Goldman Sachs Asset Management

Monthly Insights

FROM THE OFFICE OF THE CHAIRMAN

February 2012

Abstract

Prospects for Japan and Japanese Markets

Many analysts have long believed that Japan could enter a financial crisis at any moment due to its weak growth rate and inexorably rising public debt-to-GDP ratio. The shift of the external trade balance into deficit in 2011, together with the European sovereign debt crisis, have now brought renewed attention to the possibility of such an event.

In our February edition of *Monthly Insights*, we consider Japan's growth and debt dynamics, its demographic trends, the ownership dynamics of Japanese Government Bonds (JGBs) and the balance of payments current account outlook in an effort to gauge the likelihood that Japan will enter a crisis in the near future. The size of Japan's current debt stock combined with its poor growth prospects make reversing its debt-to-GDP ratio an almost impossible task without radical policy measures.

If the government wants to prevent an ultimate crisis, in our view, it needs more active policy initiatives, including a credible plan for fiscal adjustment. Oddly, while the Yen could fall sharply, its persistent strength compounds the problem. A decisive strategy to reverse the Yen seems inevitable in the shorter term in order to improve Japan's international competitiveness and support the struggling export sectors. This month's aggressive additional easing undertaken by the Bank of Japan (BoJ), in combination with a "price stability goal" of 1%, represents a step in the right direction. While we believe Japan's outlook remains extremely challenging, the possibility that an immediate crisis will occur is, as ever, unclear. Japan certainly remains a country to watch closely over the next few years.

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