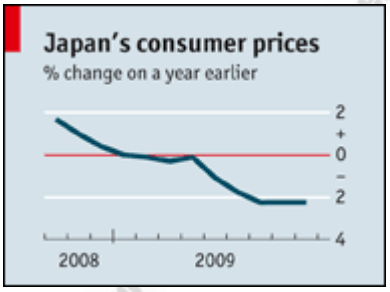
The curse of defeatism

Anybody who thinks deflation is no longer a threat should look at Japan and its flailing authorities.

Judging by the shrill comments from Wall Street, Japan's biggest problem is its huge public-sector debt, which has grown to nearly twice the size of the country's GDP. But it isn't (see article). Far more pressing is deflation.

On November 20th the new government of Yukio Hatoyama acknowledged what has been obvious for months: that prices are falling again after a three-year hiatus. This is worrying not just for Japan; countries such as America and Britain have more similarities with Japan than is commonly acknowledged (see article). Sadly neither the Hatoyama administration nor the central bank has shown any intention of tackling the latest incarnation of the deflationary curse.

That is a grave miscalculation. Prices in Japan may not yet be in a downward spiral, but deflation is entrenched: even the Bank of Japan (BoJ) acknowledges that prices may fall for at least another two years. The more they do so, the bigger the burden of Japan's debt becomes, and the more households and firms are likely to retrench. As it is, high real interest rates act as a powerful brake on Japan's incipient recovery.



Japan may have muddled through such scares before, most recently after a five-year splurge of liquidity unleashed by the BoJ between 2001-06. There may be some complacency that because deflation did not spiral downwards then, it will not do so this time. But a few years ago the world economy was strong and Japan could export its way back to health. This time around, global conditions are weaker and the yen is one of the world's strongest currencies. It is a credit to Japan's exporters that they are doing well despite such conditions. Largely thanks to them, Japan's economy jumped forward in the third quarter, though there are already signs that the pace of recovery may be slowing. But to nail deflation once and for all, bolder steps by monetary and fiscal authorities are needed.

The BoJ can start by being more assertive. It is almost as if it is so exasperated by the flaky achievements of its previous anti-deflationary efforts that it would rather sit back and wait for a recovery. But that is a defeatist attitude. If nothing else, it should publicly revive discussion of alternative plans to reflate the economy. That could include increasing government-bond purchases, or setting itself a monetary target not just based on a positive inflation rate, but on robust growth of nominal GDP. If the recovery falters, the BoJ could go further, exploring the use of negative interest rates on bank balances, which would encourage banks to lend money rather than hoarding it at the central bank. Such extraordinary measures would almost inevitably lead to a weaker yen, which would irritate Japan's trading partners. But Japan cannot get out of the deflationary mess if the yen keeps strengthening.

Mr Hatoyama's administration, meanwhile, should stop pestering the BoJ about deflation and face up to its own responsibilities. In the short run that includes keeping fiscal-easing

measures in place, at least until there is less deflationary slack in the economy. (So far the government has prevaricated about the need for continued fiscal stimulus.) In the longer term, it should strive to raise Japan's trend rate of growth, which many reckon has fallen to about 1% a year from 1.5-2% previously, as the population shrinks.

That means boosting productivity through labour-market reform, immigration policies and free trade, none of which the ruling Democratic Party of Japan has been keen on so far. Its goal of prompting growth in the underachieving domestic side of Japan's economy is a fine one, and certainly there is room for huge productivity improvements in some areas, particularly agriculture. But that should not come at the cost of harming exporters, which the DPJ has myopically threatened to constrain through union-friendly wage controls.

Big bang-bang

In short, Japan needs a double-barrelled big bang to jolt its economy back to life. If that threatens to spook investors, the authorities should have up their sleeve a credible long-term plan to restore order to public finances—but one which should be put in place only when growth is on a firmer footing and deflation has been truly licked. If the consequence of all this additional stimulus is a weaker yen, so be it. It will be a small price to pay if the eventual result is more openness and buoyancy in one of the world's largest economies.

THE curse of defeatism. **The Economist**, New York, Nov. 26th 2009. Disponível em: <www.economist.com>. Acesso em: 27 nov. 2009.

A utilização deste artigo é exclusiva para fins educacionais