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Market Watch

This Market 'Was Primed for a Reversal'
2/1/2005 6:14:07 PM

Market Report

Oil Prices: The 'Top' News Story in 2004 and the REAL Story
1/24/2005 5:40:54 PM

Futures Focus

The 'One Shortcut to Obtaining Experience'
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Global Wrap

Bond, James Bond: Ready for a Fast Ride?
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Archive

Articles for the Month:

Somebody call the DoJ,
Marginal Revolution are seeking to dominate the market for economics blogs! As Alex Tabarrok's interview suggests, there are significant first-mover advantages for those who have the entrepreneurial insight to recognise that economics is still underrepresented in the blogosphere. It is just as well Marginal Revolution are only intellectual entrepreneurs. Commercial entrepreneurs would be setting themselves up for anti-trust action were they to put in writing their intention to dominate a market.

posted on 3/31/2004

For those of you entertaining retirement fantasies,
check out Fred Bastiat's 17th century French manor house, which is on the market for under half a million euros. People pay as much to live in gentrified 19th century working-class cottages in Sydney!

posted on 3/29/2004

Samuel Brittan
reviews Clive Hamilton's *Growth Fetish*: *Hamilton's Achilles heel is his belief that neo-liberals, with whom he identifies nearly all academic economists, are at the root of all the evils he discusses. It so happens that I bought his book on the fourth floor of a large and serious bookshop. There was just one small section devoted to academic economics, with just as many texts attacking or qualifying free market economics as endorsing it. Most of the surrounding space was taken up with business books and the like, while a few yards away there were stacks of volumes of a New Age kind. The best and most attractively laid out section was on popular science. The author's claim to unmask neoliberal economists falters when he shows very little awareness of who they are or their distinctive doctrines. Friedman and Hayek always turn up as identical twins without any discussion of their differences or any mention of other neoliberals. Hayek's main concern was the advance of civilization and he avoided discussing GDP numbers or even happiness. Friedman's main concern is with individual freedom. But he regards that as a personal value judgment. Professionally he is concerned to show that a free market economy can also deliver rising living standards. Both writers formed their outlook, to some extent defensively, at a time when many people, including CIA analysts, feared that Soviet communism would eventually produce far greater wealth than the capitalist West.* Brittan amusingly notes that the 'Genuine Progress Indicator,' which Hamilton advocates as a measure of welfare at the expense of GDP, shows a happiness peak for the UK - *in 1976*!

posted on 3/26/2004

European Market Watch

Good News...Where's the Bad News?
1/28/2005 5:26:37 PM

Fallen and I Can't Get Up: Is the U.S. Dollar About to Crash ... Again? Learn More.

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posted on 3/26/2004

Robert Levy
gives the background to the latest outrageous attack on Microsoft in the name of the competition policy: *the entire process has been instigated by US-based competitors that have failed repeatedly within the American legal system to accomplish what they have been inept at accomplishing within the global marketplace...Far from promoting consumer interests, the latest EU order transforms antitrust regulation into a corporate welfare programme for market losers. The implications will not be confined to the Microsoft case. Without some semblance of regulatory consistency, companies competing globally will not be able to satisfy the dictates of divergent legal regimes. That means special interests pursuing their favourite antitrust forum in an effort to exercise the most political clout. The real costs: fewer jobs, less innovation, inferior products and higher prices.* The rent-seeking antics of its competitors is reason enough to embrace Microsoft products.
posted on 3/26/2004

