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A ticking, aging time-bomb in JGBs

Posted by **Izabella Kaminska** on Oct 05 19:05.

Somehow, this is a point that's rarely made.

And yet, *it is* pretty important.

Last time Japan went scouting for JGB investors, it had a plentiful resource in its own population base — all of whom were aging but were also looking for a risk-less investment until retirement day.

This time round, though, the aged Japanese pensioner is unlikely to be as enthusiastic a purchaser of JGBs simply because in many circumstances retirement day has already dawned. In fact, they're likely to start cashing those JGBs in.

Ben Davies, CEO of investment management firm Hinde Capital makes the point in a recent interview with King World News.

Although he adds extra detail in a recent note to FT Alphaville:

> *Respect for-the-Aged' Day (敬老の日Keirō no hi?), is a day to honour centenarians in Japan. It's come to symbolise the declining demographics of the country. Japan's dependency ratio is now approaching 100. This is significant. The dependency ratio is the percentage of retired people supported by working people.*
>
> *Very soon Japan will have more retired people than working people, and the savings rate will fall further.* ***This is not only an issue for the productive capital of economy, it means Japan will be in less of a position to use domestic savings to fund their burgeoning deficit.*** *Gross debt to GDP is 200%.*

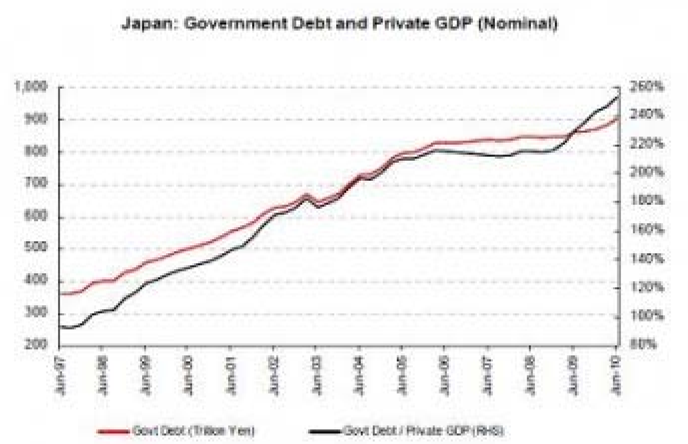
And here's the really salient bit (our emphasis throughout):

> ***Japan has survived this long because foreigners don't buy Japanese bonds. Through savings and insurance companies that are directly or indirectly controlled by the state, 94% of all JGBs have been bought by the Japanese.***
>
> *Japan's government debt to private GDP is now 253%, having moved sharply higher in the last year. The three largest holders of JGBs are the Japan Post Bank, Japan Post Insurance and the Government Pension Investment Fund (GPIF).*
>
> *Prior to the 2001 Fiscal Investment and Loan (FILP) reform, postal savings and pension reserves were required to be deposited at the Fiscal Loan Fund.*
>
> *As part of the reform, the compulsory deposits were discontinued and existing deposits and interest on deposits were to be sequentially returned. From 2001-2009, Japan Post Bank and GPIF used those returned deposits to buy JGBs, and those deposits are now almost completely liquidated.*
>
> *Japan Post Insurance will soon not be a likely buyer because insurance reserves have been in steady decline given Japan's demographics, and their year over year holdings growth is almost 0%. Banks have been filling the void, but don't have a ton of additional capacity given Basel II guidelines.*

Which he says means Japan will be forced this time to finance their issuance in international markets. Not quite as easy, given the competition – eh?

As Davies puts it:

> *We have already stated that this is highly unlikely due to sovereign debt levels around globe. Due to aging demographics, the Japanese savings rate will not rise. The Japanese fertility rate is 1.2 children born per woman (2010est) ranking them 218 out of 223. Interestingly the only countries with lower rates are some other Asian countries S.Korea, Taiwan, Singapore, Hong Kong and Macau.*
>
> *The US by comparison has a rate of 2.06 which ranks them 126 in the world. The replacement rate is 2.1 – the golden rate. The demographics dictates the savings rate will go down not rise. The lifecycle savings hypothesis points out you spend when you're young and you save when you get older and then when you get much older, you will spend the money you've saved in your lifetime.*
>
> ***Now the Japanese are getting really old, and they're about to start drawing down their savings. The savings rate will go negative. All bubbles burst when financing becomes an issue.*** *The Japanese bond market will, in the not too distant future, face a fiscal crisis that will require either draconian tax increases and spending cuts, but that would be extremely socially divisive or debt monetization. This recent intervention leads us to conclude Japan will choose to print money and create an initial illusion of health. Most countries have bad choices and worse choices. Japan has only worse choices.*



The likely result? In Davies' opinion: a wholesale exit out of the yen and JGBs by the Japanese and the makings of a hyperinflationary environment, offset by a mega rally in gold.

But, of course, Hinde Capital does manage the Hinde Gold Fund, a gold hedge fund.

Related links:
Ben Davies: Part II – King World News
Hugh Hendry: short China, via Japan – FT Alphaville
BoJ says: 'Bye, bye bank note rule' – FT Alphaville

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Comments

Wonder if when Japanese retirees start to eat their capital they'll find it's the diet version....there's a pun in there somewhere....

