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JAPAN AIMS TO JUMP-START ECONOMY

WITH $1.4TN OF

QUANTITATIVE EASING

by

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Haruhiko Kuroda, the Bank of Japan's new governor, launches aggressive drive to end a deflationary decade

Haruhiko Kuroda announces the plan to buy up government debt at a rate only just below that of the US. Photograph: AP

Japan's central bank has promised to unleash a massive programme of quantitative easing – worth $1.4tn (£923bn) that will double the country's money supply – in a drastic bid to restore the economy to health and banish the deflation that has dogged the country for more than a decade.

As part of a new set of policies known as Abenomics, formulated by Japan's new prime minister Shinzo Abe, the Bank of Japan will buy ¥7tn yen (£46bn) of government bonds each month using electronically created money, with the aim of rekindling demand and pushing up prices and wages.

Haruhiko Kuroda, the Bank of Japan's new governor, described its stance as "monetary easing in an entirely new dimension".

He promised to target a doubling in the size of the "monetary base" – the amount of cash circulating in the economy, plus the reserves held by financial institutions at the central bank – in the hope of stoking inflation of 2% within two years.

The more aggressive approach to tackling Japan's economic problems had been well-trailed, but the scale of the BoJ's operation still stunned financial markets, pushing the Nikkei index of leading shares up by 2.2%.

In a statement released on Wednesday in Tokyo, the Bank of Japan said it wanted to "drastically change the expectations of markets and economic entities", and "lead Japan's economy to overcome deflation that has lasted for nearly 15 years".

The US Federal Reserve – an enthusiastic supporter of so-called "unconventional" monetary policies such as QE – is spending $85bn a month, only just above the $70bn planned by the BoJ, in an economy almost three times the size of Japan's.

The radical new dose of quantitative easing comes alongside tax breaks from the government aimed at encouraging firms to raise wages, in the hope that consumers will respond by increasing spending, and allow prices to rise, too. Persistent deflation tends to encourage households to hoard their cash, as they wait for prices to fall further.

Guy Foster, head of portfolio strategy at Brewin Dolphin, said: "What is clear is that this is a concerted effort which is being … stage-managed for maximum effect. We also understand that there is a tremendous sense of support for such radical policy actions from the Ministry of Finance, Bank of Japan, and the Japanese private sector."

The Bank of Japan's decision is likely to spark concerns that Tokyo is deliberately depressing the value of its currency in a bid to improve its export performance in a tough global trading environment. The yen fell sharply after the decision was announced, losing about 3% of its value against the dollar in Asian trading.

David Bloom, currency strategist at HSBC, said: "Policymakers will likely hope that yen weakness will be a side-effect of their QE strategy, but given the sensitivity of 'currency war' accusations, they will not want to actively target the exchange rate through rhetoric."

The yield on Japanese government bonds hit a record low after the BoJ's announcement, which also included a pledge to buy bonds with maturities of up to 40 years, helping to bear down on long-term borrowing costs across the economy. It will also step up its purchases of other assets, including property funds.

Central banks worldwide have been battling to convince investors they still have ammunition left despite interest rates being at rock-bottom levels for years.

The Federal Reserve has used so-called "forward guidance", promising to keep stimulating the economy until the unemployment rate falls to 6.5%; George Osborne has asked the Bank of England to consider adopting a similar approach.

"It is not surprising that given the extreme set of economic conditions suffered by many countries and the resultant lack of flexibility now afforded by many central banks' main interest rates that a discussion over the appropriateness of policy tools should be gathering pace," said Jane Foley, senior currency strategist at Rabobank.

"While we remain sceptical of the ability of Japan to achieve 2% inflation over the next two years, governor Kuroda is at least stepping up the attack on deflation meaning that his chances of achieving some success have increased."

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