Excerpt from *Collusion: How Central Bankers Rigged the World* by Nomi Prins

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In the fall of 2008, as the US financial crisis gained steam, the Bank of Japan (BOJ) shadowed the Fed's policies, including introducing and expanding its supply of dollar funds for use by Japanese banks. The central bank was also cutting rates and increasing the amount of JGBs (Japanese government bonds) it bought in exchange for providing money to banks.

Two BOJ governors presided over the early-crisis through post-crisis period. The first was soft-spoken Masaaki Shirakawa – a bird-watcher in his spare time. He reigned from April 9, 2008, to March 19, 2013. The second was Haruhiko Kuroda, handpicked by prime minister Shinzo Abe for his dovishness. Kuroda took the helm on March 20, 2013, and proceeded to conjure money faster than any other central bank leader – including Ben Bernanke – ever had.

Shirakawa served under an array of six different prime ministers during a frenetic political period in Japan. The shifting of those bureaucratic deck chairs eventually landed Shinzo Abe in the prime minister post for a second run, and with that the end of his career at the BOJ.

Despite acting as central command for monetary policy, the strategies that the Fed perpetuated post-financial crisis were not created by the Fed. The Bank of Japan was the original G7 money conjurer, formulating an early version of quantitative easing in 2001.

In turn, Shirakawa was the major catalyst behind the creation of QE. Kuroda later followed in his tracks to become a long-time advocate of ultra-loose monetary policy.

Japan first used the QE method between 2001 and 2006 in response to a severe financial and banking crisis in the late 1990s. The governor of the BOJ at the time was Masaru Hayami, under whose direction the BOJ first set rates to zero (in 1999) and thereafter introduced QE. In his last speech about QE before leaving the BOJ in 2003, he said, "In March 2001 the Bank entered uncharted waters by adopting a quantitative easing framework. Commercial banks' current account deposits held at the Bank were adopted as a main target of money market operations, and ample liquidity has been provided." The amount of liquidity provided under his tutelage would be eclipsed by post-crisis maneuvers.

Later research showed the program had little effect on Japan's consumer price index (CPI) or inflation levels, which it was designed to boost. But it helped financial institutions in need of cheap money.

Regardless, in November 2008, the Fed began its first version of quantitative easing (QE1), or large-scale asset purchases, as one of an array of money-conjuring techniques. Under QE1, the Fed created money to buy mortgage assets from ailing big banks. According to the St. Louis Fed, one of the twelve banks comprising the US Federal Reserve System of which the Fed is the most powerful and central one, "In a nutshell, QE entails unusually large purchases of assets by a central bank financed by money creation." Unusually is the operative word.

THE POINT OF NO RETURN

On February 27, 2008, in his semiannual report to Congress, Bernanke expressed concerns over the US economic situation, the credit and job market, and housing price contraction. He promised that the Fed would focus on reestablishing economic activity, leave inflation control as secondary, and keep reducing rates as it had been doing since August 2007. Bernanke did so with cautious optimism. "Although the FOMC participants' economic projections envision an improving economic picture," he said, "it is important to recognize that downside risks to growth remain."

The first shoe was about to drop for Japan. The fifth largest US investment bank, Bear Stearns, was nearing collapse. On March 16, 2008, Henry Paulson, US secretary of the Treasury, defended the Fed's decision to allow US banking behemoth JPMorgan Chase to buy Bear Stearns, one of Goldman Sachs's rivals, with government help. "Our financial institutions, our banks and investment banks are very strong," he said. "I'm convinced that they're going to come out of this situation very strong." His words were prescient. Big banks did very well after the crisis.

The news propelled the yen to a thirteen-year high against the dollar, at ¥95.77. Some traders saw this as an opportunity to buy dollars, while investors questioned the wisdom of keeping dollar-denominated assets at all. Japan was trapped in a tricky position: it was a main Asian superpower but dependent on the US economy and dollar movements.

In response, the BOJ flooded the banking system with $4.1 billion to promote liquidity. Japan's Nikkei 225 index rose 1.5 percent to 11,964 on the injection; but that was after an 8 percent decrease that pushed the index to its lowest level since 2005.