***The Economist* tries to suggest that Australia's economy**
'now looks not like Mexico's, but like that of its bigger neighbour, the United States - just before its bubble burst in 2000...Australia has become another hotbed of irrational exuberance.' *The Economist's* evidence for this is at best superficial. First, there is the obligatory reference to Australia's current account deficit, which *The Economist* notes is 'even bigger than America's.' All this tells us is that the Australian economy is outperforming the rest of the world and that investment demand exceeds domestic saving. As *The Economist* notes, 'the country has run a deficit continuously for 30 years.' This in itself should tell them something: contrary to popular belief, you can run a current account deficit continuously if the rates of return on domestic investment are high enough. The day Australia starts running current account surpluses will be when we really have to worry. *The Economist* also cites Australia's household saving ratio turning negative, increased household borrowing, the investment property boom and house price inflation. *The Economist* is quick to blame the latter on the 'government's tax policies,' but this claim does not stand up to scrutiny. These developments are common to all the Anglo-American economies. A global price shock to a particular asset class can hardly be explained in country-specific terms. This is not to say that fiscal policy has not played a role in the massive volatility of dwelling investment spending in Australia since 2000. But this has nothing to do with irrational exuberance: it is simply an illustration of the hazards of activist fiscal policy. The prospect of another sharp downturn in dwelling investment is well within the terms of Australia's recent business cycle experience. Indeed, Australia came within a whisker of a technical recession at the end of 2000 partly due to a fiscal policy-induced downswing in dwelling construction. The negative wealth effects from a sharp fall in house prices might be more problematic. But it is certainly not necessary to invoke 'irrational exuberance' to explain either the recent run-up in house prices or any subsequent correction. Doing so adds nothing to our understanding of these developments, although probably does serve as a useful cloak for *The Economist's* lack of depth in its discussion of the Australian economy.

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UPDATE: Should it come as a surprise that *The Economist's* analysis appeals to the op-ed contributors over at the *Spencer Street Soviet*?

posted on 3/24/2004

Mercantilist thinking thrives in Japan,
if we are to take either of these two items seriously. National Institute for Research Advancement has released an index which purports to measure 'comprehensive national might,' in which Japan ranks third after the US and Germany. The index includes a measure of 'economic power,' and takes into account such things as 'military and government administrative ability.' Surprisingly, there is no mention of national gold hoards, or its modern equivalent, foreign exchange reserves. At the same time, METI has lost none of its faith in its ability to centrally plan the Japanese economy: *Economy, Trade and Industry Minister Shoichi Nakagawa on Tuesday proposed strengthening Japan's industrial competitiveness by designating priority sectors and making them driving forces for the national economy in the future... The government designated seven priority areas it believes are likely to support domestic demand-led growth in Japan, the official said, adding that small as well as large companies are to be fostered under the proposal. The seven areas are fuel cells, robots, information appliances, software contents, health and welfare equipment-related services, environmental equipment-related services and business support services. METI will forge a complete strategy to implement the proposal in early May, including promoting research and development by the public and private sectors and taking necessary deregulatory measures, the official said.* Unfortunately, the 'necessary deregulatory measures' do not include getting rid of METI.

posted on 3/24/2004

Ross Gittins
on the Australian Labor Party's proposed changes to superannuation contributions tax: *On my rough figuring, his cut would have a full-year cost of up to $700 million. That's money that **won't** be spent on universities or government schools or public hospitals.* The naïve assumption that more government spending on the public provision of health and education is necessarily a good thing goes a long way to explaining why Ross never met a tax cut proposal he liked.

posted on 3/23/2004

Institutional Economics
receives an honourable mention in an *AFR* Perspective story on blogging. Author Trevor Cook credits John Quiggin, Peter Gallagher and myself with having 'provided a stream of excellent analysis of the recent free trade agreement negotiations.' He cites this as an illustration that 'bloggers can provide additional depth to the daily coverage of issues in their area of expertise.' Cook notes that 'blogging is still fairly limited in Australia.' There are probably still significant first-mover advantages to be had for prospective Australian bloggers, especially those with a distinctive perspective reflecting specialised knowledge or experience. One gap I would like to see filled is that for serious Australian political commentary. There is an enormous potential opportunity here, especially in an election year. I think an ad hoc group blog devoted to the election could have a big impact, especially given that elections bring out the worst in the federal parliamentary press gallery. Andrew Norton notes that serious political and cultural magazines have a poor track record in

Australia. But with the blogging medium eliminating many of the costs associated with print publications, an on-line effort might stand a better chance of commercial success.

