# Bank of Japan's Market Dialogue

*By Sakamoto Sakae*

To Japan's financial media, a speech by the governor of the Bank of Japan is an event that must receive priority coverage. But because articles are confined to approximately 300 words, there is insufficient coverage of the content of these speeches.

Financial journalists write about the BOJ governor's views on the current economic situation, his conclusions regarding yen/dollar levels, whether fiscal policy will change and, if so, when this will happen, and other issues of the moment. But there is the inevitable tendency to ignore the basic question of the BOJ's relationship to the marketplace.

Reading transcripts of the governor's speeches to see what journalists have ignored is quite useful in understanding the BOJ's thinking. How has the BOJ tried to interact with exchange and securities markets as deflationary phenomena have increased in Japan's economy due to the tandem impact of the rising yen and falling stock prices? A review of the governor's recent speeches provides some answers.

## Exchange markets and fiscal policy

On June 10 BOJ Governor Matsushita Yasuo delivered a speech entitled "Dialogue with the Market" at the Forex '95 Osaka, an annual congress of the Association Cambiste Internationale (a conference for leading foreign exchange traders) held in Osaka. He repeated the view which has been voiced at regular press conferences: Interest rate manipulation is undertaken in line with coordinated decisions regarding internal and external economic conditions and not solely for the benefit of foreign exchange markets.

He also noted that exchange rate movements could not be ignored when making fiscal policy decisions. Although an apparently contradictory statement, it is interesting nonetheless in that it illustrates the recent "market emphasis" stance which the BOJ has taken.

Mr. Matsushita noted there have been requests, not only from those active in financial markets but also from a variety of sources as well, to set financial policies in motion (lower interest rates) when exchange rates show signs of instability (the current rapid strengthening of the yen and weakening of the dollar). "To these voices ... we would like to say that we do not implement monetary policy solely targeted at the exchange rate. The interest rate is only one of many factors which influence the exchange rate, and the effect may vary from time to time depending on the economic environment. What we should bear in mind is that if we implemented monetary policy solely targeted at the exchange rate, ... [it] would impose high costs on the domestic economy."

On the other hand, Mr. Matsushita continued, "However ... let me emphasize that what I have said does not in any way imply that we think lightly of the importance of the influence of the exchange rate in the conduct of monetary policy. As you know, while the exchange rate reflects economic fundamentals, it also exerts a variety of influences on a nation's economy."

Put differently, exchange markets have "passive" aspects that reflect economic fundamentals and "active" aspects that influence the actual economy themselves. He went on to note that the BOJ has been keeping an eye on the active elements as well.

As befits the person in the highest position of responsibility at the central bank, the phrasing is extremely subtle. Interpreted in the context of the Japanese economy's current standstill, it apparently means that the active aspects of foreign exchange (the negative impact that excessive strength of the yen and weakness of the dollar has had on export industries and the Japanese economy as a whole) cannot be ignored. However, bearing past bitter experiences (the abrupt lowering of interest rates to alleviate the negative effects of the strong yen following the Plaza Accord which then became a factor in the bubble economy) in mind, it would not necessarily be appropriate to cut interest rates indiscriminately.

## Capital markets and fiscal policy

A speech entitled "The Role of Capital Markets and Related Issues" presented to a Capital Market Research Institute (CMRI) gathering on June 14 was also quite interesting.

Touching upon the relationship between fiscal policy and capital markets during his presentation, Mr. Matsushita pointed out that the BOJ feels it would be inappropriate to bundle the stability of property and stock prices, that is, asset prices, into fiscal policy goals in the same sense that we would the stability of ordinary commodity prices. Better put, as long as asset prices move in response to people's expectations regarding economic growth, we cannot establish a clear criterion that "zero inflation is basically preferable as with ordinary commodity price levels."

However, he noted that although he said that stock and other asset prices are not direct fiscal policy targets, this was not to say that asset prices are unimportant in the management of fiscal policies. He believes that this point is clear without citing the experiences of the bubble economy. Fluctuating asset prices affect corporate and household activities in various ways and are causal factors in real economic activity fluctuations.

He went on to state that significant asset price movements act, on the other hand, to signal abnormalities in economic activities. If only for this reason, fiscal policy management should always involve scrupulous monitoring of asset price trends at the point of their link with economic activity.

So how is the monitoring carried out specifically? Mr. Matsushita provided a three-stage reply: The important thing in this case is, first, to determine in an unbiased manner and to the extent possible from asset price fluctuations people's expectations and hopes for the future; second, compare those expectations and hopes with actual economic conditions at that time, ascertaining whether those expectations and hopes have gone too far or they forecast future prospects; and, thirdly, integrate analysis of other circumstances, linking this with economic stabilization policy measures as required.

## Individual responsibility in investing

During his speech to the CMRI, Mr. Matsushita criticized managed stock markets, over-protection for investors, and other ways in which the Finance Ministry has administered securities markets, indicating a desire for a shift from the existing style of securities administration in Japan to one driven by market forces.

Regarding managed markets, Mr. Matsushita noted that it is not that companies should be constrained from issuing stock because of stagnant stock prices.

Rather, interest rate levels usually drop at such times and investors' expected rates of return on investments, or capital costs for business should fall. In this case, it could be said that such periods should provide good opportunities for entrepreneurs to raise funds to develop new business ventures.

Further, regarding investors' individual responsibilities, he said that on top of the Securities and Exchange Law, investor protection has been provided in Japan so far in such a way as to minimize investor risk burdens. Specifically, products thought to carry a high risk have been eliminated in advance to reduce investor risk, thereby supplementing and strengthening investor protection under the law

Japanese investors, especially individual investors, have been coddled up to now, in a matter of speaking. Improved corporate disclosure and a delineation of U.S.-style rules for individual responsibility will be needed to alter this custom. These types of basic areas will have to be overhauled to revitalize Japanese securities markets, mired in asset deflation.

Mr. Matsushita stressed, "I believe that what is basically sought for investor safeguards is not the previous reductions in risk burdens, but, first, the provision of a basis for investors themselves to make rational judgments regarding the extent of existing risks and, second, the offering of systems for eliminating unfair transactions and inappropriate sales. Disclosure is a prerequisite to thoroughly establishing the principle of self-responsibility and is a basis to protect investors and maintain the market mechanism."


Photo: Kyodo News Service

Governor of the Bank of Japan, Matsushita Yasuo, addressing the Forex '95 Osaka meeting.

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