

ESRI CONFERENCE

on Japanese Monetary Policy

Comments on

“Monetary Policy in Japan: Problems and Solutions”

by Takatoshi Ito and Frederic S. Mishkin

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**(Views expressed in this presentation are those of
mine and do not necessarily reflect those of the
Bank of Japan or IMES)**

Organization of this presentation

- I. Summarize the diagnosis and policy recommendations in Ito and Mishkin.
- II. State my impression on this paper.
- III. Make a few specific comments.

Diagnosis (1)

- Japan has been in deflation since 1998.
- The cause of deflation is lack of aggregate demand, rather than supply.
- Inflation and deflation is ultimately a monetary phenomenon.
- Even facing the zero bound of nominal interest rates, monetary policy can do a lot of things.

Diagnosis (2)

- **Mr. Hayami**
 1. Mistake in the judgment of economic conditions
 2. Independence trap (reluctant to cooperate).
- **Mr. Fukui**
 1. Committing himself to ZIRP very explicitly (a good sign).
 2. Explanations on changing in his action in favor of commitment is not enough. Is he serious?
 3. Mr. Fukui should clean up credibility problem by committing future price path clearly.

Three Recommendations

1. The Japanese monetary authorities should announce that monetary policy would be conducted to raise the price level to the path that it would have achieved if deflation had not set in starting in October 1997.
2. Once the price level target described in recommendation 1 is achieved, the Japanese monetary authorities should announce that they will move to an inflation targeting regime with a long-run goal for inflation of 2%.
3. If the Bank of Japan achieves the price level target with losses in balance sheet, the Ministry will inject fiscal money to restore the capital position of the Bank of Japan without asking the responsibility of Governor and other Policy Board members for such losses.

The case for Price level target under deflation

- Price level targeting is a useful device to manage expectations.
- An example of history dependent policy
- The pressure to “undo” the departure from the target implies a strong commitment towards price stability relative to inflation target.

Instruments to hit the path

- Naïve quantitative easing => We need something new.
- Purchase of long term bonds => May work if BOJ does it more aggressively.
- Foreign exchange intervention => No, Svensson's approach is not politically acceptable.
- Massive purchase of private assets => Maybe the last option.

My Impression on this paper

- Comprehensive statement on the cause and effects of Japanese deflation.
- Criticism for the past and clear policy recommendations for the future.
- Want to know what's new exactly.

Comment 1

- The paper should better be differentiated carefully from the proposal made by Svensson (2001) and Bernanke (2003).
- ✓ Ito and Mishkin rejects Svensson's foolproof way on political ground, but Ito and Mishkin lacks clear transmission mechanism to hit the price level path (Svensson has interest rate parity condition).
- ✓ What is new from Bernanke (2003) precisely? Is it a recommendation to bring the price level back to the target price path (via massive JGB purchases) + IT?

Comment 2

- Consistency with the current BOJ's commitment
- ✓ BOJ's current commitment is a kind of expectation management in terms of ZIRP.
- ✓ Need a bridge towards a new commitment that accommodate current expectations.
- ✓ What, when and how should BOJ talk?

Comment 3

- Additional Japanese empirical evidences to strengthen recommendations.
- ✓ Kimura and Kurozumi (2004): risks for forward looking policy based on empirical evidences using Japanese data (Kimura, T and T. Kurozumi, “Effectiveness of History-Dependent Monetary Policy,” forthcoming to *JJIE*)
- ✓ Kuroda and Yamamoto (2003): When inflation is below approximately 1 percent, the marginal increase in unemployment attributable to DNWR is small since DNWR is moderated by the adjustments to bonuses and extensive wage cuts observed in our Japanese data (BOJ *Monetary and Economic Studies* 21, (4), 2003).