Market Insight August, 2015

A limited grace period of at most 2 to 3 years

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We have been focused on the alignment of policy interest rate hikes in Japan, the US, and Europe since the 1970s, which we refer to as the 'five jinxes', as listed below. There has been increased alignment in the financial markets, particularly in Japan, the US and Europe, since the move to a floating exchange rate regime.

[Chart 1: '5 Jinxes' of policy alignment in Japan, the US and Europe since the 1970s]

(1) Cycles of policy interest rate hikes by central banks in Japan, the US and Europe have coincided since the 1970s.

(2) The BOJ has consistently been the last central bank amongst Japan, the US and Europe to hike interest rate in these cycles.

(3) There have been concurrent global economic downturns in the year following the BOJ rate hike in each cycle.

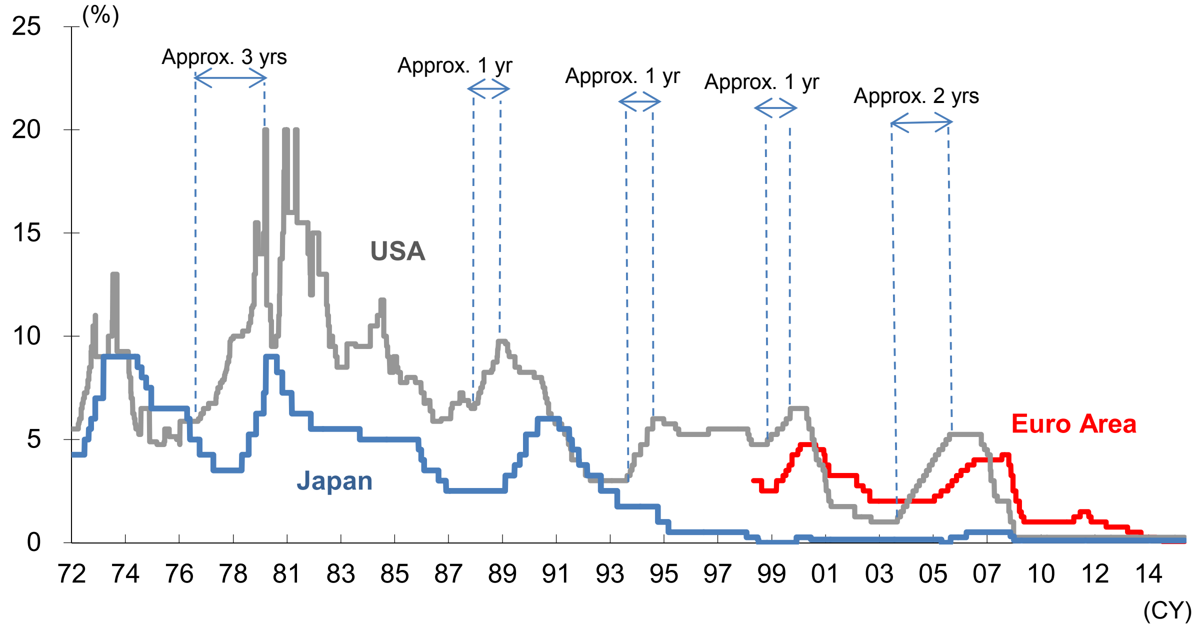
(4) This has coincided with movements in global financial markets as well as problems in developing countries.

(5) All phases (1) to (4) have coincided with periods of higher oil prices.

Source: Mizuho Research Institute

There have been five periods since the 1970s when the BOJ has hiked interest rates, and an important aspect on each occasion has been that the US has hiked interest rates first. This also means that Japan cannot hike interest rate unless the US is in the process of hiking interest rates. The issue is that periods of US rate hikes have usually lasted 1 to 2 years, and at most 3 years, as illustrated in the following chart. So, past trends suggest Japan only has a grace period of up to 3 years from when the US starts hiking interest rates to embark on its exit strategy. There is a strong impression based on past experience that the prospect of the first US interest rate hike in 9 years (since 2006) will signify a change from a major trend. At the same time, such movements indicate that grace period for Japan's exit strategy is running out. We have used an analogy of 'anesthetics and surgery' to discuss today's unusual practice of government bond purchases by central banks as merely being a 'time limited measure' during which the players are waiting for improvements in the economy and finances. There are various dimensions to such a grace period, and in this paper we suggest some form of result will need to be achieved during the period of US rate hikes and the period during which the BOJ purchases government bonds that are in both cases expected to last up to 2 to 3 years. At the same time, the political schedule encompasses a hike in Japan's consumption tax slated for April 2017. The next few years will be a crucial period to see how much sentiment can be turned around.

[Chart2 : Policy interest rates in Japan, the US and Europe and periods of US rate hikes]



Source: Compiled by Mizuho Research Institute from Bloomberg

(August 19, 2015)