First Trust
Monday Morning OUTLOOK
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Why Does Japan Still Charge Taxes?

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Investors often wonder why governments don't operate more like households, balancing their budgets year by year. Seems like good advice, right? If households can't live beyond their means forever, governments shouldn't either. But, what if your household could borrow for free? In other words, what if you were Japan!

As of Friday, all Japanese government bonds due in ten years or less were trading at a negative yield. It's better than Free! Lenders are willing to pay the Japanese government for the privilege of getting back their principal, ten years from now.

If a household were in Japan's situation, able to borrow for a fixed rate of zero percent or even less, it would have no incentive to use cash to pay for anything today. Just borrow the money you need to spend today, and pay for it later.

Which is why we think the recent debate about taxes in Japan is completely backwards. Earlier this month Japanese Prime Minister Abe announced that Japan would postpone a 2% increase in the national sales tax.

That's fine, as far as it goes. But why should a country that can borrow for free (or less!) be charging taxes at all? Instead of postponing tax hikes, Japan should be enacting huge and massive tax cuts. And it should finance those tax cuts by issuing lots of 10-year debt.

Yes, we are aware that Japan already has a national debt of about 200% of GDP. But if that debt can be rolled over at an average rate of zero percent, then why should anyone care? Even thirty year bonds in Japan now yield only 0.25%. In other words, debt service in Japan should be easily manageable for a very long time into the future.

Could larger budget deficits, caused by tax cuts, eventually lead to higher interest rates in Japan? Yes, but that's a feature, not a bug. If Japan cuts tax rates enough, especially rates on work and investment, it would generate faster economic growth. This, in turn, would lead to higher interest rates, which would boost borrowing costs. However, faster growth would also grow government revenue, offsetting some of the cost of the tax cuts. The key is to lock-in very low interest rates in the meantime by issuing long-term debt, so higher interest rates would take years to really impact.

Another implication of negative interest rates is that maybe Japan's central bank should chip in to directly pay for government spending. Normally, if a central bank does that it would lead to much higher inflation and even risk hyperinflation. Think Weimar Germany with people carrying their cash in a wheelbarrow, rather than a wallet.

But ultimately cash is just a government bond that pays no interest. And if investors are willing to accept bonds with a negative interest rate, they should be willing to accept cash, with a zero rate of interest, instead.

The bottom line: government stimulus spending and negative rates haven't revived Japan out of its long-term malaise. Instead, it's never been in a better position to enact deep supply-side tax cuts. Japan is out of options. They ought to try the one that would have worked all along.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-14 / 7:30 am	Retail Sales – May	+0.3%	**+0.5%**		+1.3%
7:30 am	Retail Sales Ex-Auto – May	+0.4%	**+0.6%**		+0.8%
7:30 am	Import Prices – May	+0.7%	**+1.4%**		+0.3%
7:30 am	Export Prices – May	+0.3%	**+0.4%**		+0.5%
9:00 am	Business Inventories – Apr	+0.2%	**+0.3%**		+0.4%
6-15 / 7:30 am	PPI – May	+0.3%	**+0.2%**		+0.2%
7:30 am	"Core" PPI – May	+0.1%	**+0.2%**		+0.1%
7:30 am	Empire State Mfg Survey – Jun	-4.3	**-5.0**		-9.0
8:15 am	Industrial Production – May	-0.2%	**0.0%**		+0.7%
8:15 am	Capacity Utilization – May	75.2%	**75.3%**		75.4%
6-16 / 7:30 am	Initial Claims – June 11	270K	**267K**		264K
7:30 am	CPI – May	+0.3%	**+0.3%**		+0.4%
7:30 am	"Core" CPI – May	+0.2%	**+0.2%**		+0.2%
7:30 am	Philly Fed Survey – Jun	1.0	**-1.8**		-1.8
6-17 / 7:30 am	Housing Starts – May	1.149 Mil	**1.184 Mil**		1.172Mil