

May the Bank of Japan Never
Turn Back Again!

Koichi Hamada (Yale University)

June 13, 2012

At the Japan Society of New York

Acknowledgement

- To
- The Japan Society for this valuable opportunity
- President Motoatsu Sakurai and Paul Seard
- The Japan Society of Fairfield that gave a similar occasion a few years ago.

A Valentine Present

- On February 14, 2012, following the Federal Reserve Decision of Inflation Target (or Goal), the Bank of Japan (BOJ) unexpectedly adopted the policy of inflationary target (prospect) of one per cent and increased the ceiling for the purchase of government bond.
- The market reacted by depreciating the yen to 82 yen/dollar range, and recovering the Nikkei index to over 10,000.

Sound economic principles are still alive.

- Despite the denials by the central bankers (BOJ), bureaucrats, many business economists, scholars and the media, economic logic prevailed in determining the exchange rate and the stock market.
- Monetary expansion and the real output slow down in Japan tend to depreciate the yen; monetary expansion (and its expectation) and the real slow down in the US will appreciate the yen.

Japan, almost the number one from the last

- Japan's economy has undergone serious problems during the past 15 years: deflation, the yen appreciation, excess capacity, economic hollowing of the country, decay of the local economy, and unemployment, even though Japan still maintains a high level and quality of life.
- In terms of the use of productive capacity, Japan's economy has travelled almost at the tail end of advanced and emerging economies.

Basic Features of Japan

- Deflation continued for a long time since the enforcement of the (new) Bank of Japan (BOJ) Law in 1998.
- Real exchange rates jump with a wide variation and create the hurdle for exporters face as well as for import competitors. (Jorgenson and Nomura 2009)

Diagnosis

- Deflation and the yen appreciation are (essentially) monetary phenomena. (Refer the Walras Law in the monetary economy). Asset prices are determined by the relative quantity of assets and their expected returns. Price level is the relative price of money and goods in general, and exchange rates are relative prices among currencies.

The Appropriate Policy Measure

- Natural policy prescription is the use of monetary expansion in a proper way, i.e. not only by the purchases of traditional short-term government debt but also by the purchases of longer term and wider ranging securities, and even by the purchases of foreign currencies as well.

This is the only way to cope with the liquidity trap.---Yale Way!
as Janet Yellen says.

And the BOJ tried at least a part of the way!! But too tiny!

Reversals in the exchange rate and the Nikkei prove, and not disprove the right theory of exchange rate determination, the theory that was in fact brought by Governor Shirakawa from Chicago.

A Japanese Myth

- The Sun Goddess at a rage hid herself into a cave. Darkness prevailed. She tried to sneak a view of the world through opening a rock very slightly. A powerful god made the rock open.
- Inflation target of only a single percent is short of a sufficient stimulus. But the world realizes that the sun (monetary policy) brightens the world.
- In this case, the Amaterasu seems to hide behind the rock again to make the dawn as a false dawn, Shirakawa's favorite phrase.

An Illustration by Elpida

- A memory chip company named Elpida, organized by the industrial policy, collapsed. In the media, management failure, lack of competitiveness and other factors are mentioned. The relative exchange rate between the yen and Korean won appreciated 60-70 percent. What kind of management or technology can cope with this extremely high hurdle? Because the BOJ could avoid this extremely high yen, one could say that the BOJ ruined Elpida.

Ignorance is not innocence but a sin.

(R. Browning, and Shozo Tanaka)

