

# Is the Bank of Japan Finally Synchronizing with their Peers?

Described as an ultra-lax monetary policy, Japan's economic model has baffled the world. Not because the East Asian nation is a poster child of rising from self-ruination in the post second world war era, but for stage-managing its monetary policy for a long time, managing its economy very differently to the rest of the world.

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As Japan put up its interest rates in March this year, after almost a seventeen-year hiatus, the last in 2007, analysts consider it a move in the right direction, the much-needed intervention by the Bank of Japan (BOJ) in a country that has long been trying to grow its economy through several calculated measures, which had failed to stoke the desired growth momentum in the economy. Unlike the rest of the world, Japan has followed a 'stuck to its own guns' monetary policy to steer the economy from years of negative inflation. Commentators view the Bank of Japan's latest move as a sign that the regulator is abandoning its 'economic experiments' and departing from its negative interest rate regime.

The 1980s were Japan's boom years, a journey of over four decades since its downfall from the Second World War to becoming the global role model of vision and innovation, efficient management practices, and industrial trailblazing. The world hailed Japan's resurgence as an economic miracle. The economy became so enormous in this period that it accounted for nearly ten percent of the global economy. Accompanying this recovery was a robust stock market reaching record highs. Real estate prices soared to such an extent that some commentators have pointed out that the value of Japan's imperial palace equaled the value of the California State in the US. All this meant the people were awash with money, stimulating heavy spending.

The economy grew at an average rate of 3.89 percent in the 1980s. Described as the 'bubble' period in Japan, it began to unravel in the latter part of the 1980s when the BOJ hiked interest rates in 1989 to control rising prices and curb speculation in the equity market. Higher interest rates led to a decline in real estate prices, which had hitherto been high and of concern to the BOJ. But this reversal impacted the economy further. The economy confronted a twin shock of plunging real estate and stock prices. What the BOJ thought it was doing right by the economy sent things spiraling downward instead. Economic growth slowed. The BOJ responded by bringing down interest rates, printing money, and increasing the government deficit.

However, its intention of stimulating the economy failed to take off as households and investors kept their cash and refused to move it around, believing that falling prices would not earn them a higher rate of return. For decades, Japan continued to lag in a 'liquidity trap' characterized by stagnation, low interest rates, and deflation. By 1992, equity prices had fallen by nearly 60 percent. Equity prices and real estate value continued on an unstoppable precipice throughout the 1990s and early 2000s.

In 2007, to stimulate economic growth, the BOJ raised interest rates by a quarter point to 0.5 percent, although the attempt failed to produce inflation. Japan's interest rates have always been well below the standard in other developed economies, such as the United States and Europe.

In 2013, the BOJ introduced the Quantitative and Qualitative Easing (QQE) policy tool aimed at overcoming deflation in the country and driving inflation by two percent within two years by increasing the money circulating in the economy while purchasing Japanese government bonds with the hope of shifting demand and pushing up prices and wages. At this point, deflation had lasted for almost fifteen years in Japan. But that experiment too waned in a few years, giving into deflation yet again, prompting BOJ to adopt negative interest rates in 2016 in a bid to stimulate economic growth and fight deflation by discouraging savings and charging banks and financial institutions for storing reserves, wanting them instead to spend and lend into the economy.

Japan's economic vicissitudes have had their benefits as well. In a deflationary setting, wages had remained stagnant for decades. It continued unchanged even though the country recorded 4.3 percent inflation in January 2023.

Introducing the Yield Curve Control (YCC) in September 2016 was another attempt by the BOJ to shake its inflation curve, a monetary policy tool aimed at managing long-term interest rates across different maturities of government bonds. In this instance, the BOJ imposed a zero percent cap on a ten-year Japanese government bond yield. If, at any point, there were indications of the market yields on the government bonds rising above the stipulated rate, the BOJ would intervene and purchase those bonds to push back the rate to the mark. However, this strategy did not persuade companies to invest as it did not satisfy their profit targets, forcing them to look outwards for better returns. No wonder Japan surpassed China in becoming the largest holder of US treasury debt.

However, things began to change. The post-pandemic landscape was when the 'normal' for Japan tilted. In 2022, Japan finally saw the curve moving to record over two percent inflation, a four-decade high. The war in Ukraine sent energy prices soaring, while a weakened yen increased commodity prices. The rate exceeded BOJ's inflation target. While this change was parallel to what countries worldwide

were experiencing in the aftermath of the COVID-19 pandemic and the breakout of war in Ukraine, Japan has always stayed away from the global stage to follow its experimental model to stimulate economic growth.

As analysts have pointed out, Japan's monetary policy has often not synced with that of its peers in the developed world. However, as the pandemic and war-led fallout became generic, Japan experienced the same travails as the rest of the world. However, this was not the ideal way the BOJ had hoped the country would come out of negative inflation, ideally stimulated through consumer spending. Japan's economic vicissitudes have had their benefits as well. In a deflationary setting, wages had remained stagnant for decades. It continued unchanged even though the country recorded 4.3 percent inflation in January 2023. But that began to change gradually. A weakened yen allowed manufacturing companies operating in the export sector to boost profits, prompting calls for changes to the country's decades of static wages. In March this year, Japan's leading companies agreed to a wage hike of 5.28 percent with the country's largest trade union, the most considerable pay hike in three decades. And that was followed by a rate hike.

BOJ is doing away with the YCC and will discontinue the purchase of exchange-traded funds (ETFs). Finally, by adjusting its interest rate from negative to positive, analysts say Japan is aligning itself with the rest of the economies. Incidentally, the Bank of Japan was the last central bank to exit negative interest rates. As Japan moves on in a new economic landscape, it is likely to see mortgages becoming expensive and interest payments on its colossal debt of more than eight trillion dollars, more than twice the size of its economy, increasing substantially.

*Information for this article was extracted from a production by Bloomberg Originals titled 'Japan's Massive Money Experiment is Over. Now What'*