posted on 3/22/2004

The Reserve Bank of New Zealand

has released a discussion paper giving the background to its request to the Minister for an expanded capacity to intervene in foreign exchange markets. In particular, the RBNZ is seeking a capital injection and an augmentation of its foreign exchange reserves in order to mount intervention operations. As discussed in a previous post (see below), the RBNZ is arguing that it should abandon its previous non-interventionist stance to 'dampen the exchange rate cycle,' selling the NZD when it is 'exceptionally and quite clearly unjustifiably high,' and buying the currency when it is 'exceptionally and clearly unjustifiably low.' The RBNZ apparently now evinces little faith in market-determined exchange rates. In particular, the RBNZ is now saying that it has 'clear' knowledge of when the exchange rate is out of line with fundamentals. This would seem unlikely. Indeed, the RBNZ's faith in its ability to make this determination is belied by its own discussion of how this policy might have operated during the large exchange rate fluctuations of the 1990s: *We have not performed an exercise of re-running history to see whether intervention as proposed might have been used in the past. Such an exercise is, by its very nature, difficult as there are no rules that can be easily applied to tell us when we would have intervened and when we wouldn't have.* If this is a difficult exercise to conduct historically, then it is an exercise that is even more fraught with difficulty when conducted in real-time. The RBNZ is cautious in not overstating the benefits of the proposed intervention policy and even concedes that 'our general assessment is that foreign exchange interventions as proposed can be effective, but that their impact is usually small and possibly temporary.' The rationale for the proposed intervention is that exchange rate volatility imposes costs on the economy. Yet no account has been taken of the increased volatility that is likely to result from the market having to second-guess the RBNZ's intervention operations. The change in policy at the RBNZ is a disturbing sign that those who think that asset prices should be the target of public policy are gaining the upper-hand. Governor Bollard's theme song must be *I think I'm turning Japanese*! **UPDATE:** I should have also mentioned Ed Nelson and Nicoletta Batini's paper, 'When the Bubble Bursts: Monetary Policy Rules and Foreign Exchange Market Behavior.' It shows, using UK data, that there are welfare losses if monetary policy reacts to exchange rate 'bubbles,' and volatility is not even necessarily reduced.

posted on 3/18/2004

The Economist

invokes folk wisdom: *Some readers might believe that we are obsessed with bubbles. Yet even normal folk cannot ignore the vast amounts of froth around at the moment.* Unfortunately, most of the froth is in *The Economist's* writing about monetary policy and asset prices.

posted on 3/18/2004

Ross Gittins
claims that the middle-class aversion to public schools and hospitals is driven by status-seeking and accuses the government of pursuing policies that encourage the consumption of basic services as 'positional goods.' Gittins' claim that these services are being consumed as positional goods is true in one sense: avoiding the NSW public hospital system might just help keep you in a vertical position, rather than consigning you to a horizontal position on a permanent basis. As the litany of horror stories from the public hospital system strongly argues, middle-class flight from the public provision of private goods is driven by the knowledge that governments are simply not competent to provide these services. Far from being an exercise in status-seeking, the enormous financial sacrifices many families make to pay for services that are made available from the government for free is a damning indictment of public provision. When you can't even give the stuff away, you know there is a serious problem. Public provision turns these services into inferior goods: consumption falls as income rises. Gittins' belief in lavishing more funds on public provision of these services at the expense of subsidising private alternatives is a massive triumph of hope over experience.

posted on 3/17/2004

Bank of Japan Superhero!
A Japanese comic strip appearing in a humour magazine features a Bank of Japan executive as one of its characters. The executive tries to do a secret deal with the US due to his concerns about the Bank's excessive yen selling interventions in foreign exchange markets. According to the *Nikkei*, the comic strip is very popular with BoJ officials, who are clearly uncomfortable with the extent of their intervention in the market at the direction of the MoF. There is a concern in the BoJ that a reversal in the direction of the yen could induce massive capital losses on Japan's USD 777 bn in foreign exchange reserves. Indeed, Peter Morgan puts the yen value of these reserves at acquisition prices at around 18% of nominal GDP. However, I agree with Morgan that there is unlikely to be a change in foreign exchange intervention policy by the end of month, as the Nikkei report would have us believe, because the MoF is unlikely to be moved by the BoJ's concerns over prospective capital losses.

