the japan times
THE INDEPENDENT VOICE IN ASIA

01.08.22

An economic lesson from Japan

How does a country that imports massive volumes of oil with a weak currency keep inflation at around 2.3%?

Bank of Japan Gov. Haruhiko Kuroda meets with Saudi Arabian officials during the Group of 20 gathering of finance ministers and central bank governors in Riyadh in February 2020. | REUTERS

BY DAVID HOWELL
CONTRIBUTING WRITER

There is a question that British economic policy makers keep asking: How on Earth does Japan manage to keep inflation so low when much higher rates are affecting so many countries — including the U.K., which has been hit particularly hard?

How does Japan, which imports massive volumes of oil and gas at ever rocketing prices, and with a weakening currency as well, still keep inflation at around 2.3%?

In the U.K. inflation is now running at 9.4%, with more increases to come. This puts it well above the danger level and means that the entire culture is poised to turn inflationary. This also spells wage and salary demands being pushed ahead with real anger and desperation, as workers see their incomes shrinking before their eyes. It is a pattern that appears unstoppable, and will leave lower income households unable to pay for basic needs, such as heating, cooking, lighting and electricity. Public sector workers are especially incensed when they are offered a 5% wage increase against a 10% to 12% inflation forecast.

The result is widespread discontent and the threat of strikes and economic disruption throughout the coming autumn. That means vital investment in industry is further deterred — unless remedies can be found, and this is where officials and their advisers have been looking to Japan in the hopes of learning something to head off the dangers.
It scarcely helps that the U.K. is in the midst of electing a new prime minister. The winner will be announced on September 5th. The choices offered to ruling Conservative Party members throughout the U.K. has been whittled down to two figures: Liz Truss, the U.K.'s Foreign Secretary, and Rishi Sunak, until recently the Chancellor of the Exchequer. Both are fairly strong center right, but with Sunak taking a more austere view on public finances and Truss more inclined to cut taxes to boost a sluggish economy. Neither have a clear answer to the worsening inflation disease and party members will have a hard time choosing between them. The winner will immediately face, along with a new Cabinet, a near impossible situation.

Those of a traditional banking and monetarist mindset think the only answer is to turn the bank squeeze on demand, and therefore on economic growth, raise interest rates and impose iron discipline on public spending.

Many hark back to the days of Margaret Thatcher, the "Iron Lady" who led the U.K. through the last major bout of inflation. That was over 40 years ago.

But what they overlook is that since then the digital revolution has transformed the way the world economy works, and the way financial systems work.

Meanwhile, Japan is following quite a different path.

Japan's central bank governor, Haruhiko Kuroda, has said he wants to keep interest rates at "current or lower levels" to prevent recession. He has argued further that small interest rate hikes, such as those now being deployed by the Bank of England, are pretty useless to stop inflation and support the currency — and that rates would have to be raised "a lot" to have any impact. He could have added that these monetary measures can take one to two years to have any effect.

But, of course, raising them "a lot" is just what would tip Japan back into the stagnation it experienced in the past. The cure would prove worse than the disease, and that is what neither Kuroda nor the Japanese people presumably want to see.

By sharp contrast, the U.K. hard-liners and the Bank of England remain heavily focused on fighting inflation by what they warn are "more forceful measures."

That in plain language means still more pressure on millions of families who are already in debt, have tightened their belts to the point of real pain and are at their wits end to know how to pay existing energy bills and find enough cash to put in their gas meters or fuel in their cars, let alone face rising mortgage rates and costlier foodstuffs.

The evidence that supply, rather than demand, is the problem, and that outside energy supply chains, which have sent prices soaring, are the real roots of the inflation, requiring international action, does not get much attention. It is as though the enormous price increases (the cost of domestic gas in the U.K. has risen seven times from last year) have appeared out of the clouds and there is nothing much to be done about them, except admonitions to use less energy and insulate homes better.

That, of course, is nonsense. There is a great deal that can be done by like-minded states working together to engender more global supplies of crude oil and gas so as to offset cuts in Russian flows to Europe, and to provide more refinery capacity to process it and more shipping to transport it. U.S. President Joe Biden was recently in Riyadh on such a mission for which he deserves some credit for his efforts.

In fact, help may be well on the way, with Kuwait already exporting tens of thousands more barrels of diesel from new refineries, as well as jet fuel, while in Mr. Biden's own backyard the shale producers are getting ready to export both more oil and more LNG gas to Europe. Iraq, too, has a new refinery about to open and the Saudis themselves have inched up their output by a few hundred thousand barrels.

In short, while monetary prudence by the central bankers may have its place on some occasions. But not all inflations are always monetary — contrary to what gurus in a past age once insisted — and not all traditional monetary medicine works or is necessary.

What western bankers can learn from the Bank of Japan governor is that the inflationary virus can take many forms and that a different vaccine must be skillfully concocted to suit very different countries' specific and varied conditions.

Oh, and there is one more lesson: The best central bankers should have a good nose for today's political realities and for the changing complexities of global energy — and a strong dose of common sense.