# Japan to keep printing money for years to come, so learn to enjoy it

The Bank of Japan will have to mop up the entire issuance of public debt for years to come, covering the budget deficit with printed money

The Bank of Japan is still showering the economy with money, buying $75bn of bonds each month Photo: Alamy

By Ambrose Evans-Pritchard

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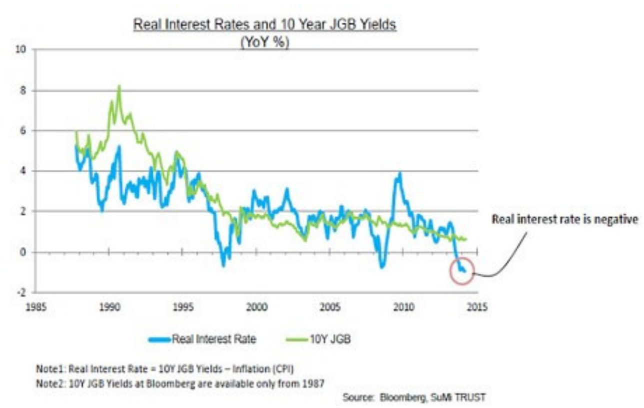
There are no one-way bets in global finance, but Japan's stock market comes close. The authorities are about to funnel large sums into Japanese stocks openly and deliberately under the next phase of Abenomics, both by regulatory fiat and by purchasing the Nikkei index directly with printed money.

Prime minister Shinzo Abe is unshackling the world's biggest stash of savings, the $1.3 trillion Government Pension Investment Fund (GPIF). Officials say the ceiling on equity holdings will rise from 12pc to around 20pc as soon as August, opening the way for a $100bn buying blitz.

Fund managers are suddenly in a race to get there first. Japan Post Bank - where Mrs Watanabe dutifully places the family money, confiscated from her Salaryman each month before he can spend it - is itching to rotate more of its $2 trillion holdings into equities before inflation pummels the bond market. So is Japan Post Insurance, no minnow either at $850bn.

Mr Abe's move comes sooner than expected and amounts to a market shock, though nobody should be shocked anymore as he keeps doubling down on the world's most radical economic experiment.

The Nikkei index stalled in December after rising almost 100pc since September 2012, even though the Bank of Japan (BoJ) is still showering the economy with money, buying $75bn of bonds each month. The BoJ's balance sheet will reach 70pc of GDP by March 2015, three times the US Federal Reserve's.




The index is down 7pc this year to 15,000, chiefly because foreigners have taken profits and pulled out $140bn, causing some to write off Abenomics as a flop. Japan's trust banks are picking up the baton. They added a record $2.5bn last week, some of it on behalf of the GPIF itself as it adapts to the new order. "We think the Nikkei will get to 18,000 by October," said Genzo Kimura, from SuMi Trust Fund.

The Bank of Japan is helping it along, buying exchange traded funds based on the Nikkei and Topix indices. "They purchase whenever the market falls, usually by about $200m each time," he said.

The bank is well on its way to defeating deflation under Haruhiko Kuroda, the first governor to launch QE with enough force to break the vicious circle. It is not yet a done deal. Three board members remain sceptical, and one (Takahide Kiuchi) thinks the undertaking is doomed to failure.

Yet core inflation has turned positive for the first time since 1997. The consumer price index rose to 1.4pc in April, adjusted for taxes. Real interest rates have plunged through the floor, transforming Japan's debt dynamics and the role of money in the economy.

Real borrowing costs on 10-year government bonds are no longer among the highest in the industrial world. They have fallen to -0.8pc. By this mathematical magic, public debt is levelling off near 245pc of GDP, after rising from 216pc in 2010. Japan has, for now, averted a compound interest trap.

Nobody disputes that the debt ratio is dangerously high. One government after another pursued a fatal mix of tight money and ultra-loose fiscal policy, the infamous bridges to nowhere. Each spree fizzled out without achieving escape velocity.

Chronic budget deficits ensued, yet nominal GDP still contracted by 8.5pc between 1997 and 2013, with hideous effects on the debt trajectory. Such is the power of monetary contraction. Mr Abe is at least trying to overturn this whole deformed structure.

