Japan moves to negative interest rates

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In what was widely regarded as a shock move, the Japanese central bank yesterday cut its base interest rate to minus 0.1 percent. It was a response to continued deflation, amid a weakening domestic economy and fears of the impact of the continued slowdown in China. In its statement, the Bank of Japan (BoJ) said it would "cut the interest rate further into negative territory if judged necessary."

The decision came as a surprise because only eight days earlier BoJ governor Haruhiko Kuroda told parliament the bank was "not seriously considering" a negative rate.

The move had immediate international consequences, helping to fuel a near 400-point rise in Wall Street's Dow Jones index. Speculators concluded that the Japanese step, together with the near stagnation of the US economy in the fourth quarter, meant the US Federal Reserve would not lift interest rates in March. There is thought to now be virtually no prospect of four interest rate rises by the Fed this year following its decision to increase the base interest rate by 0.25 percentage points in December.

Together with interest rate cuts in Europe, the Japanese central bank decision means that one quarter of global gross domestic product now emanates from countries where official interest rates are negative, with predictions this figure could rise even further. Such a situation has never existed in the history of global capitalism. It is an indication of the deepening breakdown in the world economy that began with the 2008 financial crisis.

The Japanese central bank decision was only carried by a 5–4 vote on its governing board, indicating significant divisions within the country's financial establishment. Supporters of the move claim it was necessary to counter deflation, in line with so-called Abenomics. Opponents focus on the need to pursue more conventional economic policies in order to bring down the level of Japanese government debt, which is among the highest in the world.

Under the new regime, banks will be charged an interest rate of 0.1 percent for any deposits they make with the central bank, while their existing deposits will still be paid interest at the old rate of 0.1 percent.

The official rationale for the move is to stop major corporations sitting on piles of cash and push them into making investments, the level of which has been stagnating because of deflationary fears.

"Through the minus interest rate combined with quantitative easing, I hope we can support companies and individuals in breaking their deflationary mindset," Kuroda said.

As in the rest of the world, however, the only effect of the interest rate cut and the continuation of the BoJ's asset purchasing program of 80 trillion yen a year ($675 billion) will be to promote further financial speculation, rather than investment in the real economy.

In its statement, the BoJ focused on falling oil prices and the slowdown in China rather than any weakness at home.

"For these reasons," it said, "there is an increasing risk that an improvement in the business confidence of Japanese firms and the conversion of the deflationary mindset might be delayed and that the underlying trend in inflation might be negatively affected."

The bank said its aim was to exert downward pressure on interest rates across the board.

While it eschewed any reference to the domestic economy, economic data published on the eve of the announcement would have been of considerable significance. These showed continued low growth in key areas.

Industrial production was lower than expected, down 1.4 percent in December on the previous month, compared to expectations of a 0.3 percent decline. Prices were up by just 0.2 percent on a year ago.

Preliminary figures for January in the Tokyo area indicated a fall in prices of 0.3 percent from a year ago, pointing to a possible trend in the national economy as a whole.

Household spending was down by 4.4 percent on the levels of a year ago, compared to market forecasts of a 2.4 percent contraction. December was the fourth consecutive month in which spending declined and it was the biggest fall since last May.

While there were claims the decline in consumption spending may have been overstated, there was a general consensus that it fell in the last quarter of 2015 and this would lead to lower numbers for economic growth.

Marcel Thieliant at Capital Economics told the *Financial Times* the figures were “disappointing” and “suggest that Japan’s economy barely grew last quarter. While activity should recover in the first quarter, the moderation in underlying inflation suggests that the Bank of Japan still has more work to do to reach its 2 percent inflation target.”

There is considerable scepticism that the latest move will have any more effect in halting deflation than have the massive central bank purchases of Japanese Government Bonds (JGBs) and other assets. Some analysts suggest that the interest rate cut may be an admission of failure of the bond purchasing program.

Daiju Aoki, an economist at UBS Securities in Tokyo, told Reuters that the BoJ move was a “regime change.” Its major policy tool was now negative interest rates, which showed that “the ability to buy more JGBs is limited.”

Kuroda sought to counter the idea that the move to negative rates meant the bank was no longer able to lift asset purchases, saying it could increase them in the future, as well as further cutting rates.

However, his words will do nothing to diminish the growing realisation that the various forms of quantitative easing pursued by the world’s central banks are doing nothing to halt growing recessionary forces, and that the banks are running out of policy options.

European Central Bank president Mario Draghi has signalled the bank may extend its asset purchasing program when it meets in March in order to try to counter the effect of the China slowdown and falling oil prices. In Britain, the Bank of England appears to have shelved the idea of a return to a more normal interest rate regime, while in the US there are mounting criticisms of the Fed that its December rate rise was a mistake.

Ray Dalio, the head of Bridgewater Associates, the world’s largest hedge fund, called on the Fed to abandon any further rate rises.

Summing up widespread opinion in financial markets, Jordi Visser told the *Financial Times*: “The market views tightening as a mistake now. I don’t think 25 basis points (0.25 percentage points) matters much but the market clearly does. We’re now closer to a recession than we all realise.”

While the US markets celebrated the prospect of continued cheap money with yesterday’s 396-point rise, there is growing concern that the Fed has no clear policy direction. The Fed’s statement last Wednesday, keeping interest rates on hold, said it was closely watching the gyrations in global markets. It provided no assessment of financial risks, however, indicating that it is simply reacting to events and has no idea about how to control them.