Lessons from the Recovery from the “Lost Decade” in Japan:
The Case of the Great Intervention and Money Injection

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Proof of no relation between slow Japan growth and yen rise (nor between faster Japan growth and yen fall)

Strong economic growth: following large yen Appreciation!

Lost Decade: large yen appreciation in distant past

Renewed growth now

Dec 1987 121 yen/dollar

Japan / U.S. Foreign Exchange Rate (Japanese Yen to One U.S. Dollar)
Source: Board of Governors of the Federal Reserve System

Shaded areas indicate recessions as determined by the NBER.
2006 Federal Reserve Bank of St. Louis: research.stlouisfed.org
Low Inflation, Deflation, and Policies for Future Price Stability

The Great Japanese Intervention

• Preliminaries: Five Principles of Exchange Rate Policy
• The Lost Long Economic Slump in Japan
  – Persistent deflation
  – Money growth low, non-performing loans
  – Start of quantitative easing—March 2001
• Part of new U.S.-Japan relation
  – Koizumi Election, April 2001
  – Bush-Koizumi meetings, Camp David, June 2001
• Purchasing foreign exchange would help increase money supply in Japan
  – If not sterilized
    • complex issue—day-to-day versus month-to-moth
• So, U. S. strategy was to go along with the intervention
Period of Great Intervention

Source: Board of Governors of the Federal Reserve System

Shaded areas indicate recessions as determined by the NBER.
2006 Federal Reserve Bank of St. Louis: research.stlouisfed.org
Implementing the Strategy

• Phone calls in early 2003 as MOF vice minister for international policy changed
  – Plan was to intervene more
  – Okay, but not joint
  – Daily contact, putting the Blackberry to use
• By late summer of 2003 it was “working”
  – Needed to develop an exit strategy
  – G3 meetings in California, summer 2003 (see chart)
  – Lead up to Dubai and the focus on China
  – Sharp move in Mid September, exiting not so easy?
• Intervention ended on March 16, 2004 ($230B)
  – Greenspan NYC (March 2) clarifying statement (see quote)
  – After a flourish on March 5 ($11.2 billion)
• Results: Strong recovery in Japan launched
  – And still underway.
...partially unsterilized intervention is perceived as a means of expanding the monetary base of Japan, a basic element of monetary policy. 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

Alan Greenspan,
New York City
March 2, 2006