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BoJ’s tests to hit other central banks

By Henny Sender

Masaaki Shirakawa, the governor of the Bank of Japan has travelled around the country in recent months, meeting and exchanging views with members of the business community.

The session in Nagoya in November, with the yen at its peak, was particularly acrimonious, with a deputy president of Toyota assailing the central banker for not doing more to bring the yen down.

Mr Shirakawa has been the object of increasing ire from the Japanese establishment. In February, that criticism was briefly suspended when the BoJ announced it was expanding its asset purchase programme and committed itself to an inflation goal of 1 per cent.

At that time the market interpretation was that the Bank of Japan had finally begun to heed the voice of reason coming from politicians and business. The yen sank to about Y83 to the US dollar from its highs of about Y75. The stock market rallied.

Unfortunately, the lull was only temporary. A mere 10 weeks later, the markets believe the change hasn’t been enough. The pressure to do more has steadily increased, triggering just the kind of political pressure the BoJ most fears. On April 27, the BoJ is expected to announce that it will expand its asset purchase programme yet again.

These days, the BoJ must walk a tightrope that is ever more taut. The stakes are high. If it goes too far, central bankers fear a vicious circle in which the yen weakens, exposing the country to the danger of rising inflationary pressures and destroying confidence in both the central bank and the currency.

That means in turn that the real value of the savings of Japan’s ageing population will drop and real incomes will decline, further suppressing weak domestic demand. But if the BoJ does nothing, Mr Shirakawa will continue to be blamed for Japan’s two-decade-old slump.

On April 5, the upper house of the Diet rejected a nominee to sit on the BoJ board who believes – like Mr Shirakawa – that monetary policy alone cannot solve Japan's problems. The vote was a victory for those who want to see even more aggressive monetary easing. Parliamentarians submitted a bill to the Diet that would make it possible to remove the central bank governor.

Diet oversight even forces Mr Shirakawa to ask permission from parliament whenever he leaves the country.

Little wonder that senior people at the BoJ believe that central bank independence, whatever the law states, is essentially an illusion. In the quiet corridors of the central bank, the response to the market's view of the BoJ has been one of frustration.

Mr Shirakawa has always objected to being described as conservative and has tried to point out that monetary conditions in Japan are far more accommodative than those in the US.

Meanwhile, the need for a credible plan to tackle the deficit is growing more urgent after Japan produced its first trade deficit in two decades for 2011 and 2012 appears to offer more of the same.

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Moreover, bearish economists such as Masaaki Kanno, chief economist for JPMorgan in Tokyo and a former BoJ official, predict that Japan's current account will also slide into deficit by 2015.

That means the government will eventually have to import capital from abroad and sell its debt to foreign investors, who will demand higher yields to compensate them for the risk that the currency will move against them.

Still, as Mr Shirakawa and other BoJ officials stress, to raise potential economic growth isn't the job of the central bank – it is the job of the government. But there isn't much of an effort from either the government or the private sector to come up with a precise new template for growth. Instead, Japan's reflex is to rely on a cheap yen to support exports to generate growth.

The hostility from bureaucrats, businessmen and politicians comes at a sensitive time. Mr. Shirakawa's term is up on April 8 of next year and the jockeying to succeed him has already begun. The appointment is subject to approval from the Diet – further undercutting the independence of the BoJ.

Both the bureaucrats and politicians are determined that the next BoJ governor be more pliable, preferably an appointee with close ties to the Ministry of Finance.

What the BoJ is grappling with today, other central banks will grapple with tomorrow.

“The Bank of England and the Fed are in the same place as the BoJ,” says Mr Kanno. “But the marginal return of quantitative easing diminishes over time. Everyone is in a similar position but the tragedy of the BoJ is that they are the first. They are ahead of everyone.”

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