posted on 3/16/2004

The Spanish election outcome.
The guys at Hispalibertas were among the first to link to Institutional Economics and now is an opportune time for me to return the favour in light of developments in the last week. Be sure to also check out Iberian Notes. Andrew Norton makes a chilling observation in terms of the implications for Australia's own upcoming federal election, although my guess is that any such terrorist action would greatly strengthen rather than weaken the position of the incumbent conservative government. At the same time, Mark Steyn makes a welcome appearance in the local press on the same subject.

posted on 3/15/2004

Paul Krugman's
interview with the Australian Broadcasting Corporation's Lateline program can be found in transcript here. Unfortunately, the transcript does not fully capture the stammering and squirming that took place when Don Luskin's name was mentioned by interviewer Tony Jones. I have never seen an interviewee look so uncomfortable, if only momentarily.

posted on 3/12/2004

The Reserve Bank of New Zealand
has taken a backward step, seeking wider authority to intervene in foreign exchange markets to influence the value of the exchange rate. Up until now, the RBNZ has taken a non-interventionist stance with respect to foreign exchange markets. Indeed, the Bank at one stage seriously questioned the need to maintain foreign exchange reserves at all. But there appears to have been a significant change in the intellectual climate at the Bank under Governor Bollard. It is not coincidental that Bollard has also recently expressed sympathy for the idea that central banks should target asset prices. According to the Governor: *We have recommended that when the New Zealand dollar is exceptionally and unjustifiably high, the Reserve Bank would be able to use New Zealand dollars to buy foreign exchange, which would put downward pressure on the exchange rate. And, when the exchange rate is exceptionally and unjustifiably low, we would be able to sell foreign exchange to buy New Zealand dollars, putting upwards pressure on the exchange rate. By unjustifiable, we mean when the exchange rate has moved to a level in excess of that readily explained by the relevant economic fundamentals, which occurs only infrequently. This process is similar to that used for some years by the Reserve Bank of Australia.* The RBA would I think reject the idea that it was seeking to influence the *level* of the exchange rate, although it does in fact intervene frequently in the market. In recent years, the RBA's interventions have taken on something of the character of a proprietary trading operation, buying the currency when cheap and selling it again when high, even when market volatility is quite low and there is no obvious need for 'smoothing.' There is something of a disconnect between the RBA's official 'smoothing' rationale for intervention and the increasingly routine character of its intervention operations. For the RBNZ to be using the RBA as a model in this regard is disturbing. Together with recent changes to its Policy Targets Agreement, the RBNZ has lost much of what made it distinctive in recent years. Perhaps that is the price New Zealand has to pay for giving former Governor Brash a shot at the Prime Ministership. Contrary to the predictions of some, Brash is turning out to be quite a popular opposition leader.

posted on 3/11/2004

Ian Vasquez
on the changing of the guard at the IMF: *Anne Krueger's assumption as acting head of the International Monetary Fund will not change the fact that the IMF is primarily a political institution, not an economic one. Last fall, the IMF approved a new loan to Argentina in the absence of policy progress and after the country had defaulted on IMF debt. That occurred because of pressure from the U.S. Treasury Department despite objections from IMF staff and management. Dr. Krueger can be expected to be a tougher negotiator, but we can also expect the G-7, and the United States in particular, to still make the big decisions affecting IMF lending. The crisis in Argentina highlights the backwardness of international lending to emerging markets. By making debt repayments to the IMF and other official lending institutions senior to repayments to private sector creditors, a perverse set of incentives is created. Official creditors, who "always get paid back" and whose lending is based on political considerations, face little or no accountability in the market, thereby reducing their discipline and that of their clients. On the other hand, private creditors, who have an incentive to lend only if credible reforms are actually forthcoming, are in effect forced to subsidize official sector irresponsibility. An Argentinean default on the IMF might do some good to the international financial system, though it would do little to help Argentina. It would be far better if Argentina began dealing seriously with its private creditors and told the IMF that its loans were no longer a priority -- a prospect that is unlikely to happen given the perverse incentives the IMF has set up.*

