JAPANESE MARKETS RESPOND FAVORABLY TO NEW CENTRAL BANK APPOINTEES

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Japanese prime minister Shinzo Abe has nominated Haruhiko Kuroda to succeed Masaaki Shirakawa as head of the Bank of Japan (BOJ). Nominated as deputy governors were Kikuo Iwata and Hiroshi Nakaso. Below, we offer brief comments about each candidate and conclude with our thoughts as to what this might mean for Japanese monetary policy and subsequent movements of the yen against other currencies. **Haruhiko Kuroda: The Next Leader of the BOJ** Kuroda is no stranger to Japanese policy-making circles. Most recently, he served as chief of the Asian Development Bank. Kuroda ran the Japanese Finance Ministry's currency policy from 1999 to 2003. During that time, he oversaw efforts to drive down the yen's value against other currencies. On January 3, 2000, the yen closed at 101.45 to 1 U.S. dollar. On February 26, 2002, the yen closed at 134.68 dollar—a greater than 30% depreciation and a successful effort on the part of Kuroda's policies. Leading up to his official nomination, Kuroda emphasized in interviews that the BOJ has various tools that can reverse Japan's deflationary environment. He believes that it is critical for the BOJ to achieve the recently set 2% inflation target within two years in order to preserve credibility. He also believes in large, aggressive asset purchases to encourage expansion of the money supply. Some of these asset purchases can be in foreign bonds that would potentially also serve to weaken the yen. What we find particularly remarkable are the parallels between Kuroda's beliefs and what Ben Bernanke, current chairman of the U.S. Federal Reserve, said in a December 1999 paper on Japan. In short, Bernanke wrote in 1999—and Kuroda is emphasizing today—that it is possible to transition Japan out of deflation and lackluster economic growth by devaluing the currency, growing the money supply and, ultimately, stimulating consumer demand[1]. **Kikuo Iwata: Vocal Critic of the BOJ** Kikuo Iwata is a professor of economics at Tokyo's Gakushin University. The primary thrust of his criticism of the BOJ is that the BOJ has not eased policy aggressively enough to reverse the deflationary expectations that have gripped Japan's consumers and businesses. He is in agreement with the theory that reflationary monetary policy can raise prices by pumping more money into the Japanese economy through the expansion of the central bank's balance sheet—very similar to the ideas that Bernanke espoused in his paper over 13 years ago. Iwata also postulates that the BOJ's 2% inflation target should be flexible and not mandated for any strict time frame, and he believes in going so far as to revise current Japanese law, which guarantees the BOJ's independence. Ultimately, he believes the BOJ should be able to pursue the policies it deems most appropriate, but the government should set the broad objectives and hold the BOJ accountable if those objectives are not met. **Hiroshi Nakaso: International Finance Specialist** Hiroshi Nakaso formerly held the position of BOJ executive director and specializes in international finance. He has most recently been overseeing the BOJ's international operations but lacks the substantial policy background of both Kuroda and Iwata. **Expectations for Future Policy and for the Yen** We believe the BOJ has a long way to go to reverse Japan's long-term deflationary trend. There can be little doubt that Kuroda's and Iwata's past statements and current viewpoints support bold action with the goal of ending deflation. Much of that action comes down to policies that would also potentially weaken the currency. We believe it is helpful for international political fallout that Japan's biggest supporter of this policy—perhaps its original spiritual cheerleader—was Ben Bernanke, who in December of 1999 called on Japan to print money and devalue its currency to end its economic malaise. The first meeting of these new central bankers is scheduled to take place April 3-4. Stay tuned for the announcements and their subsequent impact on the markets. The initial positive reaction in Japan's equity markets showed approval for the appointees—now it will be up to Kuroda and his team to live up to the market's expectations. **Data source is Bloomberg unless otherwise noted.** [1]Ben S. Bernanke, "Japanese Monetary Policy: A Case of Self-Induced Paralysis?" Princeton University, December 1999.

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