Bank of Japan Theater: Is this Kabuki after Noh?

In January 2009 I had the good fortune to see several traditional Japanese plays in Tokyo. First I attended the National Noh Theater and several days later the Kabuki-za Theater, shortly before the latter closed for an extended renovation. Noh is the older dramatic form, beginning in the 1300s; Kabuki is a relative newcomer dating from the 1600s.

Acting in Noh is extremely deliberate. Stage entrances by main characters seem as though they take forever, but in reality last no longer than the average tooth extraction. Dramatic action is seemingly frowned upon as it may distract the audience from the subtle emotions expressed by the actors. Plots are somewhat minimalist. This is the summary of one of the plays I witnessed, called *Suehirogari*:

> "This is another name for a fan which is made of bamboo and paper. A man tells his servant to go and buy a fan. The servant, who has never seen one, buys an umbrella according to his master's advice. It is also made of bamboo and paper."

Admittedly there are a few humorous moments along the way, but try to imagine this scenario being played out over 30 minutes.

As it was January, both theaters put on versions of a similar play with themes related to the beginning of the New Year. What struck me, after having seen the equivalent in Noh, was how lively and action-packed the Kabuki version seemed. The audience reaction was also quite different. At the Noh theater, I caught the odd patron dozing off, while in the Kabuki, patrons reveled in shouting out praise to their favorite actors in the midst of their performances. Upon further reflection I began to wonder whether the Kabuki was really intrinsically lively and action-packed or whether it was just, for me, the juxtaposition of Kabuki after Noh.

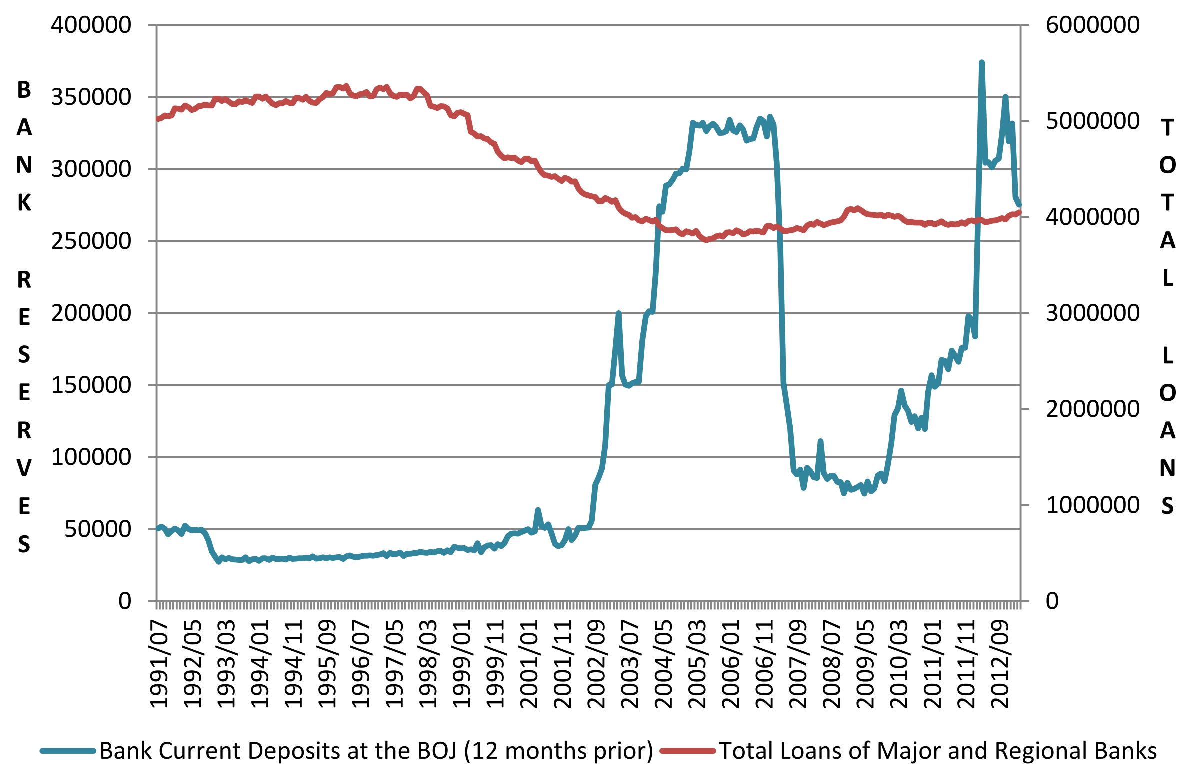
This brings me to central bank theater and whether the recent performance from the Bank of Japan is Kabuki after Noh or something completely different. Since this is Japanese theater one needs to look for subtle clues. We cannot, as they say in Hollywood, "cut to the chase" because there is no chase.

Let us consider the main policy action: the doubling of the monetary base in two years. The monetary base consists of banknotes and coins in circulation and bank deposits at the central bank. Central banks aiming to control the monetary base almost always influence only the amount of bank deposits (i.e. reserves) at the central bank thereby allowing the market to determine the value of banknotes in circulation. Accordingly, of the 132 trillion yen projected increase in the monetary base over the next two years, only 3 trillion yen is anticipated to come from an increase in banknotes. So the key protagonist to follow is the increase in "current deposits at the BOJ". This variable is set to move from 47 trillion yen at end 2012 to 175 trillion yen by end 2014, an increase of about 275 percent.

