down Japan’s enormous debt-load without curtailing their own Gucci lifestyles. These are the people who benefit the most from government policy, but who are never asked to pay their fair share.

Japan suffers from a chronic lack of demand that stems from the fact that wages haven’t kept pace with increases in production. If workers got their fair share of the profits, Japan’s economy would be firing on all cylinders and there’d be no problem. But since corporate bosses like to keep their employees as close to starvation as possible, workers have to slash their spending to make ends meet. This, in turn, weakens demand even more further exacerbating the slowdown. It’s a circle. Check this out from the CFR’s magazine Foreign Affairs:

> “Imagine the predicament currently facing a growing number of Japanese men in their early 30s. Despite having spent years cramming in high school and attending good colleges, many can’t find a full-time job at a good company. Since Japan’s rigid labor laws make it nearly impossible to lay off permanent employees in downtimes, companies now tend to fill open slots with part-time or temporary workers, and they typically pay them a third less. Today, 17 percent of Japanese men aged 25 to 34 hold such second-class jobs, up from four percent in 1988. Low-paid temps and part-timers now make up 38 percent of Japanese employees of all ages and both sexes — a stunning figure for a society that once prided itself on equality.” (Voodoo Abenomics, Richard Katz, Foreign Affairs)

See what I mean? How are you going to maintain strong growth when 38 percent of your workforce is plugging away at shitty-paying part-time service-sector jobs? It’s can’t be done. And here’s another important fact that’s worth mulling over:

> “But all the gains have been for irregular work; regular jobs have fallen by 3.1 percent. Consequently, the average wage per worker in real terms has fallen by two percent under Abe. No wonder consumer spending is anemic.” (Foreign Affairs)
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> So wages in the aggregate are falling. And if wages are falling, then households have no choice but to reduce their spending which means personal consumption is going to tank, which it has. Unfortunately, the BoJ’s “weak yen” policy has accelerated at the same time wages are tumbling. According to analyst Wolf Richter: .”under the economic religion of Abenomics, inflation has roared higher. In September, prices were up 3.2% compared to a year ago, with goods prices up 4.6% …..(At the same time) Average monthly inflation-adjusted consumption expenditures by two-or-more-person households plunged 5.6% from a year ago. It’s the sixth month in a row that expenditures and incomes have plunged in this manner.” (Bank of Japandemonium Resorts to “Monetary Shamanism,” and all Heck Breaks Loose, Wolf Street)

So prices are up, but wages are down. It’s the double whammy!

So how is QE supposed to change this situation? How is buying financial assets going to raise wages, boost hiring, put more money in the pockets of people who will spend it and pull the economy out of its 20 year deflationary funk?

It won't. All it will do is trigger a currency war (by slashing the value of the yen) and create conditions for a bond market meltdown. Think I'm kidding? Take a look at this eye-popper from Bloomberg:

> "In announcing that it will boost purchases of government bonds to a record annual pace of $709 billion, the central bank has just added further fuel to the most obvious bond bubble in modern history — and helped create a fresh one on stocks. Once the laws of finance, and gravity, reassert themselves, Japan's debt market could crash in ways that make the 2008 collapse of Lehman Brothers look like a warm-up. Worse, because Japan's interest-rate environment is so warped, investors won't have the usual warning signs of market distress. Even before Friday's bond-buying move, Japan had lost its last honest tool of price discovery. When a nation that needs 16 digits in yen terms to express its national debt (it reached 1,000,000,000,000,000 yen in August 2013) sees benchmark yields falling, you've entered the financial Twilight Zone." (Japan Creates World's Biggest Bond Bubble, William Pesek, Bloomberg)

A bond market crash that could make "the collapse of Lehman Brothers look like a warm-up"?

Indeed. The possibility of a sovereign default by the world's third biggest economy can no longer be excluded. Any rise in interest rates (even if the BoJ reaches its 2% inflation target) will make it virtually impossible to roll-over Japan's mountainous debtpile. The wacky BoJ has created a doomsday machine that will have catastrophic implications for the people of Japan.

And that's why Japan's $1.2 trillion Government Pension Investment Fund (GPIF)–the largest in the world–announced that it plans to rebalance its portfolio away from Japanese Government Bonds.(JGB). It's because JGBs can no longer be considered "risk free", so the pension fund is going to reduce its position now and put more of its resources into stocks where the rewards for risk-taking are more attractive.

Even so, that hasn't stopped the harebrained BoJ Governor Haruhiko Kuroda from adding more fuel to the fire. Kuroda remains convinced that bigger injections of liquidity via QE will end Japan's "deflationary mindset" and spark a splurge of spending that will simultaneously boost inflation and beef up GDP. After more than five years of non-stop QE in three separate countries, there's no evidence that the theory works. Economic stagnation prevails wherever QE has been used.

John Maynard Keynes explained why "increasing the quantity of money" in the financial system would not revive an economy stuck in a balance sheet recession. Here's what he said 80 years ago in his "Open Letter to President Roosevelt":

> "Rising output and rising incomes will suffer a set-back sooner or later if the quantity of money is rigidly fixed. Some people seem to infer from this that output and income can be raised by increasing the quantity of money. But this is like trying to get fat by buying a larger belt. In the United States to-day your belt is plenty big enough for your belly. It is a most misleading thing to stress

> the quantity of money, which is only a limiting factor, rather than the volume of expenditure, which is the operative factor."

Bingo. The amount of money in the economy doesn't matter. What matters is spending. Without spending there's no hiring, no investment, no growth. But people can't spend what they don't have. And what they don't have is money, which is why they need higher wages. Unfortunately, corporate bosses aren't going give away any more than they absolutely have to, which means that workers need to get their act together and fight for what's theirs.

Let the battle begin.

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