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Arcus

THE KURODA ERA - AND WHAT COMES NEXT

Summary

- Bank of Japan governor Kuroda left his post last week after ten years in office
- A panel of experts polled by Nikkei Veritas magazine rated his performance at 2.3 out of 5
- However, having reviewed his actions over the past decade, Peter disagrees with that score

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Haruhiko Kuroda, the longest-serving governor of the Bank of Japan in history, left his office for the last time last week. The reviews of his ten year stint have been mixed, to say the least.

A group of five financial experts polled by Nikkei Veritas magazine collectively scored his performance at just 2.3 out of 5. If that judgement is correct, some of his predecessors should score 1 out of 5 or even zero, given their responsibility for inflating Japan's 1980s bubble and doing so little to counter the slide into deflation.

In reality, Kuroda departs with Japan in far better shape than when he took over. Memories may have faded, but 2012 was the last in a series of truly grim years. The Nikkei Index of stock prices was floundering below 9,000, a level it had first marked in 1983.

Moreover, as a result of the triple disaster of tsunami, earthquake and nuclear meltdown that struck the year before, all nuclear reactors were offline for the foreseeable future, shutting down the source of 30% of Japan's electricity.

You might expect such an economic body blow to send the currency into freefall. Instead, the reverse happened. The yen hit an all-time high of 76 to the US dollar, crushing Japan's competitiveness at the very time it needed to get the economy back on its feet. Such a perverse outcome could only happen if monetary policy was far too tight.

The social consequences were disturbing. Youth unemployment was stubbornly high, as were suicides, with middle-aged males the most vulnerable.

Geopolitically, Japan seemed to be increasingly irrelevant as a series of prime ministers came and went in rapid succession and China's spectacular growth held the world's attention. Meanwhile, the financial bureaucracies had become self-protective and inert. Asking for fresh thinking from that source was like asking for sushi from a noodle shop.

Kuroda, like the man who appointed him, the late Shinzo Abe, advocated shock therapy. Even his harshest critics would have to admit that his policies were bold and innovative. In the financial markets his massive purchases of Japanese government bonds were likened to wielding "a big bazooka".

To say he was controversial would be an understatement. Both in Japan and overseas there were reputable observers who forecast hyperinflation for Japan and a Zimbabwe-style currency collapse. One famous hedge fund manager even set up a fund dedicated to the idea.

He ended up disappointed. Over the next seven years, the Abe-Kuroda double act made a huge positive difference. By the time Covid arrived in 2020, the Japanese malaise of 2009-12 seemed like a bad dream.

Youth unemployment had halved and suicides had declined to the lowest annual number on record. The Nikkei Index had more than doubled too, but only because corporate profits had boomed – thanks to Kuroda's success in returning the suffocatingly strong yen to a more sensible level.

The one area in which Kuroda had repeatedly failed was in generating 2% inflation on a sustainable basis. That was the substance of the "accord" made between the Bank of Japan ("BoJ") and the Abe administration in 2013. Attaining the goal was made a lot harder by repeated hikes in the consumption tax, the economic equivalent of stamping on the brakes with the other foot on the accelerator.

Even so, if Covid had not appeared when it did Kuroda would probably have accomplished his mission. As of 2019, the job market was as tight as a taiko drum and the wages of part-timer workers were rising at an annual rate of 4%, according to data from Recruit. There was a real prospect of generating homegrown "good inflation" in the closing years of his tenure.

Instead, a more malign inflation dynamic, driven by imported food and energy, has hit consumer spending in the last two years. It is, of course, a global phenomenon, with core inflation currently at 5.5% in the U.S., 6% in the UK and 5.9% in Germany. Against that, Japanese core inflation of 2.1% is no more than a bump in the road. Credit is surely due to Kuroda's BoJ for managing the post-Covid inflation so much better than Western central banks.

Bond traders and banks hated Kuroda's manipulation of the financial markets, and you can see why. He took short-term interest rates into negative territory. He used "yield curve control" to pin the yield of the 10 year government bond close to zero. He bought boat-loads of equities, to the extent that the BoJ became the largest single owner of Japanese stocks, with significant profits on its holdings.

Yet he was hardly alone in his unconventional operations. Sweden and Switzerland were the first countries to move to negative rates and took them down more deeply than Japan ever did. Others soon joined in. By December 2020, the total stock of negative yielding bonds in the world was an astonishing $17.8 trillion.

It would be good if such extreme measures were never necessary, but in our highly financialised world of booms and busts driven by the twin emotions of greed and fear, there are always going to be interventions. In the case of Japan, the original sin of inflating the 1980s bubble, probably the largest of modern times, meant there could be no return to a state of financial purity.

Incoming BoJ Governor Kazuo Ueda is likely to move carefully as the world economy is in a fragile state, caught between the opposing imperatives of squeezing inflation out of the system and maintaining financial stability. Probably, he will want to maximise his room for manoeuvre by loosening control of interest rates while continuing to influence them by market operations. In other words, keeping everyone guessing.

As for the BoJ's embarrassingly successful venture into stock market investment, there is no need to do anything except count the dividends. But a more constructive possibility would be to offer stocks to the public at a discounted price on the understanding that they must be held into the long term. Japan's newly improved NISA ("Nippon Individual Savings Account") system could be an ideal vehicle.

Over time, it is likely that "good inflation" will reassert itself in Japan as labour shortages become chronic, thus finally validating the BoJ-Abe agreement of 2013. That would be an attractive prospect for coming generations of Japanese workers, though a less favourable one for the profits of labour-intensive industries. It would also lead to a level of interest rates higher than Japan has experienced for many decades.

What about Kuroda's performance as BoJ Governor over the last ten years? Given the disastrous state of affairs before he appeared on the scene, I would rate him much higher than the Veritas panel of experts did. For creativity, courage, patience, unpredictability and entertainment value, a score of 4.0 out of 5 is surely justified. One thing is for sure – unlike most of his predecessors, he will be remembered.