‘Whatever It Takes’ Arrives in Land That Needs It: William Pesek
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By William Pesek

April 2 (Bloomberg) -- As Haruhiko Kuroda walks into his first policy meeting as Bank of Japan governor, he must be in a Mario Draghi state of mind.

Think of Kuroda’s predecessor, Masaaki Shirakawa, as Japan’s equivalent of former European Central Bank President Jean-Claude Trichet. Shirakawa was a respected economist whose doctrinaire ways caused him to stumble when unexpected things happened, such as the financial crisis in 2008. Just as Trichet’s worldview was out of sync with the times (he actually raised interest rates in mid-2008), Shirakawa was too blinded by ideology to see economic reality.

When Draghi replaced Trichet in late 2011, he acted immediately to communicate that the ECB was under new management, in word and in deed. So must Kuroda, who makes his debut as head of the BOJ when it meets this week. To get in touch with his inner Draghi, Kuroda should focus on this single
figure: 51 percent. That, according to Standard & Poor’s, is how much the BOJ has expanded its balance sheet since September 2008. It’s a pitiful increase that’s dwarfed by the 333 percent surge in the Bank of England’s holdings, the 253 percent jump in the Federal Reserve’s and 82 percent rise in the ECB’s.

How will we know if Kuroda is a genuine deflation fighter or the latest in a long line of timid BOJ leaders? Kuroda can announce his authority and buttress his maverick bona fides at his news conference this week with a simple step: scrap the self-imposed limit on the central bank’s holdings of government bonds.

Cheering Markets

There’s a lot Kuroda could do to cheer markets. He should emulate Fed Chairman Ben Bernanke’s Operation Twist, vastly extending the maturity of the BOJ’s government bond holdings. He should load up on riskier assets such as corporate debt, asset- backed securities, exchange-traded funds and even equities. He should leave the door open to buy government bonds denominated in foreign currencies. And if the end of monetizing some Japanese debt justifies the means, why rule it out?

Yet nothing would declare that the BOJ is under new and bold leadership more clearly than dropping the so-called bank- note rule that says its government debt holdings can’t exceed the value of all yen in circulation. That simple gesture would indicate that the Kuroda BOJ will be a vastly different central bank than the third-largest economy has had in more than a decade.

“If the BOJ is to implement quantitative and qualitative easing that is to be effective in overturning the public’s deflation expectations, it will have to venture much further out of its comfort zone in terms of the assets that it buys,” said Paul Sheard, chief global economist at S&P’s in New York.

Ending deflation is a confidence game, and it’s vital for Kuroda to instill some. We have heard lots of chatter from Kuroda in the two weeks since he took the helm. And that’s fine.
He believes in transparency and communication as monetary tools in their own right. Like the heads of the Fed, ECB and Bank of England, Kuroda understands that so-called open-mouth operations are as vital to managing inflation expectations as open-market ones.

Yet markets are sending Kuroda a clear message of their own. The cost of bearish options on Japanese shares is now at an eight-month high, according to Bloomberg News reports. In other words, investors who jumped into Japanese stocks in recent months doubt that the BOJ can deliver on its rhetoric. It should worry Kuroda that his vow to do “whatever it takes” to end deflation is already being questioned in financial circles.

Radical Thinking

It would be a mistake to delay actions investors know the BOJ should have taken 10 years ago. That means frontloading additional monetary stimulus, laying out a variety of other options and then letting traders fuel the momentum. Things would be helped along by serving up a couple of worst-case scenarios if fresh liquidity doesn’t gain traction -- underwriting distressed Japanese towns, punishing banks that hoard debt to avoid making loans or whatever else Kuroda can come up with. This is the time for creative and radical thinking, not the usual ineffective remedies.

Kuroda also needs to use his bully pulpit to urge the government to do its part. Economists such as Stephen Roach of Yale University and former BOJ Deputy Governor Kazumasa Iwata aren’t being cynical when they doubt Kuroda’s chances of meeting the BOJ’s 2 percent inflation target. Prime Minister Shinzo Abe must match BOJ action with equally aggressive structural changes and pro-growth strategies to generate true confidence on the part of households, companies and investors.

The worst thing Kuroda could do is sound like a typical central banker, and that gets us back to Draghi. No one is saying the ECB chief has been state of the art, but the mood swing from Trichet’s tenure to Draghi’s did as much as anything to avoid disaster in Europe. It’s up to Kuroda to channel a similar shift in Japan. There’s no time to waste.

(William Pesek is a Bloomberg View columnist. The opinions expressed are his own.)

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To contact the writer of this article:
William Pesek in Tokyo at +81-3-3201-7570 or wpesek@bloomberg.net.

To contact the editor responsible for this article:
James Greiff at +1-212-205-0370 or jgreiff@bloomberg.net.