Written by **Thomas R. Eddlem** on April 18, 2012

Global Government Debt Crisis Emerging

Though the IMF projects a relatively sunny economic forecast for the United States and Japan over the next two years (along with a debt crisis-driven recession for Europe in 2012), the IMF warns that outlandish U.S. and Japanese budget deficits are pushing economic indicators to the breaking point. “Without more action than currently planned,” the IMF report projects that by next year “debt ratios are expected to reach 256 percent in Japan, 124 percent in Italy, close to 113 percent in the United States, and 91 percent in the euro area over the forecast horizon.” The IMF notes that austerity measures in Europe will cap the debt levels after 2013, while “in Japan and the United States the debt ratios are projected to rise through the forecast horizon, which extends to 2017.”

In other words, the IMF says that the United States and Japan have no plan to ever stem their deficits and record borrowing, creating “latent risks include disruption in global bond and currency markets as a result of high budget deficits and debt in Japan and the United States.” Economic counselor and director of the IMF's Research Department Olivier Blanchard stressed in an April 17 press conference that the United States and Japan are on a fiscally unsustainable path. “Insufficient progress in designing such a medium-term plan is especially noticeable in the United States and in Japan.”

Japan will likely be the next bond bubble to burst. Japan already has far more debt than Greece did when that European nation defaulted to bond holders, but Japan's high debt-to-GDP ratio has been counterbalanced by high levels of financing of the debt by Japanese citizens, who own 95 percent of the country's sovereign debt. That may change as the Bank of Japan launches into a “quantitative easing” effort to downgrade the Yen against other currencies in a Keynesian effort to stimulate the domestic economy by making exports cheaper. Inflation discourages savings, and only high savings rates by Japanese citizens have allowed the government to rack up such giant debt levels. Keynesian-style inflation may kill the last means of financing the Japanese sovereign debt. A plunge in the value of the Yen could send Japanese investors away from bonds, or to stop saving altogether. And even if neither of those scenarios materialize, Japan is passing a carrying capacity for debt beyond which few nations have ever recovered.

But Japanese financial officials have nevertheless pledged to continue to pursue Keynesian-style economic stimulus policies. "The bank is committed to implementing additional easing measures if deemed necessary," Bank of Japan Deputy Governor Kiyohiko Nishimura announced in a speech in western Japan April 18. "We will pursue powerful easing through a virtually zero interest-rate policy and asset buying until the 1% [inflation] goal comes into view." Indeed, the Bank of Japan has done little else but “stimulate” with government spending and interest rate suppression since the Japanese economy first flatlined in 1990. Since 1990, Japanese debt-to-GDP ratios have increased from 75 percent to 230 percent of the economy and Japanese citizens have experienced no net economic growth. Indeed, the Japanese economy sunk into another recession in 2011 after the Fukushima nuclear disaster.

The idea behind the inflationary policy is to make Japanese exports cheaper to foreign consumers, but the lowered value of the Japanese Yen also means that imports will become more expensive. And with the virtual shutdown of the Japanese nuclear power supply after the Fukishima nuclear disaster, electric power is already becoming increasingly expensive for Japanese consumers and manufacturers alike as more oil imports become necessary. So while Keynesian economists such as Paul Krugman have urged currency devaluation for Japan as an economic panacea, the devaluation of the Yen will also increase production costs, offsetting much of the expected gains from cheaper exports.

The national government debt bubble is not the only sector of the bond market slated to burst. An April 18 Reuters report noted that several major U.S. cities are now on the verge of defaulting on their debts, leaving bond holders in the lurch. The Reuters report concluded, "Many failures will be due to local politicians' willingness to give unionized local government workers lucrative pensions and health care benefits when times were good. For others, the housing bust was enough to destroy their real estate tax base. They almost all share the failure to prepare for a rainy day." Reuters added that "the next series of major cities and counties in danger of defaulting on their debt can hardly point to one single decision for their malaise. Whether it be Detroit, Miami or Providence, Rhode Island, their problems have a lot more to do with financial policies that put them on course to live well beyond their means." Municipal bonds, which were once considered among the safest tax-free investments, are now showing high risk.

Photo of California Governor Jerry Brown talking about deficit: AP Images