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America is not heading down Japan’s route

Japan’s 1.5 per cent rise in output in the third quarter was met with a yawn by the markets. Was this the right reaction? Even though it was six per cent on an annualised basis, and therefore impressive compared with the 2.5 per cent growth in the US, and even more so compared to the lower-than one per cent in the eurozone, the markets may be right.

These latest gross domestic product figures will probably encourage analysts to stick with the current broad outlook for next year. The consensus view is that Japan will grow by around 2.2 per cent, the US between 1.5 and two per cent, and the eurozone by around 0.5 per cent. It is quite remarkable that on average forecasters expects Japan to be stronger than either the US or the eurozone. In essence, the consensus – backed up by depressed equity markets and low bond yields for the G7 countries - expects a “Japanisation” of these countries’ economies. The markets are assuming Japan’s post-tsunami recovery is nothing other than a recalibration for lost GDP, and that the rest of the G7 will join Japan in years of dull, or worse, growth.

I am not so sure about a number of aspects of this outlook. If Japan could sustain GDP growth above two per cent for a full year, it would be a positive step. If key export markets, especially China, succeeded in achieving a so-called soft landing, perhaps post-tsunami Japan will exceed expectations. A positive economic surprise could have a powerful uplifting impact on Japanese equities at a time when the market’s dividend yield is higher than the yield on ten-year government bonds, and the country’s one year forward price to earnings ratio trades near its lowest levels for 30 years.

Is this why the Yen is so strong? If so, why did the Japanese authorities recently intervene so aggressively to halt it rising further? There is some disconnect between the depressed level of Japanese equities, the strong Yen and the country’s policymakers’ views – unless Japan really is simply the least worst of a very bad bunch. It is hard to justify the Yen at close to Y75 against the US dollar and Y100 against the euro. When the trade balance for the auto industry is adjusted for, Japan's days of trade surpluses could be over. In this regard Tokyo needs to make sure its car companies don't entirely move production offshore in the quest to stay competitive. If that happens, Japan would soon start to justify the darker thoughts of some.

With this in mind, does Japan look attractive relative to other markets? I recently asked a major investor if he finds Italian bonds at seven per cent or Japanese bonds at one per cent more attractive. Italy has debt to GDP ratio of 120 per cent, while Japan's is more than 200 per cent. He couldn't answer me.

The question is America really heading down Japan's route of slow growth? I think the answer is no. Not only does US productivity continue to impress, but virtually all the reliable lead and coincident indicators I trust, such as weekly job claims, continue to improve – with one exception, housing. Can you imagine if that turned around? The fall in house prices in recent years has been so sharp that affordability is back to the levels of the early 1990s. Comparisons between the US and Japan seem inappropriate.

I think this is how to square all these circles when it comes to Japan. The country is still recovering following the 2008 global financial crisis and the tsunami. Its equity market is cheap and attractive. But the Yen needs to weaken, which it will do as soon as markets realise America isn't going down Japan's path. Once that happens, perhaps Japanese investors will start to add – now high-yielding – European bonds to all those other emerging markets ones, also high-yielding, they seem so keen on.

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