Fear of another episode reminiscent of the late-1990s banking crisis in Japan was palpable, and domestic disputes over how to avoid it intensified. That period coincided with a major change in the leadership at the BOJ. Sitting BOJ chairman Toshihiko Fukui ended his term on March 19, 2008, after a forty-year tenure. An impasse over the next governor followed in which politics dictated the path of monetary policy. It was a matter of grave embarrassment to the government that it couldn't agree on a central bank leader, especially when the role and power of developed country central banks were so prominent.

Still, Japan's prime minister Yasuo Fukuda of the Liberal Democratic Party (a center-right to right-wing party) could not easily find a replacement who would be approved by the opposition party. The party didn't like his suggestion of Koji Takami, a Ministry of Finance bureaucrat; they wanted to avoid government influence over the BOJ. In the end, they chose Masaaki Shirakawa because he was a career central banker and trusted enough by all parties. Many observers saw him as the mastermind behind the unorthodox policy of quantitative easing that the central bank had introduced in March 2001.

Shirakawa was born in Fukuoka, Japan, on September 27, 1949, the year the Tokyo, Osaka, and Nagoya stock exchanges opened. He studied law as an undergraduate at the University of Tokyo. After graduating, he was hired by the BOJ in 1972. Inflation shot to 25 percent shortly afterward. The prevailing high-inflation period coupled with oil price shocks stuck with him. He became wary of asset bubbles and later the risks of the QE strategies that he would create.

In 1977, he received a master's in economics from the University of Chicago, known for its free market ideologies; this was the same year that World Bank chief economist Paul Romer and Obama adviser David Axelrod earned their undergraduate degrees there. In 1995, he spent time in New York City as the BOJ's general manager for the Americas.

At the BOJ, he held a variety of monetary policy and financial stability positions, including executive director between 2002 and 2006, and was one of the key architects of the quantitative easing programs designed to combat the domestic banking crisis. After he left in July 2006, he taught at the Kyoto University School of Government until March 2008. According to Reuters, "Those who have worked for Shirakawa describe him as a workaholic and a perfectionist. His few pleasures outside work include listening to the music of the Beatles and catching an occasional movie."

Shirakawa assumed his role as the thirtieth governor of the BOJ on April 9, 2008. From the start, he was troubled about the extent to which credit conditions in Japan were already beginning to constrict, as they were in the United States. He kept the overnight call rate at 0.1 percent, but he made it clear, albeit cautiously, that he would take action to provide liquidity to the Japanese markets if he had to. "As with private-sector economic entities, complacency is the most dangerous risk for central banks," he said. "We need to be humble as numerous challenges await the global economy. My colleagues and I at the Bank of Japan will continue to come to grips with these challenges, working in cooperation with fellow central bankers, and financial supervisors and regulators. In finishing my remarks, I would like to request you in the private sector for your continued support and assistance, so that central banks can continue to progress." As worried as he was about the environment, he believed that there could be no solution to its pressures without collaborating, or colluding, with other central banks.

On May 23, 2008, while addressing Japan's National Press Club, Shirakawa talked up the barrier between the health of Japan and the chaos from the United States. He said, "It seems that Japan's economy has become more resilient to negative shocks than in the past [and] is expected to return to a moderate growth path." The world was getting more frenetic and Japan could not sit by idly and wait for a financial bomb to drop.

By August 2008, the BOJ emphasized it "would implement appropriate policies in an accordingly flexible manner." It hadn't taken long to go from publicly expressing confidence in the Japanese economy to adopting the Fed's policies of injecting money into its financial system.

The September 16, 2008, collapse of Lehman Brothers catapulted the yen up against the dollar, as a safe haven, causing it to log its highest daily gain since 2002. Meanwhile, the Dow experienced its biggest fall since September 11, 2001.

The US government decided not to save Lehman Brothers from bankruptcy. Other measures were put forth in efforts to enhance the stability of the international financial system, which was losing the confidence of the public and the institutions composing it. For the first time in ninety-five years, the Fed decided to accept equities as collateral for cash loans. It expanded emergency lending programs, while other key central banks, such as the ECB and Bank of England (BOE), injected money into their own financial systems.