posted on 3/10/2004

James Dorn
points to new evidence confirming that 'Lord Bauer was right:' *It is widely assumed that to be effective foreign aid should be linked to a needy country's adopting sound institutions and policies. That belief lies behind the Bush administration's decision to set up the New Millennium Challenge Account, intended to increase aid by 50 percent over the next several years. However, in a new study in the Cato Journal, Harold Brumm, an economist with the federal government, finds that "foreign aid has a negative growth effect even where economic policy is sound." Brumm examines data for 53 underdeveloped countries and finds a statistically significant but negative relationship between aid to countries with good policies and growth of real gross domestic product per capita. His results cast doubt on a much-cited study by World Bank economists Craig Burnside and David Dollar, who concluded in "Aid, Policies, and Growth" (American Economic Review, 2000): "We find that aid has a positive impact on growth in developing countries with good fiscal, monetary, and trade policies, but has little effect in the presence of poor policies."... It is tempting to think that aid can be targeted to countries with good policies and have a positive impact. However, once we recognize that all aid is political, since it is government-to-government assistance, we should not be surprised that it has either no effect on development or a negative effect. Moreover, the World Bank continues to give substantial aid to countries with poor policies... Free private capital markets, not the World Bank or the International Monetary Fund, can judge whether policies are good or bad. Those countries that walk the walk of the free market will find the capital they need for development. Private lenders, in the absence of bailouts by the IMF, will have an incentive to direct capital to where it has the highest risk-adjusted return, and that will be to countries following good policies. Hong*

Kong's development path of free trade is far superior to the dead end of aid.

posted on 3/9/2004

Alan Reynolds

on US Presidential elections and the interest rate cycle: *In short, incumbent presidents usually do better when the Fed is pushing rates up than when it is pushing rates down, unless high inflation is involved (1980). This is not as paradoxical as it may sound. Falling interest rates are usually a sign of economic distress, while a reasonable rise in interest rates is a routine side effect of a vigorous economic rebound. It makes neither economic nor political sense to sell stocks cheap out of fear that the lowest interest rates in modern history are sure to move a bit higher, sooner or later. When the herd sells good stocks for bad reasons, I buy.*

posted on 3/8/2004

A number of my former colleagues have formed Action Economics,

a new wholesale financial markets consultancy. Having previously worked with most of their analytical team, I can highly recommend their service to anyone with an interest in financial markets. Here is the spiel from their website: *Action Economics, LLC provides a new breed of commentary to support trading-room decision-making in the global fixed income and currency markets. The partners of Action Economics spearheaded the early innovations of real-time market commentary with the development of MMS International, the industry leader of its time. After managing its award-winning content for over two decades, this team of seasoned economists and analysts now plans to take analysis to a new level. Our goal is to produce Highly Actionable commentary that raises standards for the real-time information industry.*

posted on 3/6/2004

Australia has rocketed into the top 20 of A T Kearney's Globalisation Index

at 13th from 21st in the previous survey. Yet their discussion of the reasons for Australia's elevation can only make one suspicious of the survey's overall methodology. The report credits Australia's strong FDI inflows, yet Australia runs the fifth most restrictive FDI regime in the OECD, suggesting that no account is being taken of the opportunity cost of Australia's institutionalised capital xenophobia. The report also says that: *Automobile companies such as Ford and Mitsubishi Motors selected Australia for their regional operations and research and developments centres, reflecting the country's attractive combination of high productivity and low operating costs.* Not to mention tariff protection and generous government subsidies, measures designed specifically to act as an offset to globalisation, not promote it! Are these guys running a globalisation or a mercantilism index?

