

**ESRI CONFERENCE**  
**on Japanese Monetary Policy**

**Comments on “Monetary Policy  
and Bank Supervision”  
by Takeshi HOSHI**

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## **My Impression on “MP and BS”**

- **Clear analysis on Monetary Policy and Bank Supervision**
- **Stimulating Hypothesis on the behavior of the Bank of Japan from 1998 to 2002**

## **My comments on “MP and BS”**

- **According to new the BOJ law, BOJ is not responsible for bank supervision.**
- **Is it true that “the BOJ may have chosen too tight monetary policy to encourage the restructuring of the banking industry”?(p8) Probably not.**
- **There may exist other possible reasons of CB involvement of bank examination.**

# **1. Is the BOJ responsible for Bank Supervision ?**

- **HOSHI argues: BOJ retained its own bank examination function and felt responsible for bank supervision [p 6 ]**
- **Under the new BOJ law, the role of BOJ in Financial stability is very limited.**
  - The drafting committee of BOJ laws believed that the government should be responsible for financial stability.
- **On-site examination is far from bank supervision. BOJ could provide guidance and advice only.**

## **BOJ law: Chapter I (Objectives)**

**Article1 The objective of the Bank of Japan, as the central bank of Japan, is to issue banknotes and to carry out currency and monetary control.**

**Article2 In addition to what is prescribed by the preceding Paragraph, the Bank's objective is to ensure smooth settlement of funds among banks and other financial institutions, thereby contributing to the maintenance of an orderly financial system.**

## **On-site Examination ( BOJ web site)**

**“The Bank of Japan sends its staff on direct visits to ("on-site examinations") and receives financial reports from client financial institutions having current accounts with the Bank. The Bank then provides guidance and advice based on the findings of the financial and management conditions to thereby ensure the soundness of the financial institutions. This procedure is called "on-site examination." ...It is of great importance also from the perspective of conducting monetary policy for the Bank of Japan to understand and to estimate how the Bank's policy changes will affect the market behavior of financial institutions and how these policy changes will be transmitted through the economy.”**

## **Is the BOJ responsible for Bank Supervision ? : conclusion**

- **It is dubious that the BOJ felt responsible for bank supervision.**
- **Of course BOJ should be deeply concerned with the soundness of the financial system, just as other CBs which are either responsible or not responsible for bank supervision.**

**Possible main reason: The soundness of the financial system will affect “how policy changes will be transmitted through the economy”.**

**● 2. Is it true that “the BOJ may have chosen too tight monetary policy to encourage the restructuring of the banking industry” from 1998 to 2002?**

**● Need to check the opinion of the BOJ board members during this period.**

**● In general, speeches of the governor and deputy governors made from 1998 to 2002 may suggest quite a different story.**

## **CASE STUDY:**

### **Lift of ZIRP in August 11, 2000**

#### **August 11, 2000**

**BOJ lifted zero interest rate policy(ZIRP).**

**---Decision criticized most severely as too tight monetary policy**

#### **August 4, 2000,**

**Then Deputy Governor Yamaguchi made a speech entitled “Thinking behind Current Monetary Policy” to explain about “Points at Issue Relating to the Termination of the Zero Interest Rate Policy”.**

## **Points made on excessive corporate debt and the financial system problem**

**“While we may be far from a situation where many banks aggressively assume credit risk with appropriate risk control systems in place and strongly support economic growth, we are not in a situation where the lending attitude of banks is so cautious that it would hamper economic recovery. Therefore, while there remain industries and firms burdened with excessive debt, I think it possible to expect a recovery, though not as speedy as in previous recoveries, of the overall economy as momentum for new growth intensifies reflecting the progress of technological innovation.”**

## **Points made on the relationship between structural adjustment and monetary policy (1)**

**“Similarly, it will take a long time before structural reform promoted by Japanese firms leads to improved productivity and higher potential growth. Here, it should be noted that various forces other than structural adjustment influence the economy. And hence, even if the potential growth rate is low, the economy will be able to grow strongly with the cyclical growth rate exceeding the potential growth rate. This, I think, is the business cycle.**

**To deal with the decline in potential growth stemming from structural factors, a policy targeted to solve structural problems and firms' own efforts for restructuring are indispensable. There is no other way. In short, monetary policy cannot replace structural policy.”**

## **Points made on the relationship between structural adjustment and monetary policy (2)**

**“It is true that the zero interest rate policy,..., could create a situation where banks and firms have become less sensitive to borrowing costs and liquidity risks. Indeed, it is through this effect that the policy supports economic recovery and promotes structural reform. At the same time, it cannot be denied that the policy may tend to delay structural reform by making economic agents with a large amount of debt less conscious of borrowing costs and liquidity risks. Of course, I do not think it appropriate to lift the zero interest rate policy to prevent moral hazard. Let me make it clear that the termination of the zero interest rate policy depends on whether we can be confident that the economic recovery is being primarily led by private demand.”**

**Is it true that “The BOJ may have chosen too tight monetary policy to encourage the restructuring of the banking industry” in August 2000?**

**Seems to be NO.**

- **BOJ was cautiously optimistic about financial stability at that time.**
- **BOJ emphasized a necessity of a policy targeted to solve structural problems, however it was not focused on the financial industry.**
- **BOJ did not consider it appropriate to lift the zero interest rate policy to the intention of preventing moral hazard and encourage restructuring.**

**The reason BOJ lifted ZIRP was its confidence on the economic recovery primarily led by private demand.**

➤ **3. “Central bank may have better information about the conditions of banks”(p7)**

- **BOJ argues that bank examination is of great importance from the perspective of conducting monetary policy.**
- **However, without involvement of bank examination, it is not easy for CB to have enough information.**
- **A Fed Staff argues that confidential bank supervisory information is used by FOMC members to guide monetary policy (Peek et al. [1999]).**

**Does the BOJ utilize information from bank examination to guide monetary policy ? If yes, how?**