

The Bank of Japan and the Markets

By Sakamoto Sakae

In late June, the yen surged against the dollar, breaking through ¥100 to the U.S. dollar in both domestic and foreign markets. Analysts attribute this to the weakness of the dollar—the overheated economy and increasing fear of inflation in the U.S. But what triggered the yen hike was “trivial remarks” by Mieno Yasushi, governor of the Bank of Japan (BOJ). The business community in Japan is not pleased with the stronger yen, which means less competitiveness of its exports. In the midst of fierce calls for taking action against the stronger yen, the governor must have realized the danger of speaking carelessly.

Before talking about Mieno's comments, it seems necessary to give some background on the BOJ's public relation activities. Historically, every governor has considered it important to dialogue with the public, and so occasional accounts in the Diet, periodic press conferences (currently every two weeks) and lectures at various meetings (Governor Mieno, for example, gave 21 lectures last year) are the norm. Considering that heads of central banks in the U.S., U.K. and Germany seldom express their banks' positions through press conferences and lectures, the Japanese central bank is very “democratic.”

It was during a question and answer session following a recent lecture that the “trivial remark” which pushed up the yen in foreign exchange markets came out. In reply to a question, the governor stated: “[Although a stronger yen has both merits and demerits] at this point [when the economy is picking up], the impact should be [negatively] felt first by export industries. Interventions [by buying dollars to support them against the yen] may have some impact, but it is impossible to manipulate the level [of exchange rates] as easily as clay. [The basics are] how and where to conduct the fundamentals.”

Under normal circumstances, this statement should have been ignored by the media, or at least by the foreign exchange markets, even if it was reported. Unfortunately, the markets were very nervous amid an accelerating triple drop in U.S. bonds, stocks and the cur-

rency. The governor's remark on the limitations of intervention, expressed in “as easily as clay . . .,” convinced the market of a further strengthening of the yen and led to a huge run on yen bought with dollars.

This time, the BOJ has bought as



Tokyo Foreign Exchange Market, where the yen hit a postwar high of ¥97.25 to the dollar on July 12. (Ueda Harlow Ltd. in Nihonbashi-kobunacho).

Photo: Kyodo News Service

much as several billion dollars in the belief that intervention works. This proves the BOJ does not think of intervention as useless, implying that the markets ran away at the governor's off-guard remark.

Dialogue with markets

With the development of electronic media, a statement by the central bank chief is now delivered in seconds to financial, stock and commodity markets. Moreover, by being delivered fragmentarily, rather than in its full text, the exact intention of the statement is not necessarily understood. Also, depending on market conditions, the statement may have different impacts: It may have a major impact when the markets are in some state of excitement, while it may be ignored when the markets are looking in other directions. It is difficult for a financial authority to follow the whims of the market exactly. In this sense, establishing good public relations via electronic media is a major task for a central bank.

Ironically, Governor Mieno referred to the importance of dialogue between the financial authority and the markets in the lecture that triggered the yen's appreciation: "While using market reactions [such as the weakness in the bond market] as a point of reference [to evaluate the current economic situation], the BOJ is trying to explain its economic judgment as clearly as possible to provide a reference for market participants to vote [i.e., buy or sell, for instance, currencies]." How disappointed the governor must have been, as the market "voted" for yen buying—totally against the intention of the BOJ—immediately after this "explanation."

As I mentioned in the last issue, the BOJ governor has been hoisting the flag of deregulation, preaching the importance of the market principle. In one lecture emphasizing the importance of dialogue with the market, he even stated, "The BOJ considers it very important to utilize information gathered from the financial markets to elaborate the methodology of our financial policy. It can be said that financial markets are compasses for financial policy."

According to the governor, the meaning and nature of information extracted from the financial markets can be explained through four aspects. The first is the objectivity of the market. "The market behavior—selling or buying something at some price—of each economic body is 'a ballot denominated in yen' and an indication of people's valuation. For companies, this 'voting' is based on serious calculations that determine their survival. Thus, market behaviors constantly and genuinely reflect the ultimate choice and will of market participants after careful consideration."

The second is comprehensiveness. As every economic transaction is ultimately reflected in the money flow and interest rates, the financial market comprehensively concentrates the broadest information in the national economy.

The third is foresightedness. Financial markets are where participants' speculations on the future are always intersecting, and are settled in trade deals every second. This is to say that the financial market is an institution concentrating huge volumes of information as well as the decisions of participants seriously looking at the future. The genuine economic outlook of people—either fears or expectations—are condensed there.

The fourth is immediacy of data in the financial markets; price information, such as interest rates and stock prices, is available instantaneously. Taking into account the implications and characteristics of this, Mieno expressed his humble attitude towards the markets, "The markets contain ample information worthy of examining carefully when the BOJ tries to read the future of the economy."

Revising dialogue?

It will be in the summer holiday season when this article is published, and it is difficult at this point (early July) to forecast August yen rates—whether the yen will remain in the ¥90s to the U.S. dollar range or ¥100-¥110/U.S. dollar.

Assuming the former rate, the Japanese economy could repeat last year's pattern—early signs of recovery were reversed by a sharp rise in the yen

coupled with an unusually long rainy season and a cold summer, rendering the economy back to recession. This year is different from last in two regards: companies are more resistant to the stronger yen than last year, and the current yen appreciation is due mainly to the problems of the U.S. economy.

In late June, a major U.S. securities company forecast in its report to clients, "Neither the Clinton administration nor the Federal Reserve Board (FRB) wants a weaker dollar, but their policy priorities are set first by the economy and then by interest rates, leaving foreign exchange in the third position. Therefore, defensive measures for the dollar will be limited to concerted interventions (by financial authorities of Japan, the U.S., Germany, etc.), and it is unlikely that the FRB would raise interest rates simply to support the dollar." The securities company forecast a rate of ¥95 to the dollar in one year.

A totally opposite forecast was made by a think tank affiliated with a major Japanese securities firm in its mid-June report. It described a scenario in which a slowdown in the U.S. economy will stabilize its bond market, and the difference in interest rates between the U.S. and Japan should encourage investment in dollar-based bonds, pushing up the dollar against the yen. The think tank forecasts a ¥108/U.S. dollar exchange rate a year later. This scenario reflects the wishes of Japanese corporations.

Whether the yen will continue to remain in the ¥90s against the dollar, or jump back to a ¥100 plus/dollar range, the BOJ must be very concerned, as it was the governor who triggered the current yen hike. If the BOJ takes the consequences of the governor's statements seriously, it will revise its public relations policy. It may sharply reduce the number of press conferences and lectures, limiting the governor's presence in line with major Western countries. For the press, this means fewer chances for reporting and dialogue. ■

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