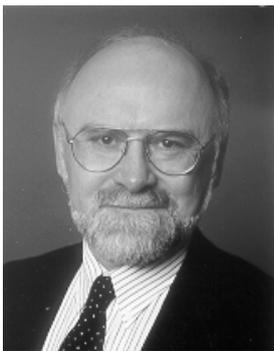


# Editorial



Wolfram Schrettl, PhD,  
Head of the Department of  
International Economics, asks:

"A Japanese Abyss?"

*Japan is not exactly a country that is still entertaining the world with sudden moves. The period of success was very long indeed. When it finally ended in those famous bubbles – not entirely without some Japanese hubris towards the end – their bursting was not a rapid process either. Instead, a painfully slow process of deflating the bubbles began, which is still going on – a decade later. A stagnant GDP, rising unemployment, and ever higher budget deficits resulting from failed attempts at overcoming the economic stagnation and contributing to a frighteningly high debt-to-GDP ratio have become hallmarks of Japan. The same is true for a Nikkei index that 'tanked big time', as did real estate prices. Add to this the accelerating erosion of the huge Japanese current account surplus, to which the U.S. especially had become used, if not addicted, and it must seem understandable that the rest of the world is getting ever more seriously worried about Japan.*

*Not that Japan itself had not long ago begun to tinker with its economic maladies. The favourite medication, in addition to those failed fiscal injections, was corporate restructuring. Such efforts are not entirely misplaced given that huge pockets of inefficiency had managed to survive even in supposedly super-efficient Japan. However, they did not touch the present core problem of the Japanese economy: the inability to get rid of price deflation and, more importantly, of deflationary expectations.*

*A lack of resolve in handling the fallout of those bursting bubbles had resulted in a problem of ever more serious dimensions. The doctors in the Bank of Japan (BoJ) were continually administering what amounts to an underdose of the right medication: monetary expansion – just too timidly. Now, the latest twist – after periods of abandoned and now resumed zero interest rates in the money market – is a mild (or, again, timid) form of inflationary targeting: "OK, we shall expand, but only until prices stop falling."*

*Will that be enough to put an end to a decade of agony and to turn the economy around? Many observers remain unconvinced. Indeed, reading the evasive statements of Mr. Hayami, the head of the BoJ, makes you wonder. But does this mean, as has been suggested, that Japan has a potential to draw the world economy into an abyss? I have a hard time believing that. Let me just mention three reasons: first, foreign exchange markets have already started to move. The wildly overvalued yen has begun to depreciate, and current talk is mostly about avoiding an 'excessive speed' of the slide. At a minimum, this means that foreign exchange markets have some credibility to lend the new monetary policy. Second, the BoJ seems to be increasingly alone – and Mr. Hayami seems to be increasingly alone within the BoJ – in portraying the right dose of monetary expansion as an overdose. That provides some reason for optimism that appropriate policies will be further strength-*

*ened before too long. Third, although Japan has a track record of holding out, sometimes to a bitter end, it has also learned its lessons. Therefore, it looks like a safe bet that authorities will act well before disaster really strikes. In sum, Japan is a rather unlikely candidate as an immediate source of any global economic drama. For such a drama to happen, it is much more the U.S. and Europe that would stubbornly have to refuse to do their homework. Again, some are faster and some are slower in that respect. But at the end of the day, there is little reason to abandon optimism.*