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It is Easy to Increase Bank Loan Growth

FUND GOVERNMENT SPENDING THROUGH BANKS, NOT BONDS; USE WINDOW GUIDANCE AND MOBILISE FOREIGN EXCHANGE RESERVES

By Richard A. Werner

We all would like Japan's economy to recover. This is not difficult. For a recovery, all we need is more credit creation. This can come from two sources: the Bank of Japan and the banking system. The BoJ is already printing money at full throttle, as we have reported before. It needs to keep up this policy. Moreover, bank loan growth is actually higher than reported by the official loan statistics, because they are distorted by the write-offs of bad debt. However, there are several simple ways in which the government can quickly accelerate bank loan growth.

Suspend bond issuance - fund all government spending from banks

The government is currently implementing its Y16 trn fiscal stimulus package. On top of that, the government has to fund a vast fiscal deficit. To do this, it is currently using a method that does not help, but hurts the economy: it issues large amounts of bonds and borrows its money from the bond market. The problem is that the bond market does not actually create new purchasing power. It merely re-allocates already existing purchasing power. To make cash available to buy those bonds, the bond market investors need to pull their money out of other forms of investment (for instance, investments in stocks or in corporate bonds, which would otherwise have funded corporate capital expenditure). As a result, the private sector has less money available for its own investments. Using bond funding means that every yen of additional government spending actually is taken out of the pockets of the private sector. We are currently in a credit crunch situation, which means that there is excess demand for funds. In this situation, MoF should not use up the already scarce existing purchasing power.

Instead, MoF should use a method of fund-raising that creates new, additional purchasing power. That way, investment by the private sector will not be reduced. There are two ways to do this: the Ministry of Finance can ask the Bank of Japan to print money and buy its bonds. This is partly happening and should continue. However, there is another method, which would additionally provide badly needed help to the banking system: Although banks are not keen to lend to small firms, as they now perceive them to be risky, they would be happy to lend to the government, because that carries zero risk. Not only would banks' business expand (helping them to earn normal profits on this business), more importantly, additional purchasing power would be created, which would boost overall economic activity. And the government spending would not reduce any private sector investment activity. In other words, the fastest way for the Ministry of Finance to kick-start bank loan growth and hence create additional demand in the economy, is to immediately stop all bond issuance and from now on raise all its needed funds by directly borrowing from banks. Should credit creation pick up so much that banks would hit their reserve requirements, the Bank of Japan should then supply more reserves to the banks, if necessary in the form of discount window loans. Opposition from stock brokers and their circles, who would lose underwriting commissions, should be ignored - the health of the banks has priority.

Reintroduce Window Guidance

Another, well-tested method to raise loan growth is to use BoJ window guidance. As happened for almost fifty years in the post-war era, the BoJ could simply order the banks to raise loan growth. If banks complain that they are worried about losing their money, then the government could set out a list of approved sectors, even firms, that need funding, that would use the funds productively and create jobs, and issue public guarantees for these loans. Firms could be made to compete for being put on this list. If some firms become insolvent, the BoJ could simply print money and refund the banks.

Suspend BIS ratio, mobilise foreign exchange reserves

In addition to this, measures to help banks write off bad debts should continue. This includes public funds, tax breaks for write-offs and BoJ purchases of newly issued preferred bank shares. Better still, the Bank of Japan should simply buy the bad debt from the banks at above-market prices, using newly printed money. Moreover, the government should exempt all banks from the BIS capital adequacy rules for 3 years. The international investment community would be shocked and the so-called Japan premium of Japanese banks would jump. That is no problem, however: The Japan premium is only relevant if banks want to borrow abroad. They do not need to: The BoJ can provide them with yen liquidity. And should they need US dollars, then the Ministry of Finance should simply use Japan's foreign exchange reserves, which are the biggest in the world, and lend them to the banks, at below international rates. The main objective of government policy must be to create a recovery, so that more Japanese people find a job again. To do this, the government should utilise all its resources, including the vast pile of foreign exchange reserves, which the Japanese people have earned through hard work. Currently, those foreign exchange reserves support the already strong US economy, because they are invested in US Treasury bonds. However, Japan has been in its worst post-war recession. Instead of helping the US economy, the Japanese government should instead think of its own people first.

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