posted on 3/5/2004

Robert Feldman

is one of the best economists writing about Japan today and one of the few to understand the political economy of Japanese monetary policy. In the course of fisking his colleague Stephen Roach, he more or less summarises my own view about the role of monetary policy in Japan's recent experience of the business cycle: *I would agree that the failure to raise interest rates in 1988 was a blunder. However, the failure to cut rates quickly after the collapse of the equity bubble in 1990-91 was not necessarily a mistake. From pure macro considerations, inflation was still on its way up in 1990-91, as aftereffects of the 1980s bubble kept product and factor markets tight. Land prices were still rising. In addition, financial institutions continued to miscalculate their levels of non-performing assets, and to throw good money after bad to more and more questionable borrowers. The financial regulatory authorities (at the Ministry of Finance) were light-years behind the curve, and the BoJ had no legal powers in this area. Finally, even if one believes that macro-policy action was needed in the aftermath of the drop of equity prices (which were acknowledged by virtually everyone at the time to be too high anyway), the BoJ acted earlier and more aggressively than did fiscal policy. Indeed, PM Miyazawa waited until August 1992 before triggering any major fiscal response; BoJ rate cuts began in July 1991. In short, both the fiscal authorities and the regulatory authorities had their heads in the sand in 1990-92, and the BoJ is getting the blame.*

posted on 3/5/2004

John Makin of the American Enterprise Institute

is critical of Japan's massive intervention in foreign exchange markets, but for all the wrong reasons. Makin argues that: *If the Bank of Japan would stop sterilizing its currency intervention (i.e., withdrawing from domestic money markets the yen it uses to buy dollars), Japan's money supply would rise rapidly and help to end deflation. As it is, the sterilization helps to perpetuate chronic yen appreciation.* It is true that the increase in current account deposits at the Bank of Japan has not reflected the size of its interventions in foreign exchange markets on behalf of the MoF, implying almost complete sterilization, although there have been some episodes of unsterilised intervention in recent times. But in a zero interest rate environment, there is no real difference between sterilized and unsterilised intervention. To illustrate, base money in Japan grew 16.2% in the year to February, 16.4% in 2003 and 25.7% in 2002. In 2001, base money growth exceeded 30% and its highest ratio to nominal GDP in a century, yet this did little for nominal GDP growth or broader money and credit aggregates. Unsterilised intervention would make almost no difference in this context. Those who advocate naïve monetarist policy prescriptions for Japan need to take a look at the data on velocity and the money multipliers, which have collapsed to record lows. Makin's characterization of Japan as suffering 'intensifying deflation' is also wide of the mark. His claim of a '4 percent-plus deflation rate at the end of last year' could only be justified by annualising the quarterly data. The year on year rate for the GDP deflator was -2.6% in Q4 and -2.1% in Q3. The CPI, which is the more relevant measure for monetary policy, is showing an annual growth rate that is close to flat, having seen a distinct moderation in the rate of deflation in recent months. This looks more like price stability than 'intensifying deflation.' By drawing the link between foreign exchange market intervention and monetary policy, Makin is falling into the intellectual trap that

Japanese officials have set to help make their attempt at running a de facto fixed exchange rate regime look more respectable.

