Useful Japanese Bond Market Phrases

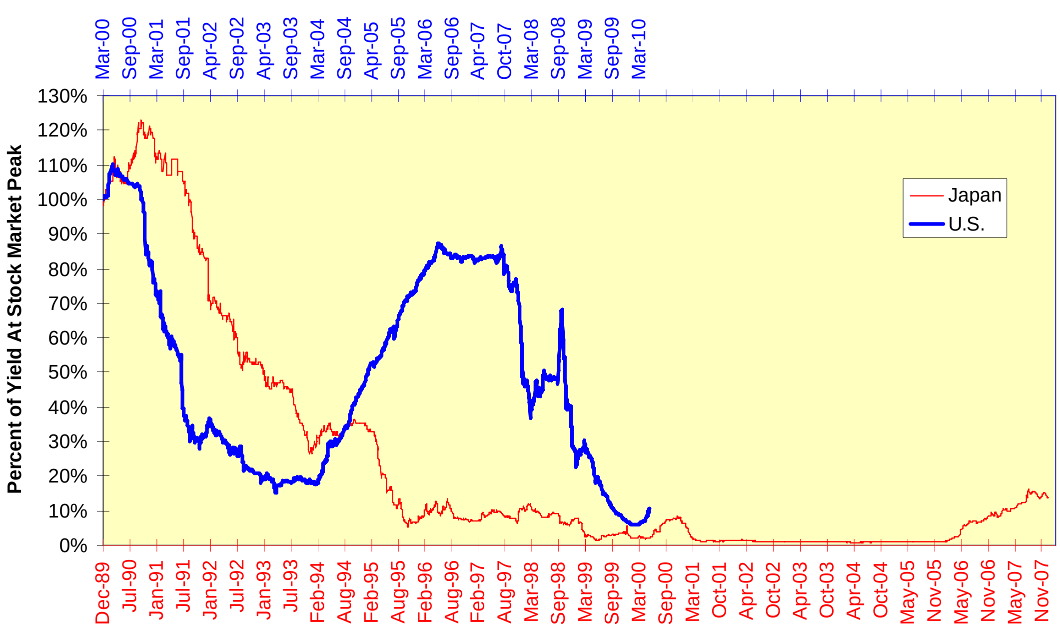
One of the more effective advertising taglines is, "I've fallen and I can't get up!" Whether you buy the medical alert device or not, you certainly remember the ad. We could use the same line for ten-year Japanese government bond yields; they fell and have not been able to get up for years. When Japan went to its zero interest rate policy in February 1999, ten-year Japanese government bonds closed the month at 2.015%. They have not traded higher since that time.

The U.S. has not yet fallen into that miasma, but let's not think we have broken loose of some strange vortex of destiny pulling us into a Japanese parallel. Let's construct an analysis from two bull market peaks, the Japanese stock market peak of December 29, 1989 (another seven months and a person could have reached legal drinking age without having seen a new all-time high in the Nikkei 225) and the U.S. broad market peak of March 24, 2000 (yes, I know we hit a nominal high in October 2007, but the 2000 high was made in far more bubbly conditions). We can re-index U.S. and Japanese six-month LIBOR and ten-year government bond rates (is "sovereign" a dirty word yet? Discuss) to these dates and compare their progress over time.

First, let's compare the short-term yields. One of the lessons the Federal Reserve concluded from its study of both its own response in the early 1930s and Japan's response in the early 1990s was the central bank has to be aggressive in cutting rates early on in the game. Otherwise, you could end up with a decade of low growth, sideways financial markets and deflationary pressures; thankfully the Federal Reserve has prevented all of these from occurring.

As a result, the U.S. six-month rate path between 2000 and 2004 fell further and faster than Japan's did; the Federal Reserve then began a series of seventeen consecutive rate hikes. Otherwise, we could have wound up with a credit bubble, a housing bubble, a weak dollar and inflationary pressures in all manner of physical commodities by 2007-2008; thankfully the Federal Reserve prevented all of those from occurring.

U.S. Short-Term Yields Following Japanese Path

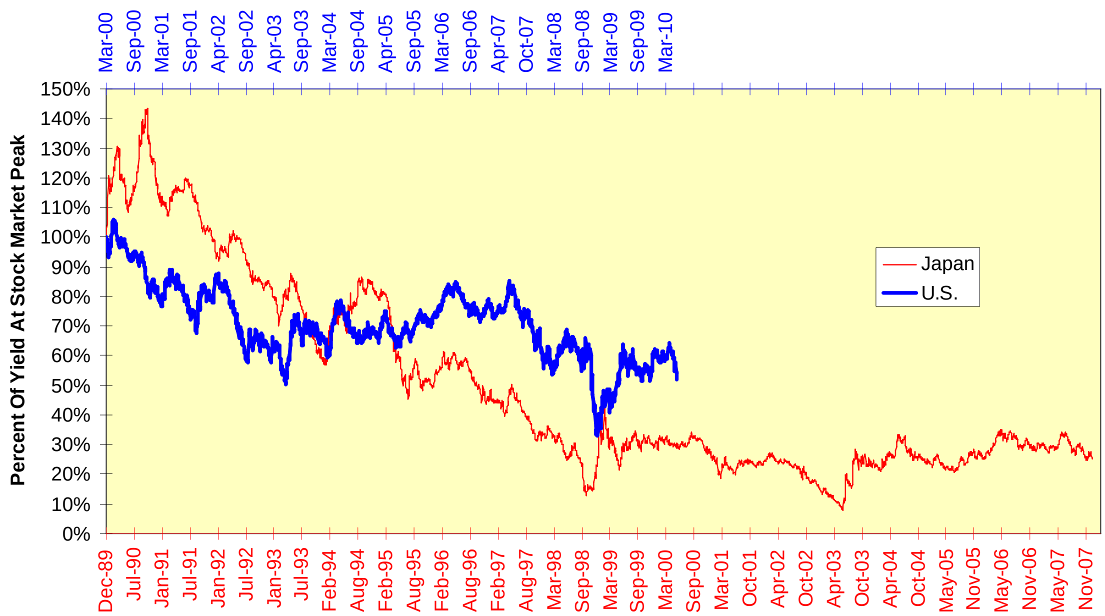


At the end of this all, what do we see? The U.S. did things differently than Japan and has a short-term interest rate path remarkably parallel thereto.

Long-Term Comparison

U.S. long-term rates also fell further and faster than their Japanese counterparts did, but then diverged to a higher path by 2005. This was one comparison I was prepared to lay to rest until the credit mess (I am getting very tired of calling everything a "crisis." World War II was a crisis; these are financial markets. Let's get a grip on what is and is not important already). By the end of 2008, we had converged to the Japanese path only to diverge again during what proved to be a bad year for long-term bonds in 2009. Guess what? We are heading back down to the Japanese path again; I never though I would see the ten-year Treasury back under 3% again, but it very well may happen.

Can U.S. Long-Term Yields Fall To Japanese Path?



There is something tragic in the classic sense here: It is as if the Fates have spoken and, just to make sure we were listening, slapped us upside the head once or twice. We may be condemned to follow Japan down its path of stacking one Lost Decade on top of another.