

## Japanese Inflation On The Rise

Einstein, the man whose name we have made synonymous with genius, was famous for his thought experiments or *Gedankenexperimenten* if you prefer. You can try one yourself, right here and now. I will give you a brand new Benjamin, good for \$100 of goods and services if you spend it now but good for only 98% of those same goods and services one year from now. At which point in time were you wealthier?

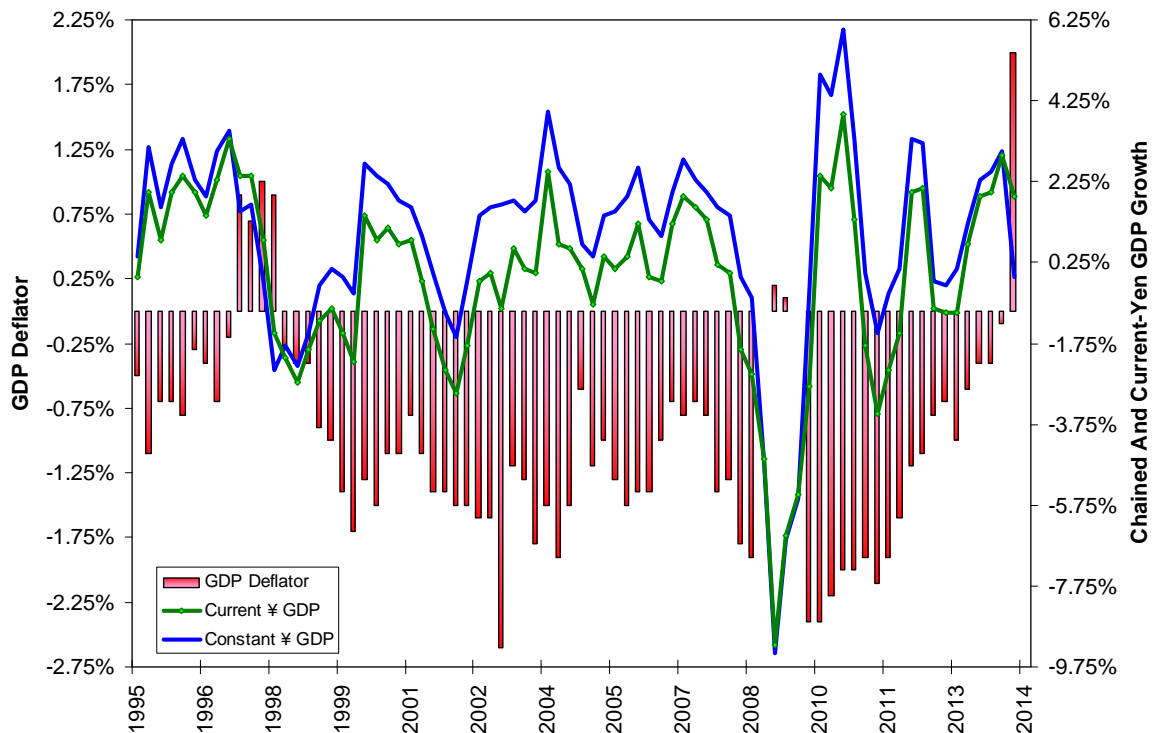
The answer should be obvious to everyone but a central banker focused on imposing that 2% inflation tax upon all and sundry, whoever “sundry” is. This is why I have been so leery about the notion inflation is not high enough for central planners’ tastes, especially after coming of age during an inflationary era. Once that genie gets out of the bottle, it is devilishly difficult to re-confine. I saw central bankers fail at this task during the 1970s and have seen them fail at stimulating output and employment since the financial crisis. Why I should have confidence in their ability to produce any sort of future deterministic output is beyond me.

### Rising Sun, Rising Consumer Prices

The bad news for Japanese consumers is the Bank of Japan has started to succeed at reducing their purchasing power. Not only are domestic prices rising, the yen is falling and making imports more expensive. For any dimwitted mercantilists – a redundancy if there ever was one – who rejoin, “Yes, but Japanese exports are cheaper! Whoop-de-damn-do!” consider how someone else is getting to consume the fruits of the Japanese worker’s output. I define wealth as the capacity to consume and Japan’s capacity to consume is shrinking. Ergo, their policies have failed.