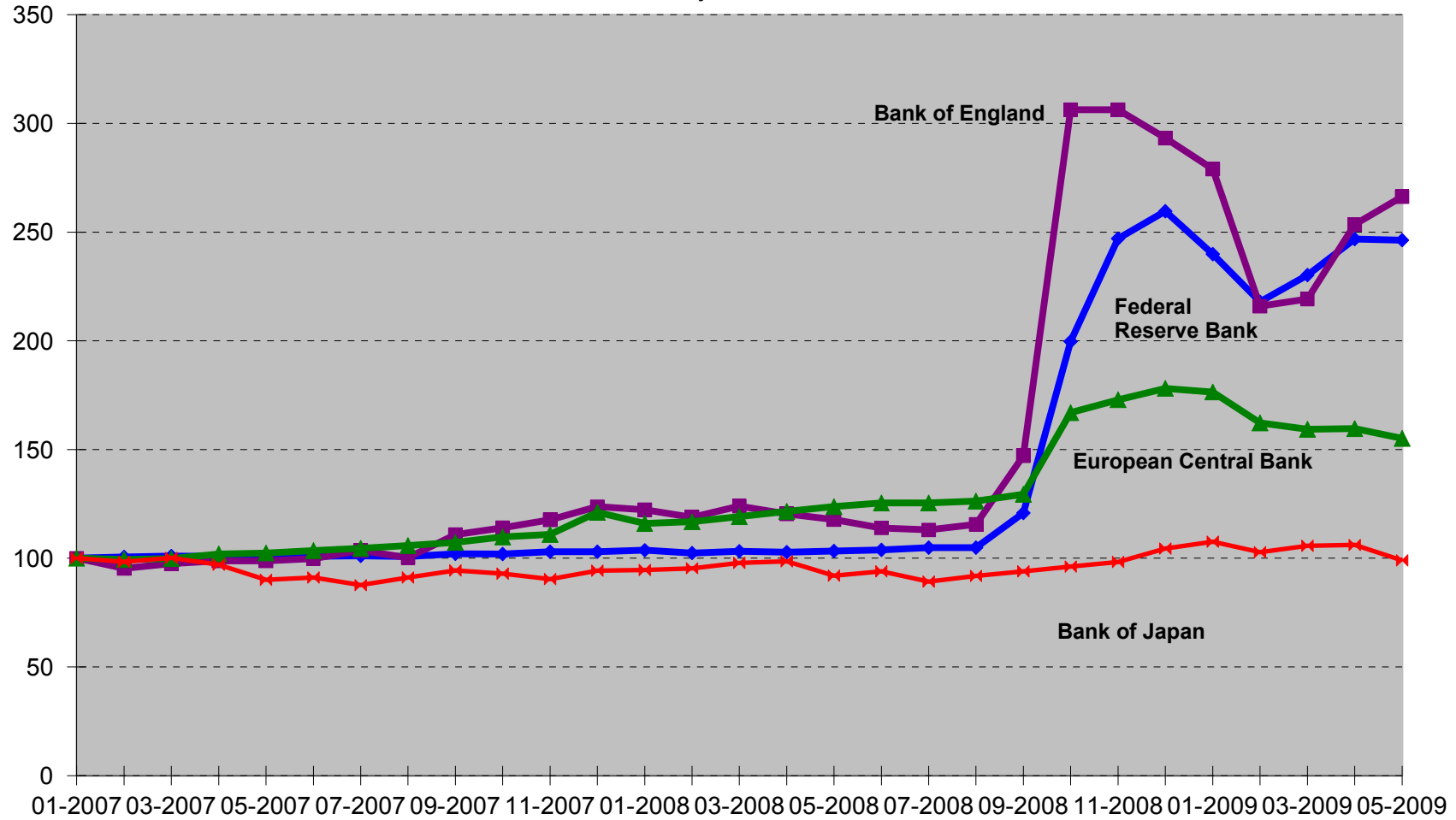
- Japan is a beautiful country. Physically and more importantly in the human nature of its residents as shown by the concerted efforts after the earthquake in Tohoku.
- Japan keeps a civilized, safe and relatively clean environment. It enjoys the highest net foreign asset per capita among most countries.

Newspapers and television do not convey the right economic reasoning involving money, taught in most countries in the world.

The Subprime Crisis started in Anglo saxon Country but trimmed the production most in Japan.

