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Ueda's New BOJ Regime: Two Favorable Conditions Not Present in Kuroda's Regime

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The government has presented to the Diet a proposal for appointing Kazuo Ueda, an economist and former BoJ policy board member, to replace Bank of Japan Governor Haruhiko Kuroda. The appointment will be made by the Cabinet with the consent of both houses of the Diet. Deputy Governor Masayoshi Amemiya who has long been considered the main candidate and was reportedly approached by the government in a prior Nikkei paper, has been said to decline, believing that "a new perspective is needed for future monetary policy.

Moderate Ueda Understands Kuroda's Aggressive Monetary Easing

The market is interested in whether Mr. Ueda is a reflationist who supports Mr. Kuroda's monetary easing or a hawk who opposes it, but he seems to be a man who falls somewhere in the middle. Based on his eight years of practical experience as a member of the Bank of Japan's policy board, he believes that economic and financial realities are not simple enough to be sorted out by specific theories, and that effective theories and tools should be applied flexibly depending on the situation. His flexible and prudent pragmatism is evident in his opposition to interest rate hikes on two occasions, in 2000 (by Governor Hayami) and 2006 (by Governor Fukui), and in his promotion of unconventional policies such as the time horizon effect (forward guidance = a promise to continue easing for a long period of time that enhances the effectiveness of easing).

In the Nikkei's Economic Colum Ueda wrote that the road to achieve sustainable 2% inflation in Japan is still far away and that rushing to raise interest rates will have a negative impact on the economy and inflation. But he also noted that the prolonged and exceptional monetary easing framework will require serious consideration at some point.

Two difficulties faced by Kuroda (1) : Japanese disease and incompetence of traditional monetary policy

The Kuroda-BoJ regime started out under the critical conditions of Japan's economy and unleashed revolutionary policies that were far removed from the norm in the past: extraordinary monetary easing and yield curve control. When Governor Kuroda took office in March 2013, in the immediate aftermath of the Great East Japan Earthquake and the European debt crisis, households and businesses were all pessimistic. Japan was the only country in the world with deflation, high-tech companies were losing competitiveness due to the super-strong yen, the six-fold burden was seriously eroding the profitability of Japanese companies, and stock prices, real estate prices, and consumer prices continued to decline. Economists and media around the world called this as the "Japanification" disease, and central banks in advanced economies such as the Fed, the ECB, and the BoE considered it the biggest disease they had to fight.

Moreover, traditional monetary easing policies had clearly reached their limits. Monetary policy affects aggregate demand through credit creation, but the channel of controlling bank lending was no longer working as there were no borrowers beyond the banks. In addition, interest rates were stuck at zero, leaving no room for further rate cuts. Japan's economy and financial system were in an even more dire state of limbo than when former Fed Chairman Ben Bernanke introduced quantitative easing in the wake of the GFC, and a revolutionary approach to monetary policy was needed to end deflation and restore the economy to a growth trajectory.

Two difficulties faced by Mr. Kuroda (2) : Intense policy criticism

The implementation of the extraordinary easing policy was subjected to intense criticism from Bank of Japan alumni, academics, economists, and the media, all of whom adhered to the traditional policy. To begin with, there was a widespread belief that Japan's deflation was a mild "deflationary equilibrium" rather than a Great Depression-type spiral, and that it was something that should be endured under the circumstances of a declining birthrate and an aging population. Nevertheless, in March 2013, when Shirakawa was still governor of the Bank of Japan, the Abe administration pressured the BOJ into signing an Accord, a policy agreement between the government and the BOJ to end deflation. The left-wing media, entrenched in their criticism of the Abe administration, continued to half-ideologically criticize the revolutionary monetary policy of BOJ's Kuroda, the core of the Abenomics program.

This intense criticism of the BOJ's policies, which assumed that Abenomics will fail and never be able to rid the Japanification, stifled animal spirits by promoting people's backward-looking economic behavior, thus self-fulfilling Ly depriving the policies of their effectiveness. It, along with the two consumption tax hikes implemented on two separate occasions, continued to worsen economic performance and prevent the realization of the 2% inflation target. ECB President Mario Draghi, who once promoted quantitative easing, responded to German criticism of negative interest rates by saying, "Total denial without alternative measures is unacceptable," and this applies precisely to the criticism of the Bank of Japan policy.

Two favorable conditions that Mr. Ueda would enjoy (1) : A dramatically improved economy and market

Assuming that Ueda is appointed as the new BOJ governor, there are two favorable conditions under the new regime that are the exact opposite of those under Kuroda. The first is the dramatic improvement in the economy and markets. The Nikkei Stock Average has risen from just over 10,000 yen to just under 30,000 yen, and market capitalization has increased from 300 trillion yen to 700 trillion yen. The number of workers, which had been stagnant at around 63 million from 2000 to 2012, increased by 4 million to 67 million. Corporate recurring profit, which had hovered around 40 trillion yen from 2000 to 2012, doubled to 87 trillion yen in FY2021. In addition, tax revenues increased 50% from a decade ago to 65 trillion yen in FY2022 (budget), thanks to two consumption tax hikes and an increase in income taxes due to economic expansion. Although overseas factors were the main cause, the inflation rate in January was 4.4% y/y in Tokyo wards and 1.7% y/y in core prices (excluding food and energy), almost reaching the target. The momentum for wage hikes is growing as a result of the united efforts of government, labor, and management, and the environment is now in place for the long-desired 2% target to be realized. Although completely ignored by the BOJ's critics, the results of the extraordinary monetary easing have been tremendous, and Mr. Ueda will inherit them.

Two favorable conditions that Mr. Ueda would enjoy (2) : Thick confidence from both doves and hawks

The second condition that can be expected from the new regime is that there will be no more boos against the BOJ. Expectations that the BOJ will be moderate in its policies and carry out its policies with an open mind have been expressed both by doves and hawks, who have been the sharpest critics of the BOJ's policies in the past. It is becoming a global standard that the leaders of the world financial system, including Janet Yellen and Ben Bernanke in the U.S., are not bureaucrats or politicians, but academics and economists of the highest intellectual caliber. This may make the BOJ's dialogue with the market, which has been a bitter pill to swallow for Kuroda, smoother.

The lineup of Shinichi Uchida, who led the monetary policy implementation team under Kuroda, and Ryozo Himino, former director general of the Financial Services Agency, who was the first Japanese to serve as secretary general of the BIS Banking Supervisory Committee and is respected worldwide for his financial acumen, is superb as deputy governors.

It is in this environment that the BOJ's policy changes are likely to progress.