



## The Bank of Japan Turns Hesitant Once Again

*After a strong effort to boost chronically low growth and inflation through aggressive monetary easing, Tamim Bayoumi and Joseph E. Gagnon say the Bank of Japan has made the mistake of backtracking just as the policies were starting to gain traction.*

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Pedro da Costa: I'm Pedro da Costa, Editorial Fellow at the Peterson Institute for International Economics. I'm joined by Joseph Gagnon and Tamim Bayoumi, Senior Fellows here at the Institute.

So, we're going to talk about the Bank of Japan's recent inaction and the market's reaction. You guys wrote a blog recently telling Mr. Kuroda to be bold and essentially you're telling him to go big or go home. Why do you think the Bank of Japan has become so hesitant after what seemed to be a pretty aggressive series of actions by Governor Kuroda once he took the helm of the BOJ?

Joseph Gagnon: Yeah, that's a wonderful question. I don't fully know the answer myself but I can certainly speculate. I think when they moved to negative interest rates in January, there was a lot of public criticism about it and political complaints, which I think they're still dealing with and trying to figure out how to respond. I'm not quite sure why they didn't move more on the other side, which is a quantitative easing because I don't sense any public reaction against that. So, I'm a bit puzzled as to why.

Pedro da Costa: So what do you think were the bank's biggest mistakes?

Tamim Bayoumi: Well, I think that Joe sort of hit the nail on the head although I put this in a slightly different way. I think that they thought that moving to negative rates was a big move and the fact that it didn't work through them made them gun shy. Actually, I think the truth of the matter is, it is a very small move.

Pedro da Costa: And the markets read it as such which is why they [inaudible 00:01:35].

Tamim Bayoumi: And, the markets read it as -- even though it was sort of dramatic in terms of action moving to negative rates, which of course the Governor had said he would not do. It was such a small move.

Pedro da Costa: Which again was another messaging error, right?

Tamim Bayoumi: Yeah. But then he suddenly turned around and did it but did it not very big. So, sort of in a sense, if you're going to do that kind of thing, you've got to make it serious or don't do it sort of thing.

Pedro da Costa: So Joe, I know that you've argued in papers and in the blog recently that the Bank of Japan and other central banks should not in fact out of ammunition. So what would you propose that they do in the face of continued deflation or continued disinflationary forces at least

and their inability to hit their inflation target over the years?

Joseph Gagnon: Yeah. So, what I would say is that they were bold initially and they got good results initially. The core inflation has come way up from before Kuroda got in office. But, nobody knows exactly how much is enough, nobody knows exactly how much is needed. And, they needed another push, one push to get over the line as it were.

And then, for the past six months, they've been delaying and I don't know quite why. But what they could do aside from even more negative interest rates and they could try to cushion some of the effect by both lending and borrowing at negative rates so banks have access to cheap funding, as well as a negative rate on their deposits. But they could also do more of that but also they could do more quantitative easing.

And in particular, I think what would really help now would be to go into other assets because the long-term bonds are buying. They pushed rates down very low to zero, negative rates on those and I think probably can't get much more on that.

Pedro da Costa: And they have a broader mandate than the Federal Reserve does, right?

Joseph Gagnon: Right, they have.

Pedro da Costa: They have a broader range of assets they can purchase.

Joseph Gagnon: They can. With the government's approval, they can purchase anything. And they are little bits but what they should really do is ramp up, I think, equities and possibly the real estate but especially the equities they're buying. They could buy a lot more. There's plenty of room and that would really send a signal to markets and say, "They're serious. This is big time that they're doing in a big way."

Pedro da Costa: What do you think, Tamim? I mean, the critics have [inaudible 00:03:47] point to Japan as a place that kind of tried and failed. Here was the experiment where they went for it and after 20 years of hesitation, they finally did QE and they went for it, and it failed. How do you see that? Do you think they should continue? Is that a doubling down of a mistaken policy in all that?

