ESRI conference “Japanese Monetary Policy: Experience and Future”, Tokyo, June 22, 2004.

Monetary policy from now on: Lessons from Japan’s experience

James Harrigan
Federal Reserve Bank of New York

please note:
All views expressed here are my own, and in no way reflect the position of the Federal Reserve Bank of New York or the Federal Reserve System.

What lessons should central bankers take from the experience of Japan since the end of the bubble economy?

Much can be learned, and I look forward to hearing the views of conference participants. Two lessons which I have learned:

1. Avoid the zero bound

2. The importance of talk

Avoid the zero bound

A decade ago, most economists would have said

Pr(short term interest rates = 0) = ε

As a consequence, avoiding zero bound wasn't a concern.

What should central banks do to avoid a repeat of BOJ's dilemma?

1. An inflation objective high enough so that even very bad aggregate demand shocks won't cause zero bound to bite.

2. Price level target. Low *average* inflation objective, but higher desired inflation when price level falls below target (Eggertson-Woodford).

Importance of talk

At zero bound, few monetary policy instruments available. “Open mouth operations” have increased importance.

Woodford emphasizes that policy rate by itself is of no consequence; only thing that matters is expected future path of policy rate.

Communication about expected future path of policy rate is key task for central bankers.

Importance of talk

Bank of Japan

No substantive change in policy instrument setting when Mr. Fukui became head of BOJ. But change in communication style has been widely heralded, and may have amounted to a loosening of policy: expected future path of interest rates perhaps lower than under Mr. Hayami.

FOMC

Increased signaling of intentions/goals in 2003.
- “unwelcome further fall in inflation”
- “considerable time”
- “patience in removing policy accommodation”