



Japan Could Shake Global Markets

Investors are always worried about something.

fact statement

It's interesting to look back at what those things were decades ago. Some old fears about Japan's effect on the world's markets seem quaint today but, with its long-term bond yields hitting alltime highs last week, there are scary parallels.

In 1989 Michael Lewis, a former Salomon Brothers bond salesman, wrote a piece of speculative fiction about the potential financial effects of a major earthquake in Tokyo in 1993. There have been devastating temblors about every 70 years and the last one, 1923's Great Kanto Earthquake, destroyed much of the metropolitan area. "Liar's Poker," the book that made Lewis famous, wouldn't be published until later that year, but the article caused a stir.

It was a different time: Japan seemed to be taking over the world and its stock market dwarfed America's. The country was home to the world's four largest companies— all banks. Aside from the awful human toll of another quake, what might happen to Japan's massive pool of savings if it suddenly were needed back home was a risk that sparked conversation.

Today the world's 10 most valuable companies are all American and the U.S. stock market is about 13 times as big. Japan, meanwhile, has built up by far the world's largest mountain of government debt relative to its economy over 3½ decades of trying to recover from its financial bubble. In that respect, at least, it has left the U.S. way behind.

But what hasn't changed is America's dependence on the kindness of strangers. East Asian central banks and financial institutions play a huge role in financing federal borrowing. Earlier this month a sudden, sharp rally in the Taiwan dollar spooked regional investors facing large paper losses on U.S. bonds.

Now tremors are showing up in Japan. By American standards, government bond yields in the largest foreign owner of Treasury debt still seem low—well under 4%—but their recent surge has sparked two concerns.

One is a slow-motion version of what Lewis imagined 36 years ago—capital flowing back home and sending the U.S. into a crisis as borrowing costs surge. U.S. 30year bonds hit their highest yield since 2007 last week. The U.S. lost its last triple-A credit rating this month after a downgrade from Moody's.

The other concern—hard to imagine in 1989—is Japan itself facing a debt squeeze. Rates there have been so low for so long that rising bond yields could overwhelm its budget. Prime Minister Shigeru Ishiba's recent comment that Japan's fiscal situation is worse than that of former basket case Greece didn't help matters.

He was exaggerating for local political effect, but his comments had aftershocks halfway across the world in Washington. Instead of a natural disaster, a man-made one decades in the making is keeping some investors up at night.

—Spencer Jakab

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