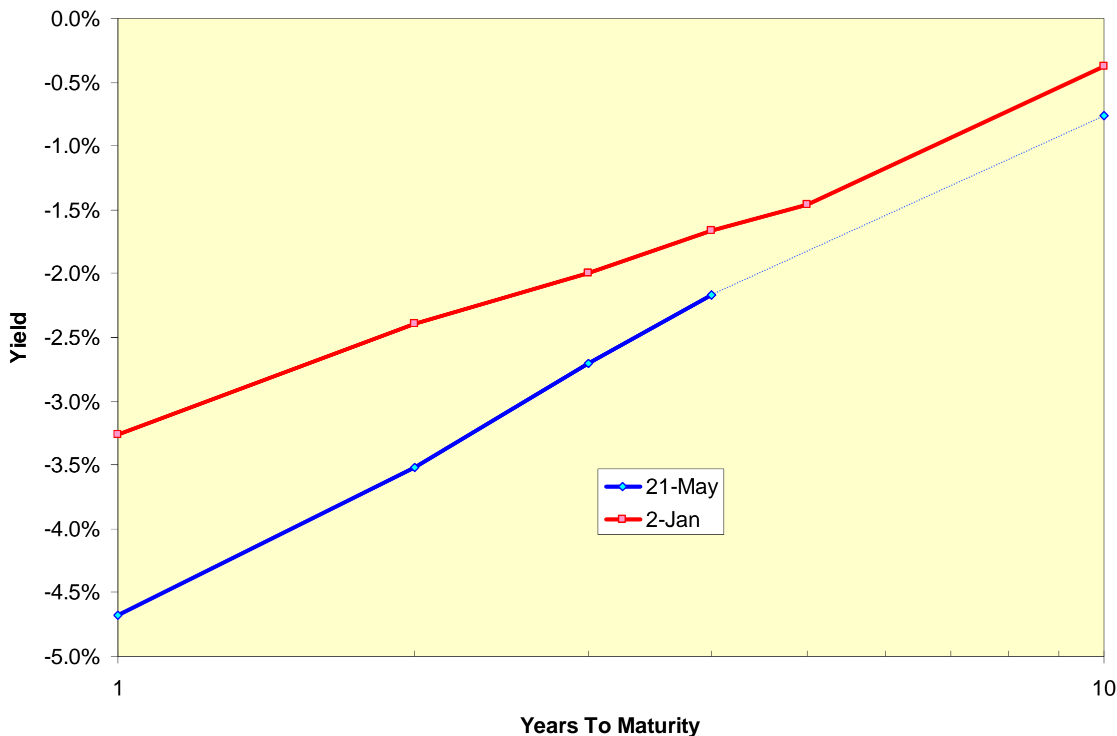
# Japan Shows QE Exit Easier Said Than Done

In one of the more memorable scenes from *Animal House*, Bluto bellowed, "Nothing is over until we decide it is! Was it over when the Germans bombed Pearl Harbor? Hell, no!" Well, we can say the same thing about Japan's long-running experience with near-0% interest rates, lackluster economic growth, dismal long-term stock market returns punctuated by extravaganzas such as 2013's 28.23% return in USD terms and spectacularly low long-term interest rates accompanied by breathtakingly negative short-term real interest rates.

