

Bank of Japan's shock stimulus further destabilizes global economy

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It is indicative of the breakdown of the global capitalist economy that measures taken by the world's major central banks to boost their own national economies contribute to growing instability internationally.

Last Wednesday, the US Federal Reserve announced the ending of its program of asset purchases as a step towards a return to a more normal monetary regime. But one of the likely effects of this move will be to promote the shift of volatile financial capital out of so-called emerging markets that have been the main source of economic growth since the financial crisis of 2008.

Likewise, Friday's shock decision by the Bank of Japan to increase its purchases of government bonds in an attempt to lift the country out of its deflationary spiral, moving in the opposite direction to the Fed, will impact adversely on economies in the Asian region, notably South Korea and China, and will also hit the euro zone.

One of the immediate effects of the stepped-up Japanese version of "quantitative easing" will be to further push down the value of the yen, which has fallen markedly in the past three years. The currency hit a seven-year low against the dollar last Friday and has fallen 40 percent against the dollar, euro and Korean won since mid-2012, and 50 percent against the Chinese yuan.

Hans Redeker, who is in charge of Morgan Stanley's foreign exchange strategy, told the London-based *Telegraph* that Japan was exporting its deflationary pressures to other countries.

"It is not clear whether other countries can cope with this," he said. "There have been a lot of profit warnings in Korea. The entire region is already in difficulties with overcapacity and a serious debt overhang. Dollar-denominated debt has risen exponentially to \$2.5 trillion from \$300 billion in 2005, and credit efficiency is declining."

Other analysts point to the danger of currency wars as Japan seeks to get out of its deflationary trap by exporting

deflation to other countries.

On Friday, following a narrow 5-4 decision on the Bank of Japan governing board, bank Governor Haruhiko Kuroda announced that the central bank would buy enough assets, mainly government bonds, to lift its expansion of the monetary base from the present level of between 60 and 70 trillion yen (\$539-\$629 billion) to 80 trillion a year, equivalent to \$721 billion.

The decision came as a shock because previously Kuroda had claimed that the program of asset purchases, initiated in April 2013 as part of "Abenomics", was working. But data on the Japanese economy indicate that after providing an initial boost, asset purchasing has failed to break the deflationary cycle.

After rising to 1.5 percent in April, Japan's core consumer inflation rate dropped to just 1 percent in September, casting doubt over the Bank of Japan's goal of reaching a 2 percent inflation rate by next April. The economy is experiencing little or no growth and contracted by more than 7 percent in the second quarter, largely as a result of an April increase in the country's consumption tax from a rate of 5 percent to 8 percent. The rise more than cancelled out a growth rate of over 6 percent in the first three months of the year.

While growth is expected to resume, the rebound in the third quarter is expected to be lower than previously anticipated, with Bank of Japan economists halving their own growth forecasts for the 2014 fiscal year to just 0.5 percent. Weak production and retail data for July and August have exacerbated fears of lower growth, with one source close to Prime Minister Abe telling the *Financial Times* that "all the economic indicators are going south."

Announcing the central bank decision, Kuroda said that Japan, which is the world's third largest economy, had reached a "critical moment" in its struggle to break the grip of deflation. "There was a risk that despite having made steady progress, we could face a delay in

eradicating the public's deflation mindset," he said.

Relative to the size of the Japanese economy, the central bank's latest measures are even bigger than the asset-purchasing program of the US Fed. The Bank of Japan will now increase its balance sheet by the equivalent of 15 percent per annum. This is three times the rate of increase under the Fed's quantitative easing program.

Under its expanded market intervention, the Bank of Japan will now buy the equivalent of more than twice the new bonds issued by the government to finance its fiscal debt.

This has raised concerns about the stability of public finances. In order to allay them, the government, with Kuroda's backing, appears set to proceed in October with the second tranche of the consumption tax rise, from 8 percent to 10 percent. If the rise is cancelled, or even delayed, questions will begin to be raised about the financing of Japan's government debt, which, at \$11 trillion, or 240 percent of Japan's gross domestic product, is the highest of any country in the world.

However, a further increase in the consumption tax will dampen economic activity in Japan, further adding to the deflationary pressures that the central bank is trying to counteract through its stepped-up asset-purchasing program.

So far, government debt has been financed by internal sources, including the country's massive insurance funds, but analysts maintain there is a limit to how far this process can go without causing a crisis.

The narrowness of the vote on the bank's governing board, in contrast to previous decisions for which Kuroda has secured a large majority, indicates that these concerns have extended to the Bank of Japan itself. Bank officials and observers of the central bank said they could not recall such a narrow vote in the bank's history.

In another reflection of the growing irrationality, not to speak of insanity, prevailing in the global economy, while virtually all analysts were noting that the Bank of Japan move pointed to mounting problems, the financial markets indulged in an orgy of celebration.

Last Friday, US stock prices surged, with both the Dow and the S&P 500 closing at record highs as a result, at least in part, of the Bank of Japan's decision. Earlier in the day, Japan's Nikkei index had risen by nearly 5 percent to reach its highest level in 7 years. These results further indicate that stock markets have become global casinos in which the "house", in the form of the major central banks, supplies endless amounts of cheap cash to finance speculation. However, these measures themselves

have the potential to set off a financial crisis.

As *Financial Times* columnist John Authers noted: "As the response by share prices shows, markets like QE (Quantitative Easing). But the broader perspective is alarming. Sharp shifts in currencies are perilous, particularly when so many different countries attempt to perform the same trick at the same time."

The impact of the Japanese move is certain to be under discussion at the next meeting of the European Central Bank (ECB), scheduled for Thursday, where Governor Mario Draghi will be under increased pressure from financial markets to step up his own version of quantitative easing.

In a comment published on Monday, *Washington Post* economic commentator Robert Samuelson started with a question: "Can Mario Draghi save Europe?" The fact that the question was even being raised, he wrote, was an "unsettling reminder" that the European crisis, once declared to be over, was anything but. Europe resembled a patient with a chronic condition, sometimes improved, sometimes worse, whose "illness persists and constantly threatens to cause acute, possibly catastrophic crisis."

Europe's economy has experienced two recessions since 2008 and is considered to be on the verge of a third. Output in the euro zone is still 2 percent below where it was in 2008 and investment has fallen 15 percent.

These problems will only have been worsened by last week's decisions by the Japanese central bank.



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