Negative rates are forcing money out of the mattresses. "Companies have been holding on to $2 trillion because they had no incentive to spend, but cash is no longer king. Toyota is investing $5bn in a new Prius plant," said Mr Kimura.

The economy did not buckle when consumption tax was raised from 5pc to 8pc in April, as widely feared. There has been no repeat of the disastrous tax rise in 1997, which kicked in at the outset of the Asian financial crisis. This time fiscal shock absorbers were in place to cushion the blow. Machinery orders are surging back to pre-Lehman highs.

"Although there will be some inevitable contraction in the current quarter as a payback for the elevated rush of demand before the tax increase, we believe that the underlying growth momentum remains strong," said David Lipton, from the International Monetary Fund. "You can see that in the tight labour market conditions, high capacity utilisation and strong investment in the first quarter. We project growth will be 1.4pc this year."

Japan's "misery index" has risen to its highest since 1981 as Japanese workers feel the pain of rising food and import costs from yen devaluation, without seeing the gains. Yet the one-off hit is largely over. Unemployment has dropped to modern-era lows of 3.6pc. That is likely to halt the fall in real wages very soon, if it has not done so already. Pay rises in the Spring round of talks were 2.14pc, with a bonus of 0.48pc to be paid in June. Restaurant wages in Tokyo are up 10pc in a year.


Ryutaro Kono, from BNP Paribas, says the country is on the cusp of an acute labour shortage as the demographic crisis deepens. The number of young males aged 15 to 34 has collapsed by a quarter from 10.47m to 7.88m since 2000. "Young workers come from a steadily shrinking supply. It will be increasingly hard for firms to find cheap labour," he said.

Mr Abe must now deliver the "Third Arrow" of his national revival plan, a Thatcherite blitz intended to drag Japan's pre-modern service sector into the 21st century, break the feudal grip of the rice farmers, reverse the falling birth rate with three-child families and make the workforce a place fit for women.

None of this will be easy. Nor is it clear that he can smash Japan's edifice vested interests - allegedly by using the Pacific trade deal as a sledgehammer - since those interests are largely owned by the Liberal Democrat Party. The IMF warns that unless Mr Abe steps up the pace when he unveils new measures this month, trend growth will remain stuck below 1pc, too little to lower the debt ratio.

Even if Mr Abe's reflation strategy succeeds, he will have to face the terrifying consequences. Who will buy his bonds once inflation takes off and devastates creditors? "Rising interest rates could trigger fiscal and financial chaos owing to the enormity of Japan's public debt," said Mr Kono.

"The Bank of Japan will have to hold rates down even after deflation ends, and this will be the start of full-fledged financial repression. Unless Japan is very lucky, the merits of ending deflation will be dwarfed by the demerits of a destabilised economy."

The BoJ will have to mop up the entire issuance of public debt for years to come, covering the budget deficit with printed money. Officials admit privately that this is the purpose. Mr Kuroda will not stop when the 2pc inflation target is reached. There will another long phase when the BoJ says it must be sure. "There is room for interpretation," said one insider.

Mr Abe has never disguised his aim, telling a Mansion House audience in London that his policies were inspired by Takahashi Korekiyo, who lifted Japan out of deflation in the early 1930s by reducing the central bank to an arm of the Treasury. "His example has emboldened me. It is impossible to get rid of ingrained deflationary psychology unless you clear it out all at once," he said.

The US Treasury and the Federal Reserve played the same dirty pool in the late 1940s, whittling away war-time debt by stoking inflation while keeping debt-holders captive by repression. Such a policy amounts to a haircut for creditors, often the elderly. It is harsh. Yet Japan is picking the lesser of poisons. The pre-Abe paralysis was leading ineluctably to bankruptcy.

Pessimists ask what happens five years hence when the Bank of Japan has accumulated half the government's debt stock, with a balance sheet beyond 100pc of GDP, technically insolvent itself.

Optimists answer that nothing will happen. The BoJ's liabilities are an electronic accounting fiction. The debt can be switched into zero-coupon bonds in perpetuity, or the certificates can be burned on a ritual pire beneath the cherry blossoms. Japan will have slashed its debt to manageable levels by legerdemain. Too good believe? We will find out.

How we moderate

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