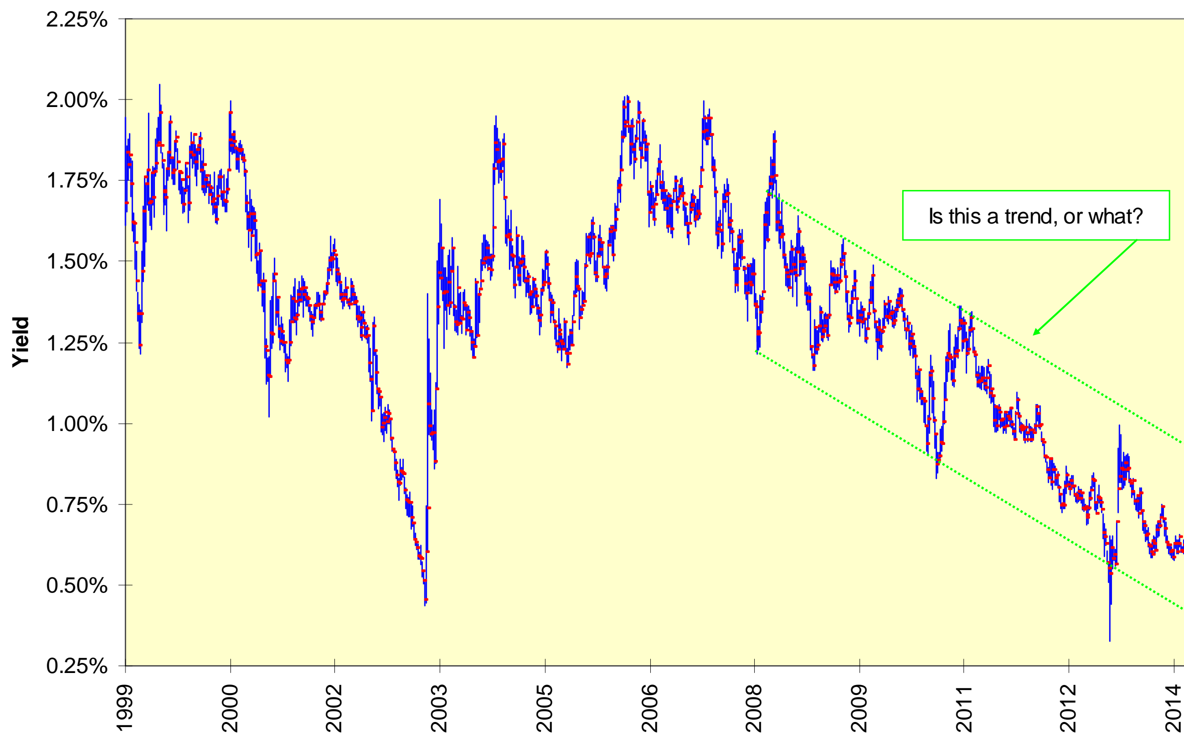
Even Godzilla must be ready to let up on his homies by now out of a sense of fair play.

**Are Those Real?**
First, let's take a look at those negative rates and how they have changed so far in 2014. Even though these rates are far more negative now than they were at the start of the year, a surefire sign the supply of yen has been growing faster than the demand therefor, the yen itself has gained 3.82% against the dollar and 6.9% against the Chinese yuan. It is also a surefire sign Japanese investors have increased their demand for cash balances, a disinflationary development.




**Eleven Years After**
Those very same risk-averse investors are willing to pay the Japanese government for the privilege of lending it money. Remember, Japan's ratio of debt to GDP is approaching 250%, but once those numbers cross 100%, they become increasingly meaningless. I have to marvel at U.S. deficit scolds' continuous warning our debt will have to end in ruinous inflation and higher interest rates when Japan's public debt has led to persistent deflationary pressures and those negative real rates noted above. Lost in translation, I guess.

If we map ten-year Japanese government bond yields since Japan first went to its zero interest rate policy (ZIRP) in February 1999, we see how they moved down to 43.8 basis points in June 2003, doubled from that level by July 2003 and after several years of meandering, entered their present downtrend in the second half of 2008. They are trading just under 60 basis points as I write.




Given this environment, can Japan do anything other than persist in the policies that have failed it for more than fifteen years? I doubt it; they tried to renormalize short-term rates in the spring of 2006 only to back away as yen carry trades around the world unwound. If the yen is rising in the face of falling real rates now, what would it do if the supply of yen started to diminish? And if their growth is weak now, what would it look like if the government's debt service costs started to rise.

I think Japan is trapped. Worse, I think we have wandered into the same tar pit and will encounter the same problems if and when we start to renormalize interest rates.