Japan’s central bank cuts rates to zero to fight strong yen, deflation

Tue Oct 5, 6:51 AM
Tomoko A. Hosaka, The Associated Press

By Tomoko A. Hosaka, The Associated Press

TOKYO - Japan’s central bank cut its key interest rate to virtually zero in a surprise move Tuesday and is looking to set up a US$60 billion fund to buy government bonds and other assets as it tries to inject life into a faltering economy.

The Bank of Japan’s nine-member policy board voted unanimously to set its overnight call rate target to a range of zero to 0.1 per cent, returning to zero rates for the first time in more than four years.

The decision underscores growing worries about the Japanese economy, which is being battered by a strong yen and persistently falling prices. The central bank had left rates untouched since December 2008 when it lowered the target to 0.1 per cent.

Recent economic indicators point toward deteriorating exports, industrial production and corporate sentiment. Authorities intervened in currency markets last month to weaken the yen, but the impact was short-lived.

Lawmakers repeatedly called on the Bank of Japan for more help.

"Although Japan’s economy still shows signs of a moderate recovery, the pace of recovery is slowing down partly due to the slowdown in overseas economies and the effects of the yen’s appreciation on business sentiment," the central bank said in its statement.

The rate cut is the first step of a three-pronged approach outlined by the central bank to answer critics who had disparaged previous efforts as inadequate. It did nothing at its last meeting in early September, which followed an emergency meeting in late August when it expanded a low-interest credit program.

"It's a good move," said Kyohei Morita, chief economist at Barclays Capital Japan. "All that they announced today is something that is beyond my expectations."

Other analysts agreed. Junko Nishioka, chief economist at RBS Securities Japan, said the central bank "made major progress" Tuesday.

Part two of what the BOJ describes as a "comprehensive monetary easing policy" is a pledge to maintain the zero rate policy until prices start rising again. That will probably take three or four years, which means rock-bottom rates are here for a while, Morita said.

Japan last period of zero rates lasted for five years starting March 2001. Through its "quantitative easing" policy to boost the economy, the central bank flooded markets with excess liquidity to hold short-term interest rates near zero.

The final piece of the central bank's strategy is the creation of a temporary 5-trillion-yen (60 billion) fund to purchase financial assets such as government securities, commercial paper and corporate bonds in an attempt to stimulate the economy by lowering longer-term interest rates and risk premiums. About 70 per cent of the fund will be used to buy long-term government bonds and treasury discount bills.

The central bank will offer another 30 trillion yen ($359 billion) through its loan program.

The rate cut gave an immediate boost to the stock market, with the Nikkei 225 index jumping 1.5 per cent to 9,518.76 after spending much of the day in the red.

Chief Cabinet Secretary Yoshito Sengogku said he welcomed the central bank's announcement. The decision stands "in concert with the government’s efforts to overcome deflation," he told reporters, according to Kyodo news agency.

In addition to a 915 billion yen stimulus package announced last month, Prime Minister Naoto Kan is expected to unveil new spending through a supplementary budget that could be as big as 5 trillion yen.

The central bank's government bond purchases will help fund Kan’s extra budget, which could spur some growth, said Christian Carrillo, head of Asia-Pacific interest rate strategy at Societe Generale. But it's unclear whether the Bank of Japan’s steps will have a meaningful impact on the overall economy.

"I wouldn't say it's something that will strongly stimulate the economy," Carrillo said.

Tuesday’s news comes amid speculation that other central banks may also ease monetary policy. Federal Reserve Chairman Ben Bernanke fanned expectations Monday when he said that the economy could be helped by another round of asset purchases by the central bank.
The Fed, which meets next on Nov. 2-3, is considering launching a new program to buy government debt, a move aimed at driving down rates on mortgages, corporate loans and other debt. During the recession, the Fed ended up buying a total of roughly $1.7 trillion of mortgage securities and debt, as well as government bonds.

Slowing growth in the U.S. is just one of the headaches facing Japan, which has relied on overseas demand to fuel its recovery. Figures last week showed that core consumer prices in August fell for the 18th straight month as a strong yen pushed import prices south.

While lower prices may boost individual purchasing power, deflation hamstrings an economy. It plagued Japan during its "Lost Decade" in the 1990s, curtailing growth by dragging company profits, sparking wage cuts and causing consumers to postpone purchases. It also can increase debt burdens.