On September 29, the US House of Representatives rejected a proposed $700 billion rescue package for banks, unleashing international panic. As a result, the Standard & Poor's 500 stock index fell almost 9 percent and the DJIA decreased nearly 778 points (almost 7 percent) to 10,365.4. The Nikkei shed about 500 points. Three European banks went bankrupt.

The allied central banks moved to jointly cut rates on that fateful day, October 8, 2008. As part of the coordinated measure, the Fed lowered its target for the federal funds rate by 50 basis points to 1.5 percent. The ECB cut rates by 50 basis points. The BOJ said it "welcomes the policy decisions made by six central banks" and engaged "in decisive actions of liquidity supply, ranging from the uninterrupted provision of ample yen liquidity in the market to the introduction of US dollar liquidity operations." It didn't cut rates yet. They were already too low.

As Shirakawa told the joint annual gathering of the IMF and World Bank in Washington on October 13, 2008, "In response to elevated strains in the global financial market, the Bank of Japan, with other central banks, has taken coordinated action to provide US dollar liquidity, and it has supported interest rate cuts implemented by other major central banks."

Nine days later, the yen hit another high against the dollar on risk aversion capital flows (a thirteen-year record) and the euro (a six-year record). An emerging markets crisis deepened. Many developing countries were in talks with the IMF about financing in case of a liquidity squeeze. Some central banks, such as Brazil's, were forced to intervene to boost liquidity.

On October 27, amid the turmoil, the yen became a target. The G7 chose to express dissatisfaction with the stronger yen, considering it a threat to international stability, because it could have adverse implications for economic stability. It was a ridiculous stance given the fact that the United States had just shown itself to be reckless in managing its financial system, so castigating Japan for being the recipient of speculative capital was misplaced criticism – Japanese money was simply returning to Japan from emerging markets, and speculators were riding the wave. Of all the issues caused by the rashness of the US banks, the G7 body considered yen appreciation to be the culprit harming developed nations' way of managing the international economy. Specifically, the G7 was "concerned about the recent excessive volatility in the exchange rate of the yen" and its "adverse implications for economic and financial stability."

The Fed had its own problems, with a US banking system lacking internal confidence and starved for liquidity. On October 29, the Fed cut rates another 50 basis points – to 1 percent for the federal fund rates and 1.25 percent for the discount rate. It noted, "Coordinated interest rate cuts by central banks, extraordinary liquidity measures, and official steps to strengthen financial systems should help over time to improve credit conditions and promote a return to moderate economic growth."

Then came the kicker. Two days later, for the first time in seven years, the BOJ announced it would cut rates. This was one day after the Japanese government announced a $51 billion stimulus package. The key interest rate (uncollateralized overnight call rate) dipped from 0.5 percent to 0.3 percent. The Nikkei fell 5 percent and the yen appreciated counterintuitively after the announcement.

According to Shirakawa, "A reduction in policy interest rates and a further increase in the flexibility of money market operations were necessary to maintain accommodative financial conditions." He likened the situation to the Great Depression of the 1930s.

He explained, "The turmoil in financial markets that began in the summer of 2007 as well as its impact on economic activity were, at first, limited to the US and European economies, but have since gradually spread to Japan as well as to emerging economies. This global turmoil has now become the largest problem facing the world economy."

The central bank moves so far weren't enough to restore confidence to the markets or to ordinary people watching their pensions dwindle and home prices dive. On December 16, the Fed cut the federal funds rate to 0.25 percent. It was the first time it cut rates below 1 percent. That caused the dollar to fall sharply against the yen to levels last touched in July 1995.

The BOJ was widely expected to swing into even bolder action. And that's exactly what it did. On December 19, it slashed the uncollateralized overnight call rate by 20 basis points to 0.1 percent. The motivation reflected the alarming speed with which the US banking collapse spread to the world economy. "Exports have been decreasing, reflecting a slowdown in overseas economies, and domestic demand has become weaker against the background of the declining corporate profits and the worsening employment and income situation in the household sector." The BOJ increased purchases of government bonds from ¥1.2 trillion to ¥1.4 trillion per year.

Shirakawa denied this was a return to the old QE policy. After the 1990s banking crisis, a 1998 law officially declared the BOJ independent from the government to promote "price stability." Shirakawa was trying to preserve that independence and not yield to government pressure to go full throttle on QE in order to accommodate the Fed.

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