

## Money supply squeeze ‘hurting Japan’

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The Bank of Japan is reining in money supply too quickly, an “irrational” policy that is contributing to weakness in the economy, Heizo Takenaka, architect of the previous administration’s economic policy, told the Financial Times.

Mr Takenaka, a former financial services minister often credited with laying the foundations for Japan’s current recovery, said the BoJ was rushing to normalise monetary policy.

“It will take two or three years to normalise the situation,” he said. “But the BoJ is too urgent, too rapid.”

Since March, when the BoJ ended its ultra-loose monetary policy, the central bank has been draining liquidity, and in July it raised interest rates to 0.25 per cent, the first increase in six years.

Mr Takenaka said it was premature to squeeze money supply so aggressively when prices, as measured by the gross domestic product deflator, were still dropping 0.8 per cent a year. “Who is responsible for that?” he said. “Is the government responsible for that? Are companies responsible for that? No. The BoJ is responsible for that.”

The outspoken Mr Takenaka, who has returned to academia since leaving the government in September, has been a long-time critic of the central bank. But his latest attack is particularly blistering in linking the current economic slowdown with BoJ policy.

Third-quarter GDP numbers, due out on Tuesday, are expected to show the economy is weak or even contracting. On Friday, data showed machinery orders slipping 7.4 per cent from the previous month, sparking concern that companies might be cutting capital spending. “We cannot ignore the poor BoJ management of monetary policy [in this],” Mr Takenaka said.

Most BoJ officials are dismissive of Mr Takenaka’s analysis, arguing that the link between money supply and nominal growth has broken down since the mid-1990s when Japan first slipped into deflation. Flooding the markets with liquidity did nothing to stimulate broader money supply, bank officials argue, so draining it off should have no impact on real economic activity.

The bank, which holds a policy board meeting on Thursday, is highly sensitive to any suggestion that its actions could be damaging the modest but long recovery, now into its fifth year. Shinzo Abe’s government has told the bank, an independent body, to support growth.

Toshihiko Fukui, BoJ governor, has said the bank will keep interest rates low for a long time. However, he has also made clear it will not refrain from acting pre-emptively against inflationary pressures.

Takatoshi Ito, a member of the government’s powerful economic policy council, says the BoJ does not appear to understand that the risks of tipping back into deflation outweigh those of acting too slowly against inflation. He accused the bank of targeting interest rates, rather than inflation, something the BoJ firmly denies.

Mr Takenaka did not spare the new Abe administration from criticism, saying he saw no evidence of passion or a strategy to push through regulatory and labour-market reforms. “I do not see any good signs as far as reforms go yet.”

He said proactive reforms were needed to raise Japan’s potential growth from its current rate of below 2 per cent.

The BoJ’s growth expectations were too low, leading it to tighten prematurely, he said. “The role of the BoJ in this regard is very important. They should at least consider the possibility of a higher potential growth rate.”

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