While a 275 percent increase over two years in bank reserves might sound very large, particularly to someone thinking that with a constant "money multiplier" money and credit ought to increase at triple digit rates somewhere soon down the road, it is helpful to put it in perspective. Bank reserves at the Federal Reserve increased from $32 billion on 10 September 2008 to $860 billion on 31 December 2008 or 2,588 percent in less than 4 months. So comparing the BOJ actions to the Fed's is akin to comparing the weapons used in Akira Kurosawa's Hidden Fortress (1958) with those in the Star Wars trilogy it inspired. But perhaps more interestingly, the base money weapon has been employed before in Japan with no discernible impact on prices or credit.

In Figure 1 I show bank current account balances at the BOJ and total loans and discounts extended by the major and regional Japanese banks over the past two decades. One would expect, if causality runs from bank reserves to credit and money, that the reserve figures should be increasing before the credit figures; so I present the reserve data from 12 months before the credit data. In other words, on the graph, the red line ought to be rising when the blue line is rising and vice versa if it takes about a year for the impact of an increase in reserves to percolate through the system. In fact, credit continues *falling* even a year after the start of the first experiment with quantitative easing in 2001. Nor does there seem to be any particular negative impact on credit growth a year after the QE ended in 2006[1].

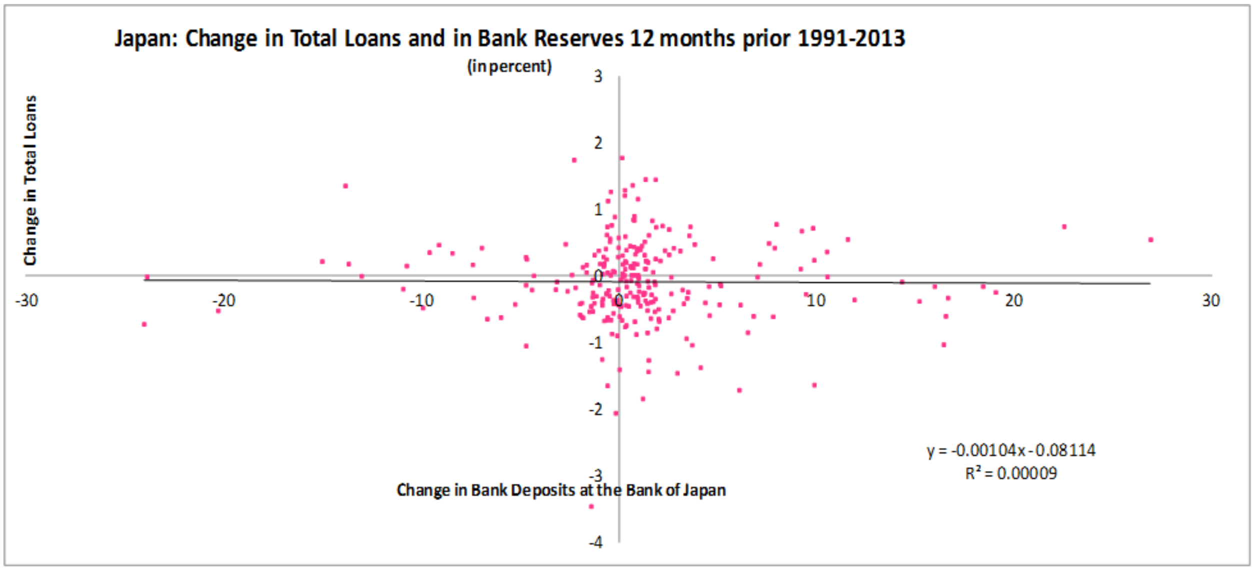
Figure 1. Japan: Bank Reserves and Total Loans 1991-2013
(in 100 million yen)



Source: Bank of Japan. Data for end 1999 were excluded to remove distortions related to the temporary injection of reserves related to Y2k fears.

Figure two illustrates the same idea from a different perspective. It shows a scatter plot of the change in the three month moving average of bank reserve balances at the BOJ 12 months before the corresponding change in bank credit.

[1] The increase in bank reserves at the BOJ from 2001 through 2004 was about 600 percent.



As is evident from the picture, the proportion of the variance of loan growth explained by the variance in bank reserves is virtually zero. (The estimated simple regression line has an r-squared of 0.00009).

So the basic story line is the same as in 2001 although perhaps the pace of action will be a bit quicker… but even that is beginning to slip as the BOJ has already suggested the target date for arriving at 2 percent inflation is more likely to be 3 rather than 2 years….

In other words the plot of this new performance seems quite familiar: “Prime Minister sends the Governor of the Bank of Japan to obtain a package of inflationary measures. The Governor, never having seen such a package, comes back with base money expansion instead”. The audience, expecting even less, and impressed with the fast pace of the show, greats the performance with robust applause.

But perhaps this is just Kabuki after Noh.

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