

# WSJ Print Edition

*Markets reprice risk after an extended cheapmoney experiment.*

## The Easy Money Reckoning Arrives

### REVIEW & OUTLOOK

The selloff in global stocks that began Friday and continued on Monday is in part a correction from sky-high values, especially in tech shares. But it may also be the start of a reckoning for a decade and a half of excessive spending and easy money that is going to arrive eventually. How soon and rough the reckoning will be is the great unknown.

The selloff has hit hardest in Japan, with the Nikkei index down 12.4% on Monday, its worst day since Black Monday in October 1987. This extends Friday's 5.8% drop, and other Asian markets fell too. European and U.S. shares also tumbled, the Nasdaq by 3.4%.

The Japanese plunge is a direct result of a long-needed shift in monetary policy and exchange rates. The Bank of Japan raised its interest-rate target (to 0.25%) last week and laid out a timetable for tapering its quantitative-easing program. BOJ Governor Kazuo Ueda said these moves are intended in part to arrest the falling yen, an unusually explicit statement about exchange rates for a central banker.

These moves have triggered a predictable and necessary repricing of risk in Japan following an extended period of extraordinarily loose money. The yen's dramatic depreciation throughout this year arose from the yawning gap between relatively high U.S. interest rates and abnormally low Japanese rates. That gap is now narrowing as the BOJ normalizes policy and the Fed prepares for rate cuts.

A weaker yen enticed foreign investors into Japanese stocks that appeared cheaper in the investors' home currencies. As of March, foreign holders owned about one-third of Japanese equities by value according to economist Jesper Koll. Yen depreciation also boosted the expected yen-denominated profits of Japanese companies.

Mr. Ueda has made clear that these times are over. It's no coincidence that while Japan's stock market in recent days has lost all of its gains since January, Japan's currency has gained back all of its losses from the same span. Having hit a nadir of about ¥162 to the dollar last month, the yen soared to ¥144 on Monday. Anecdotal reports suggest much of the selling in Tokyo has been driven by foreign investors cashing out.

The next dropping shoe may be a retreat of Japanese investors abroad. Low rates and the weak yen fueled a massive carry trade, which meant borrowing in cheaper yen and investing in dollar assets for a higher return. The yen's appreciation implies this is starting to reverse. It's now a waiting game to see if the sudden yen swing and capital flows have caught anyone overleveraged. Foreign markets, including U.S. Treasuries, need to prepare for the withdrawal of this Japanese capital.

And what about the U.S. economy, and the fear of recession? The fear is real, and Wall Street and Washington are blaming the Federal Reserve. The theory is that no sooner had Chairman Jerome Powell signaled last Wednesday that he wasn't cutting interest rates immediately than a poor U.S. jobs report on Friday suggested a recession is nigh.

One problem with this theory is that the July jobs report, while uninspiring, didn't show recession-levels of unemployment. And it's hard to see what a quarter-point reduction in the Fed's short-term interest-rate target in July as opposed to September would do about it.



Another counterpoint is that monetary policy hasn't been all that tight. Stocks have soared since last December when the Fed signaled three interest rate cuts in 2025. That plan was delayed by an inflation comeback in the first quarter, but last week Mr. Powell signaled one cut in September and the markets were signaling two or three more this year.

It isn't obvious what economic boost rate cuts would offer since the market is already anticipating them and has eased financial conditions. A 50-basis point "emergency" cut, as some are calling for, would look panicky and might spur more selling.

The clamor for the Fed to save the day reflects that it's the only game in town. Congress is gridlocked on economic policy, except for more spending and bad tax and trade ideas. Since the 2008 financial panic, the U.S. economy has been sustained for the most part by government spending and cheap money aimed at supporting consumers and asset prices.

But cheap money is never free, and it can't last forever. It builds distortions and excesses that are unsustainable and must eventually be addressed. That's what the Fed had to do by raising rates to arrest inflation, and part of that bill is now coming due. Government spending is also restrained by rising debt, even as low-income consumers have spent down their pandemic savings. The current economic slowdown is one result.

This market selloff doesn't look like a repeat of 2008, but it is a warning about growth. As the Fed takes the political heat, we hope it keeps its focus on the real economy and the real incomes of workers, not on asset prices to please the clamor on Wall Street.

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