

FOCUS · Japan: monetary policy under scrutiny

The Bank of Japan (BOJ) is battling hard to allay the risk of deflation. The official interest rate is currently -0.1% and the BOJ's assets have gone from 147 trillion yen (30% of GDP) in 2012 to 436 (87% of GDP), and are expected to reach 110% of GDP by 2017.¹

In spite of the forcefulness of the BOJ's measures, a brief review of the main indicators for the Japanese economy does not provide a very reassuring view of their effectiveness. Core inflation stood at a moderate 0.3% in July and, although this is higher than the average figure reached between 2000 and 2012 (-0.6%), it is still clearly below the 2% target set by the BOJ itself in February 2013. Moreover, inflation expectations are still far below this target.

The trend in demand indicators, both domestic and external, is not encouraging either, particularly the relative lack of dynamism in private consumption and exports. These figures are especially worrying because financial costs and the exchange rate have certainly reacted to the BOJ's measures. The 10-year sovereign bond's interest rate went from 0.8% at the end of 2012 to -0.25% in July 2016 while the yen depreciated in effective nominal terms by 25% between the end of 2012 and mid-2015, despite the most recent appreciation due to the ECB's QE and the delay in the Fed's interest rate hike.

To assess the effectiveness of the BOJ's measures we must remember that other factors may have also played against them and neutralised their impact. For example, core inflation would be higher if oil prices had not fallen (due to indirect and second round effects), the trend in consumption would have been slightly more vigorous without the VAT hike and exports would have performed better if the Chinese economy had not slowed down. However, even after taking these and other setbacks into account, the impact of the measures still seems limited.²

There is a long list of factors that can explain this limited effectiveness. In particular, the limited credibility of the BOJ itself after decades spent attempting to boost inflation and whose actions over the last few years have trailed behind events. The country's high level of debt, both public and private, has also meant that lower interest rates have not managed to stimulate credit.³

1. This forecast was raised over the summer after the announcement of an increase in equity purchases and will probably be raised again in the coming months when further measures are announced.

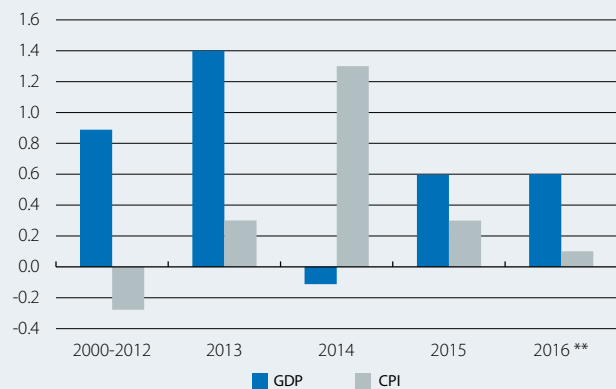
2. See Hausman, Joshua K. and Johannes F. Wieland (2015), «Overcoming the Lost Decades?: Abenomics after Three Years.» Brookings Papers on Economic Activity 2015.2: 385-431. And Andrea De Michelis and Matteo Iacoviello (2016), «Raising an inflation target: The Japanese experience with Abenomics.» European Economic Review.

Moreover, for the large number of Japanese savers a reduction in the interest rate makes them save even more in order to achieve the future level of capital they want, an important characteristic in the Japanese economy given the ageing of its population. Lastly, the fact that other central banks have also implemented policies that are just as expansionary as the BOJ's has not helped the situation either, limiting the impact of QE on Japanese exports.

In summary, the bulk of the evidence available suggests that the focus should now shift from the monetary front to structural reforms, another of the pillars of Abenomics which, to date, has not received enough attention. Unfortunately, this does not seem likely to happen in the near future.

Japan: GDP and CPI *

Annual change (%)

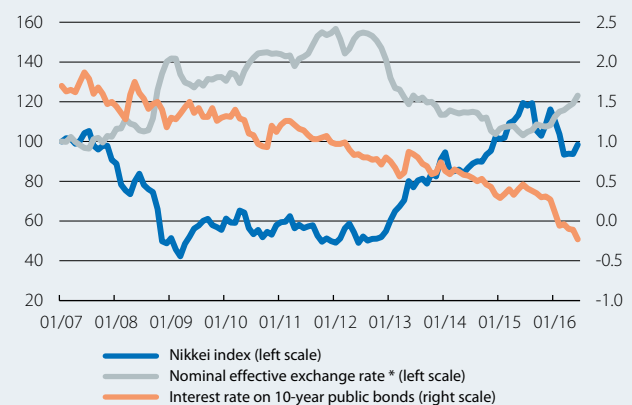


Notes: * The annual change in the CPI does not include the VAT hike from 5% to 8% in April 2014. ** Forecast.

Source: CaixaBank Research, based on data from Thomson Reuters Datastream.

Japan: financial markets

Index (100 = January 2007)



Note: * An increase indicates the yen has appreciated against a broad basket of currencies.

Source: CaixaBank Research, based on data from Thomson Reuters Datastream and the BIS.

3. Public debt stands at 250% of GDP and private debt at 165%.