



Chris Andrew
and Mustafa Zaidi
ca@clarmond.co.uk
+44 20 7060 1400

October 2017
Market Comment

CLARMOND

An Orgy of Blood

The Bank of Japan's current path provides an ominous reminder of a similar era 80 years ago. These policies, which are also being followed by the other world central banks, will lead to disaster.

“ONE MAN - ONE KILL” RAILED INOUE Nissho, leader of the Ketsumeidan (the Blood Pledge Corps), a Japanese ultranationalist group of the 1930s committed to cleansing the country of ‘traitors’ - the leaders of business and government.

The first name on their death list was Inoue Junnosuke, a former Finance Minister, an austerity advocate and former governor of the Bank of Japan (BOJ); he was shot as he visited a nursery school. The next name was Dan Takuma, head of the Mitsui Group, the Japanese Goldman Sachs; he was shot in front of his office in the fashionable Nihonbashi district. Further attacks on the BOJ and Mitsubishi Bank followed but were unsuccessful. The “world of cosmopolitan finance had collided with nationalist resentment.” The liberal elite was stunned, unable to provide answers to the social turmoil of the time; and with the establishment paralysed, the public began to sympathise with the killers’ aims.

Enter Finance Minister Takahashi Korekiyo (see *Resurrecting Reflation*: November 2012). He placated the nationalists by championing massive deficit financing, via the BOJ, to pull Japan out of its economic morass. Japan’s economy soon embarked on a period of economic growth with stable prices, full employment and humming factories, an “economic nirvana.” Seven decades later these results were heralded a success by another central banker trying a similar trick - Ben Bernanke.

Korekiyo’s plan was to fund government spending by having the BOJ directly purchase all the government-issued bonds. The hope

was that, when conditions and inflation improved, the bonds would be sold back into the market. Four years later, the BOJ’s balance sheet was 90% of GDP, and the economy (and for “economy” read military) was totally dependent on government spending financed by the BOJ.

As the first modest hint of inflation arrived Korekiyo attempted to sell government bonds publicly, but the auction failed. With this failure it became clear that the bonds which had been stuffed onto the BOJ’s balance sheet could never be sold. Korekiyo’s struggle to ‘cut up the credit card’ culminated in him suffering a similar fate to Junnosuke and being cut up in an attack of army machetes. As the BOJ’s balance sheet crossed 100% of GDP, there could be no turning back, the road to conflict had been primed by the BOJ’s swollen balance sheet and the money that had flooded into the military.

A world at war?

The current Bank of Japan’s balance sheet has now again crossed that fabled 100% of GDP and it is getting close to owning 45% of outstanding government bonds. There is no end in sight with the BOJ buying \$60 billion a month of government debt. At this current pace the modern BOJ will by 2019 be the proud owner of 60% of the local bond market. There is no longer a market price for a Japanese Government Bond, it is an asset whose price is set by the BOJ. The key difference between today and the 1930s is that Japan now has an open capital account, therefore the only untethered market price is the currency. The Yen’s continued

devaluation will be deep and comprehensive, while Japanese equities will continue to rise, adjusting to the currency loss. (see *Gamblernomics*: February 2014).

But there is an even darker side to the actions of the BOJ and its central bank brethren. Central banks continue to act as the enablers to their respective governments. They provide funding that papers over the underlying social anxiety, delaying our much needed dialogue.

When historians look back and see the cavalier balance sheets of the central banks they would rightly assume there was a world war going on as every central bank balance sheet is now approaching or exceeding levels not seen since 1945. However, the worrying truth is that there are no external enemies to overcome; the central bankers are only maintaining the growth trajectory that we demand.

The age of sloganeers

The current social contract is mired in the quicksand of global finance. It is being kept alive by the corpulent balance sheets of central banks, who do their government’s bidding so that the politicians do not have to put unpleasant choices in front of their electorates. This cowardly behaviour gives rise to slogans and sloganeers, who provide familiar but false checklists of remedies. “Take bank control”... “America First”... “One Belt, One Road”... “Ein Volk, ein Reich, ein Fuhrer”... “One Man - One Kill”.

Central banks are currently furnishing the excess credit that, in the past, has been followed by an orgy of blood. ■