Tamim Bayoumi: No, I don't think it is. I agree with you that the perception before Abenomics was that one of the problems that had happened in Japanese policymaking was that they tried to do things but then they kept on saying, "Well, we'll just stop it as soon as we can." And that isn't the message you want to send. You want to be bold. You want to carry on being bold. I think the Abenomics starts that way but then, I think, hesitancy started coming in.

Pedro da Costa: And the April tax hike from last year was kind of a first sign.

Tamim Bayoumi: Yes, exactly. That's sort of a first sign that--and what's happened as was mentioned is that over the last six months essentially they haven't really -- having brought core inflation up from -1% to +1% which is a big deal. A 2% change in core inflation is a big deal. Having done that and having apparently been successful, they kind of lost their nerve.

Pedro da Costa: They backpedaled.

Joseph Gagnon: Yeah.

Tamim Bayoumi: Yeah. And that I think is the thing, which is rather than once they were seeing success carrying on.

Pedro da Costa: Yeah.

Tamim Bayoumi: They saw success but then they started getting cold feet.

Pedro da Costa: I want to go back to your point from earlier Joe and I want both of you guys to chime in on this because in a way, Japan is a unique case because Abe, in a sense, was elected to push for this Abenomics, right? And so, there was a sense of fiscal monetary cooperation and there was the sense of public approval for aggressive monetary easing in a way there hadn't been before. But now, the public support seems to have retreated. Is this kind of a sign of the perils of fiscal monetary cooperation in the sense that once they started meddling, they can meddle in any direction they want?

Joseph Gagnon: Well, I don't know about that. I would say almost uniquely, there's many parts of Abenomics, which we can't go--we can't tell the details here. But monetary was from the beginning even during his election, he talked about monetary policy and how he wanted the Bank of Japan to get more inflation and then he went big, so he had a mandate.

I think the public was with him up until, I think, sort of the concept of negative interest rates I think is what sort of has caused some of this issue I think. And I think the Bank of Japan maybe needs a better communication.

Pedro da Costa: Mm-hmm.

Joseph Gagnon: Because frankly, they will be able to get back to positive interest rates faster if they do more sooner.

Pedro da Costa: Yeah.

Joseph Gagnon: It's sort of otherwise you just languish and things get worse. And I think that they need to communicate that through the markets why they need to act boldly now.

Pedro da Costa: And what do you think, Tamim? Do you think they have lost these expectations game or is there still time for them to get back into it?

Tamim Bayoumi: I think that the story of Japan is there was this entrenched expectation the process would stay even or even go down. The Bank of Japan started to change that. But then, they didn't continue and people reversed it back. The worry is that you all go back. And the reason this matters is the Japanese government has an enormous amount of debt as a ratio to its GDP.

Frankly, the only way that that debt becomes capable of being brought down is through a certain amount of inflation growth. Without that frankly, the prospects are extremely dim and therefore Abenomics was this answer to Japan's long-term problems. And now start thinking that Japan may go back into the [inaudible 00:07:44]. Just basically stagnation I

think is a very worrying characteristic not simply for Japan but for the world.

Joseph Gagnon: Yeah.

Tamim Bayoumi: This is a very big economy so.

Joseph Gagnon: One more point is they said they wanted to and there's a sort of interesting dynamic here whereby if you can achieve to and sustain it, then it becomes self-sustaining and you don't need to keep doing bold and new things. It kind of becomes part of the pattern. But if you set a goal and you don't achieve it, then I think you do risk sliding back and that's why this is so troubling because they were so much on their way. But you can't just stop halfway and say, "Well, that's good enough," because that's not what you told people.

Pedro da Costa: Sure. Well, Kuroda has implied that he also believes in whatever it takes mantra, so we'll keep an eye and see whether or not they follow through.

Joseph Gagnon: Yeah.

Pedro da Costa: Thank you guys so much for your time.

Tamim Bayoumi: Thank you, Pedro.

