Despite government and IMF opposition

Bank of Japan lifts interest rates

By Joe Lopez
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Despite opposition from the Japanese government and International Monetary Fund concerns over the stability of the economy, the Bank of Japan (BoJ) announced the first interest rate rise in a decade earlier this month, ending the “zero interest rate” regime of the past 18 months.

The “zero rate” regime was introduced in February 1999, in the aftermath of the Asian economic crisis, and amid fears of a deepening recession and a deflationary spiral.

Speaking at a press conference after the announcement of the increase in the BoJ's discount rate to 0.25 per cent, central bank governor Masuar Hayami, who has been pressing for a rise for several months, said the “zero rate” policy was an extraordinary arrangement aimed at warding off a financial crisis and such a policy had to end at some point.

“We are not tightening money,” he said, “we are just fine tuning what has been an unusual policy.

Hayami's assessment that the time for the emergency policy has passed is shared by economic analysts, who see the decision as a sign that debt-ridden companies and banks will finally undergo “restructuring” and that the policy of bailing out so-called economic “zombies” may be coming to an end.

Reflecting these views, Jeremy Markwick Smith, an analyst with the Banque National de Paris in Tokyo, explained: “Mr Hayami wants to make borrowers and lenders a bit more conscious of the cost of money and thereby make them less blasé about asking for and offering bad debt write offs all the time without any pain. The rate increase may be seen as reformist but will cause a short term squeeze on lending margins at banks and bring economic reality closer to the hopeless category of indebted companies that economics dictate should go under.”

However, the Mori government believes it is still too early to start increasing interest rates, views echoed in an IMF statement issued on the eve of the BoJ's decision.

According to the statement: “Directors cautioned against moving away from the ‘zero interest rate' policy at this time. They noted that, notwithstanding the inherent difficulty of assessing the degree of output slack under current circumstances, a range of indicators suggests that a still significant degree of economic slack remains in Japan, with the prospect that deflationary pressures are likely to persist for some time. While some Directors were sympathetic to the authorities' desire to re-establish a more normal monetary environment, Directors considered that in present circumstances, the potential costs of premature tightening—which could push the economy back into recession—outweigh the risks of waiting to move to a less accommodative monetary policy stance. Directors suggested that timely action could yet be needed to provide further monetary stimulus in the face of events that could undercut the recovery, including upward pressures on the yen unjustified by the strength of the economy or an economic slowdown in the United States.”

The somewhat unusual stance by the IMF—normally it could have been expected to concur with the BoJ's decision—reflects the fact that, despite recent optimistic forecasts, there are concerns over the depth of the Japanese economic crisis and its implications for the global economy.

The IMF fears that a rise in interest rates will lead to increased bankruptcies, rising unemployment, further falls in consumer demand and a drying up of both corporate lending and investment, resulting in a continuation of the economic stagnation which has gripped the world's second largest economy for the past decade.

Figures from Japan underscore these concerns. Japanese corporate bankruptcies rose for the ninth consecutive month in July, climbing 21.4 percent over the past year. The credit research firm, Teikoku Databank, announced last week that total debt owed by Japan's growing ranks of bankrupt firms has hit a post war high, with more failures predicted following the interest rate increase.

An article in the *New York Times* by columnist Calvin Sims cited analysts who claimed that the immediate impact of the rise would be “tightening of credit that is available to small and medium sized companies, thus increasing the number of bankruptcies and unemployment level. Particularly vulnerable are the real estate, construction and retail sectors, which are the most heavily indebted. Higher interest rates will also make it more costly for the government to borrow money to feed the massive spending projects that have kept Japan's economy from collapsing over the past decade.”

In a bid to soften the blow of the interest rate increase, the Mori government has announced plans for a supplementary autumn budget to include a new spending package aimed at preventing the economy from falling back into recession.

The new spending package, yet to be given a figure, will add to the Japanese public debt, already 130 percent of GDP and the highest of any major capitalist country. Successive Japanese governments have spent more than 100,000 billion yen (almost $1,000 billion) over the past decade in a bid to kick-start the economy, but to little avail.

Now there are growing conflicts within the ruling Liberal Democratic Party over how long these polices can be continued.

Yasushisa Shiozaki, described as a “Young Turk” of the LDP, is one of those to voice opposition to the government's support for failed banks, retailers and construction companies. “At this time, our economy very much needs structural reform of our industries. This can't come about by just extending rescue lines to troubled companies,” he said.

A recent article in the *Australian Financial Review* entitled “Japan's Struggles for Change” pointed to the emergence of a new faction within the LDP pushing for reform of the party and its policies. “A new group of politicians,” it stated, “The Group to Build a New LDP, is disgusted at the way the party is acting and, fearful it will cost them their careers, is calling for drastic reform. But the group's leaders say the old guard refuses to accept the need for change and is desperate to cling to power through ‘forbearance'—an LDP euphemism for pandering to special interest groups, particularly rural areas, the construction industries and ‘Old Japan' businesses.”

The independent stance taken by the Bank of Japan, in the face of government opposition, is an indication that major economic changes are underway. The business-as-usual policies of bailing out banks and failing corporations and undertaking big government spending packages are being challenged by sections of capital, both internationally and within Japan, demanding the “restructuring” of the entire economy.