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Analysis of today
Assessment of tomorrow

By: Daniel Lacalle

Japan. Another Keynesian failure

Japan is the perfect example of why Keynesian policies always fail. Record government debt, stagnation, negative long-term real wage growth and, despite an allegedly independent central bank, the yen is falling against the US dollar, long-term bond yields reach an all-time high and debt servicing costs soar to record levels despite low interest rates.

The yen has suffered its steepest weekly drop in over a year, and Japanese long-term government bond yields have hit multi-decade highs.

The tough reality of decades-long Keynesian policies driven by constant government fiscal expansion and currency debasement is now undeniable.

Japanese ex-prime minister Shigeru Ishiba said his country's financial condition was worse than Greece's.

Defender of "expansionary" fiscal and monetary policy

Regrettably, Sanae Takaichi, the new prime minister, is making similar promises and insists that the Bank of Japan's decisions must be in line with the government's economic policy.

You guessed it. Takaichi is a staunch defender of "expansionary" fiscal and monetary policy, which means more spending and printing.

Sanae Takaichi's economic plan promises, again, a substantial government spending programme to combat rising living costs, stimulate investment, and boost growth.

> The transformation that Takaichi promises is based on the same system

Therefore, she promises to print more currency to combat inflation, which is truly fascinating, and she expects that economic growth will improve with the same failed spending programmes of the past, including the so-called Abenomics she praises, which generated no transformation and only left debt and unsustainable public accounts.

Unfortunately, the transformation that Takaichi promises is based on the same system where constant state intervention, mounting debt, and persistent fiscal deficits have left the nation with poor growth, rising financing costs, and a weak currency weakens... And now, Japan also faces persistent inflation.

The yen tumbles and bond yields soar

October 2025 has seen the yen tumble to its weakest level since February, approaching and surpassing the 153 per dollar mark. However, the weak long-term trend of the yen against the US dollar is even more concerning when compared with gold.

The worst decline of the yen in a year comes after market participants understood that the political and economic environment will be even more interventionist and make it impossible for the Bank of Japan to control the monetary impact of the government's fiscal excess, which has led to persistent inflation and weakening demand for sovereign bonds.

The new government is committed to more fake "stimulus" from government spending, which means printing currency. Therefore, investors are rightly concerned that Japan will continue down the path of fiscal and monetary imbalances and further currency depreciation.

> The 30-year JGB yield reached 3.3%, reaching all-time highs, while 10-year yields rose to 1.6%—a 17-year high

Many defenders of Takaichi's government spending binge were betting on a weak US dollar to disguise the enormity of the monetary and fiscal problem of Japan. However, that was a mirage.

Lower U.S. yields and stronger demand for the US dollar have made the greenback index (DXY) strengthen since August, and the large difference between US and Japanese monetary policy has accelerated the yen's decline.

Additionally, yields on Japanese government bonds have soared. The 30-year JGB yield reached 3.3%, reaching all-time highs, while 10-year yields rose to 1.6%—a 17-year high.

However, the Bank of Japan's extremely accommodative policy means that real rates are still at deeply negative levels due to persistent inflation.

This yield rise is not just a correction but the direct result of years of yield suppression, ignoring the mounting fiscal imbalances of the government and the evidence of inflationary pressures.

The Keynesian "miracle" that never existed

The Keynesian "miracle" of high debt, low inflation and an eternal government monetary bailout has vanished, because it never existed.

Japanese governments did not understand that the only thing that allowed them to consistently increase spending and debt without elevated inflation was the enormous inflow of dollars from an exporting economy.

Now, declining demand from investors for government debt and weaker inflows of reserves have proven that the government does not have a formula that allows it to spend without control.

> Japan is the failed Keynesian experiment

Japan's problem is enormous. The government needs to issue more debt to fund new plans, which leads to persistent inflation from currency printing and an increase in the required yield to attract some investors.

Foreign investors are selling their Japanese bond (JGB) positions at a fast pace, but the government does not pay attention and wants even further debt monetisation.

Japan is yet another example of what Keynesian government "stimulus" brings: a high-debt, low-growth trap that is difficult to escape. Japan is the failed Keynesian experiment.

Constant monetary easing, equity purchases, and government credit expansion have created stagnation and left a crippled yen and unsustainable government finances.

Cheap money becomes very expensive in the long run

The Japanese central bank balance sheet is a time bomb, holding massive amounts of government bonds and equities, which further distorts markets and makes the yen a weaker currency in the long term.

Japan is another example of why a nation should never put government spending as the engine of growth - Daniel Lacalle

Instead of cutting spending, reducing taxes, and boosting productive growth, years of government excess have delivered mounting deficits, misallocations of capital, and an unsustainable spike in debt service costs.

Far from being a stabiliser, Keynesian policy in Japan has ensured both currency debasement and stagnation, with diminishing returns with every new round of "government plans".

The problem with perpetual government stimulus is that every round buys less time and creates more instability.

The Bank of Japan became the biggest speculator in its markets, and by allowing the government to spend without control and print more currency, it eventually destroyed investors’ confidence and left its economy exposed.

Japan is another example of why a nation should never put government spending as the engine of growth. Cheap money becomes very expensive in the long run.