I thought this was quite good, from Edward Harrison:
http://www.creditw...-currency-war.html

And Europe is not far behind Japan in this respect, say 15-20 years. With several countries already now with a huge trade deficit and mainly borrowing from abroad.
Also the voter population of these countries is moving towards the part of society that benefits from the welfare state (elderly, welfarepayment receivers, civil servants etc) which will make it more difficult and timeconsuming to get to a proper solution for this.
With Europe again in a worse situation than Japan in several ways.

print, monetize debt, gov't spending, stuff it in pension/insurance/bank systems, rinse your hands and repeat again.
this ultimately retrenches consumption and suppresses phony CPI, but makes inflation of foodstuffs and other necessity products ever more important on savings decisions. i am afraid there is no way out of this unless someone is willing to erase all debt and bankrupt the financial sector. this is certainly what central banks do not want to happen anywhere. so, let's get back to the routine.

Thanks Taxloss, that's right -- please let's keep the conversation civilised.

No need to be rude Lady E. Or we'll have to refer to you as Chav E.

Good questions Ho Hum.

Ho Hum

Why ask me you seem to be clever one with all the answers you tell me, Tā kěnéng kàn qǐlái nǐ láizì zhōngguó

Helolo Lady Economist. I read your hotlink, re material by DGov BoJ dated December 7, 2004 which relates demography and deflation. What concerns him is how to boost the economy, which is no surprise whatsoever. One of the means of attaining this growth, in fact the "third way" according to him, is :

a. via "the increase in labor productivity" ...

b. ... to attain "higher rate of return on savings" ....

c. ... by means of "raising productivity of the non-manufacturing sector through the application of advanced information technology and the more efficient management of firms"

So my simple questions are :

1. Since 2004, now being 2010, what has become of this "application of advanced information technology"?

2. Does "application of advanced information technology" refer to money-printing? If so, the "more efficient management of firms" might aptly apply to the BoJ's forthcoming money-printing venture.

3. Further, are you disheartened to learn that the BoJ economic department's output, for all its gee-whiz and references to American-san scholars (such as Krugman whom you can ignore, after all why should you be the only mugs in town to pay any attention to him?) amounts to something as simple as printing money?

4. Lastly, why am I not surprised to find every other bright whiz in the world seems to have converged on money-printing as a solution? It appears to have ended up this way.

Isn't it funny the way things turn out whatever the analysis?

Speech was given by DG wata san in 2004.

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http://www.boj.or....s/koen/ko0412c.htm spot of analysis and speech given in 2008 that give you a idea of what was been thought then.As to Ben Davies the 11 a hedge fund super star in the making,Well what goes up must come down.35% woman do not work in the Japanese workforce but that is changing,As to saving we have another 38 years worth of saving to go in household accounts,Also Japan has over $1 trillion in assets that is sovereign wealth fund assets. really would like read BENS research.

This idea about committed societies and all that is a hollow idea. It presumes there is anything to commit in the first place.

How and what can be committed if the place is full of oldies? There are no fiscal sleights-of-hand that would alone solve this.

Today should prove how the Japanese will fund their deficits: the same way they have in part for the past 15 years. When inflation is 10%, maybe they will have to make a change. I suspect that to be some time away.

Leveraged investors are keen on shorting JGBs because of convexity which leads to asymmetry of investment returns. It also costs little to short the JGB and you can hedge the bet by being long a UST or a Bund. So the profile is right, but will these capacities actualize anytime soon? Japan is a command economy and can repress the JGB quite effectively for a long time if it wants to.

The question is whether there is a contravening policy goal that could lead to higher rates. I can't think of one off hand in the short-term, but it may exist. Beyond that, it seems only significant and destabilizing currency weakness and inflation could force their hand. There is one policy risk which has been brought up by some thinkers. Cheap money holds asset prices up, but that has one very negative effect which is to make the cost of living higher for young people which discourages population growth and can create social strife. China is experiencing this with property right now and is the published reason for policy tightening there. Japan has been in the trap for 20+ years which has directly led to the population issues it is now having. It is very hard for young young people in Japan to have children because of rent and basic consumer product costs. If the Japanese policymakers ever felt overly threatened by population declines, they would push asset prices down aggressively.

This article is way over the top. For a start, Japan's old age dependency ratio (the dependency ratio quoted presumably includes children) is not heading to 100%. According to the medium variant of the UN's world population prospects projection (http://esa.un.org/unpp/index.asp?panel=2), Japan's OAD will reach 48% by 2020, and 74% by 2050 - the highest in the world perhaps, but not 100%. Second, the advantage of debt being internal is that the state has taxation access to the recipients of its interest payouts. Japan is a relatively lightly taxed country at the moment, especially when it comes to VAT, which of course would be paid by the ageing consumers. And Japan has relatively high inheritance tax to capture what the elderly fail to spend. Third, although they might not like it, Japan has considerable potential for a bit of inward migration. Fourth, Japan is one of the most cohesive and committed societies in the world - when their back is to the wall, they will endure hardship to tackle their problems. Still, it would be shame to let facts get in the way of a sensational story.

Like a plane that eventually runs out of fuel, it will just carry on until one fine day there is just no throttle response. That's all.

Back to the same explanation (think it was pragcrap) said, basically japanese government borrow the money, bank use bank reserve to buy the money, japanese government then spend the money and those money comes back as bank reserve. Then the cycle repeats.

How are they going to run out of money? Classically, this leads to inflation and currency collapse...doesn't seem to be happening either.... strange place..

Its a good point. Good enough for me to post twice. Good point!

Ah yes! This is a very good point that's been simmering away unnoticed. That Japanese society is getting exponentially aged.

Good point!