To review the bidding, the downside breakout in the yen began two years ago and has been reinforced twice, in April 2013 and again in October 2014. Japan’s GDP deflator has been climbing since 2010:Q1 but did not turn positive until 2014:Q2. The 2.0% reading is a two-decade high. This jump in the deflator occurred within a period of slowing economic growth; year-over-year growth in chained and current-yen GDP was -0.1% and 1.9%, respectively.

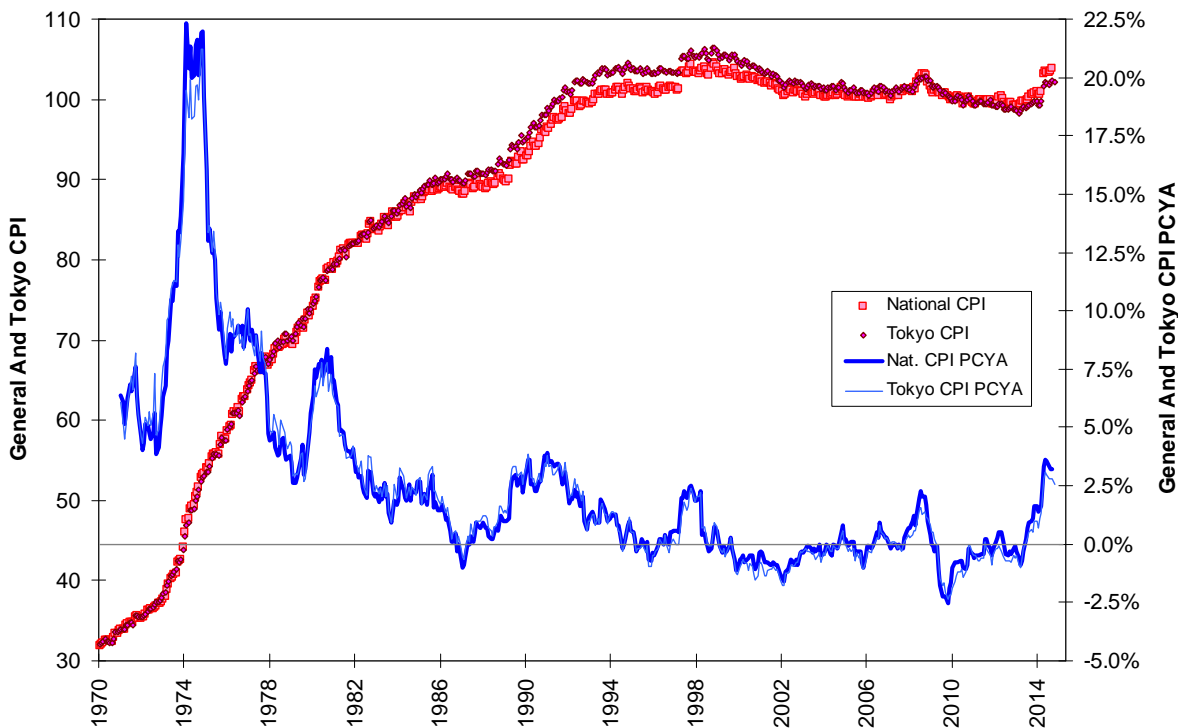
### 2014:Q2 GDP Deflator At Two-Decade High



Let’s move from the GDP deflator down to measures of consumer prices and take a longer-term perspective. While both the national and Tokyo CPI measures have jumped from June 2014, the general index is at levels first breached

in September 1997 and the Tokyo index in September 1992. The year-over-year for the national and Tokyo indices are the highest since August 1991 and June 1992, respectively. If we are in the early phases of rising inflation in Japan, this trend will be a secular one, not simply a few months of higher prices.

### Japanese Consumer Prices Rising



Breaking a deflationary psychology is one thing, but simply creating a higher rate of inflation and a weaker currency in a slow economy with an aging population, sub-replacement birthrate and a very high level of public debt is another. Can anyone be surprised a nation whose population has been impoverished by benighted policies has slipped back into a recession?

The Abe government may finally get the message and postpone an increase in the consumption tax. This should be followed by a decrease in Japan's long-out-of-control public works boondoggles and a financing of its national debt by open-ended monetary creation. If you run a thought experiment on that one, you might find 1) it is very un-Japanese and 2) it just might work. After all, this is a nation 25 years through a Biblical 40-year wandering in the desert, if I may mix metaphors and cultures.