posted on 3/4/2004

Speeches from Alan Greenspan
have been thick on the ground in recent weeks. I would, however, strongly commend his speech to the NY Economic Club on the current account and exchange rates. Greenspan does an excellent job putting recent developments in perspective, providing a useful corrective to some of the lazy commentary on the subject that characterises publications like *The Economist*. The widely held view that foreign exchange market intervention by Asian central banks is underpinning the euro and US Treasuries gets the critical scrutiny it deserves: *But a more likely possibility is that Asian currency intervention has had little effect on other currencies and that the trade-weighted average of the dollar is, thus, somewhat elevated relative to the rate that would have prevailed absent intervention. When Asian authorities intervene to ease their currencies against the dollar, they purchase dollar-denominated assets from private sector portfolios. With fewer dollar assets in private hands, the natural inclination to rebalance portfolios will tend to buoy the dollar even against currencies that are not used in intervention operations, including the euro. These transactions raise the dollar against, for example, the yen, lower the yen against the euro, and lower the euro against the dollar. The strength of the euro against the dollar thus appears to be the consequence of forces unrelated to Asian intervention. As I will explain later, this does not mean that when Asian intervention ceases the dollar will automatically fall because other influences on the dollar cannot be foreseen. Some have argued that purchases of U.S. Treasuries by Asian officials are holding down interest rates on these instruments, and therefore U.S. interest rates are likely to rise as intervention by Asian monetary authorities slows, ceases, or even turns to net sales. While there are obvious reasons to be concerned about such an outcome, the effect of a reduction in the scale of intervention, or even net sales, on U.S. financial markets would likely be small. The reason is that central bank reserves are heavily concentrated in short-term maturities; moreover, the overall market in short-term dollar assets, combining both public and private instruments, is huge relative to the size of asset holdings of Asian monetary authorities. And because these issues are short-term and hence capable of only limited price change, realized capital losses, if any, would be small. Accordingly, any incentive for monetary authorities to sell dollars, in order to preserve market value, would be muted.* I would, however, take issue with one aspect of Greenspan's analysis, when he says: *Granted the level of intervention pursued by the Japanese monetary authorities has influenced the market value of the yen, but the size of the impact is difficult to judge. In any event, it must be presumed that the rate of accumulation of dollar assets by the Japanese government will have to slow at some point and eventually cease. For now, partially unsterilized intervention is perceived as a means of expanding the monetary base of Japan, a basic element of monetary policy. (The same effect, of course, is available through the purchase of domestic assets.) In time, however, as the present deflationary situation abates, the monetary consequences of continued intervention could become problematic. The current performance of the Japanese economy suggests that we are getting closer to the point where continued intervention at the present scale will no longer meet the monetary policy needs of Japan.* There may well be limits on

the accumulation of dollar assets, but there are few limits on the ability of a country to weaken its own currency, in contrast to the limits that foreign exchange reserves place on the ability of the authorities to strengthen their own currency. I also disagree that Japan's foreign exchange market intervention, even when unsterilised, has anything to do with monetary policy. Japan's intervention in foreign exchange markets is at the direction of the MoF, not the BoJ, and has a barely disguised mercantilist rationale. To the extent that the Japanese authorities make the link to monetary policy, it is only to make their policy of running a de facto fixed exchange rate regime look more respectable. The Ministry of Finance have never been overly committed to market-determined exchange rates.

posted on 3/3/2004

Capitalist acts between consenting adults.

This story nicely illustrates how consumption taxes bureaucratise virtually every transaction in an economy: *The GST as applied to stripteases and lap dances is so confusing that the Australian Taxation Office has had to withdraw a previous "interpretive decision" and replace it with three new ones to try to explain just who pays what when somebody goes the full monty. The new decisions, titled "GST and adult entertainment services", cover the situation that arises when a dancer, engaged by a club, performs a lap dance or striptease for one or more of the club's customers. At issue is whether the club, the dancer or somebody else is responsible for filling in a business activity statement and remitting the GST back to the Tax Office. "When a customer requests a lap dance or striptease, they approach the [club]," the decisions say. "It needs to be determined whether the entire amount paid by the customer is consideration for the [club's] service, or if any of the consideration is paid to the [club] acting as an agent on behalf of the dancer who is making a separate supply of their services." The three rulings cover a range of possible circumstances: where the dancer is directly engaged by the club; where the dancer collects her (or his) own money and simply pays the club a portion for the use of the premises; and where the club contracts the dancer from another promoter, to whom the dancer is contracted.*

posted on 3/1/2004

Everywhere a bubble.

My definition of a 'bubble' is any asset price inflation that the person using the term cannot otherwise explain. Increasingly, however, the term bubble is being applied to almost any asset price movement that disagrees with our prejudices or preconceived ideas. Here is an overblown example of such thinking from Stephen Roach, in an open letter to Alan Greenspan (as if Greenspan needs lessons from Roach): *There are already signs of such excesses. Property markets are frothy and so are government bonds, credit instruments, high-yield debt, and tech stocks (again). Here we are, only four years after the bursting of the first bubble, and the risks of new bubbles abound.* Peter Garber's *Famous First Bubbles: The Fundamentals of Early Manias*, is a very useful corrective to this sort of intellectual laziness.

posted on 3/1/2004

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