Comments on “Is the Persistence of Japan’s Low Rate of Deflation a Problem”

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Outline

1) Review the assumptions and framework

2) Alternative assumptions and implications

3) Big Picture
Basic Framework

• Two step argument

Step 1 assume:

a) conditions that lead to constant real level of output in the economy

b) that money growth is constant ($\mu_0$)

→ M/P must be constant too

(note that I don’t see why velocity has to be constant, so I am not even sure I agree with this)
Step 2: assume money growth falls $\mu_0 \rightarrow \mu_1$

- M/P will be constant still, but trend inflation must fall and nominal rates will eventually be lower too.

- Transition path will require the Price LEVEL to fall.

- With falling prices, unless wages fall, real wages will rise $\Rightarrow$ RECESSION.
More realistic assumptions

• Monetary policy was tightened early in the 1990s but then eased (Mihara!)

• Downward nominal rigidity is only moderately important
  – Kuroda and Yamamoto find 25% of all “wage” changes are negative between 1994 and 1998

• Output growth slowed starting in 1990

• (Fiscal policy was also loose)
This is the puzzling period
Puzzle(s) about the recession

• Why did deflation persist in the late 1990s and early 2000s in the face of large monetary stimulus

• Why did recession persist with both monetary and fiscal policy eased?

• My answer Zombies…..
Bigger picture questions

1. Are the zombies really dead?

2. Is an ex-post low rate of inflation (and money growth) harmless?

3. Is the BoJ rationale for the low inflation target convincing?

4. Does it matter if the BoJ aims for a low inflation target?
Percent of Japanese Bank Loans Less than 1.5%
Conclusions

• Not convinced that the “a structural” approach of this paper is going to get us very far

• Sorting out whether things are really back to normal in Japan remains important
  – especially in light of likely monetary and fiscal tightening

• BoJ’s low inflation target seems imprudently low