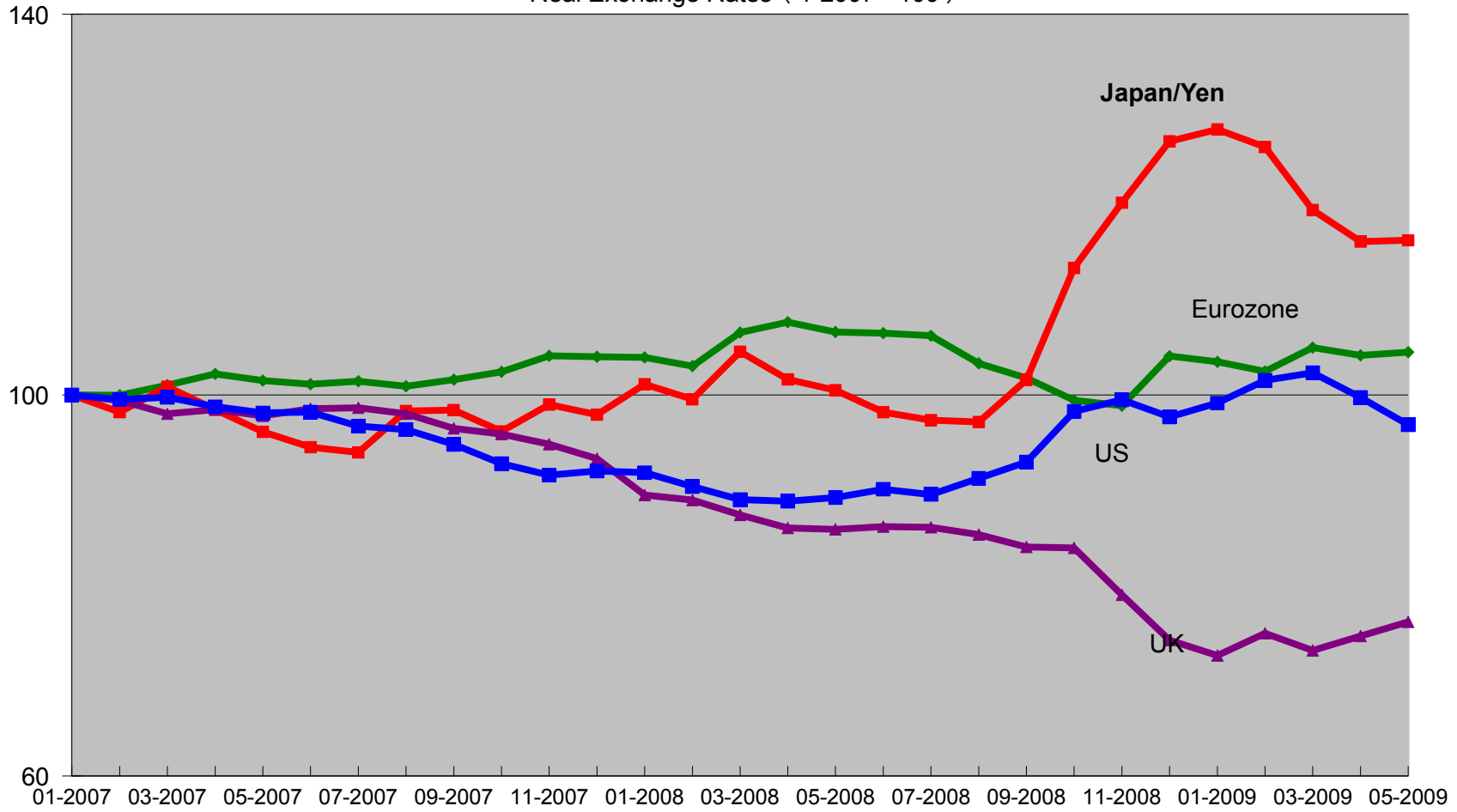
- Why do we not keep our wealth and tradition by understanding true economic logic rather than listening to the ideology, or the excuse of the monetary authority?
- The three excel graph show that the reluctance of the Bank of Japan to ease money supply after the Lehman shock appreciated the yen and gave the hardest blow to the Japanese economy (normalized by the GDP scale.)

Balance Sheets of Major Central Banks (1/2007=100)



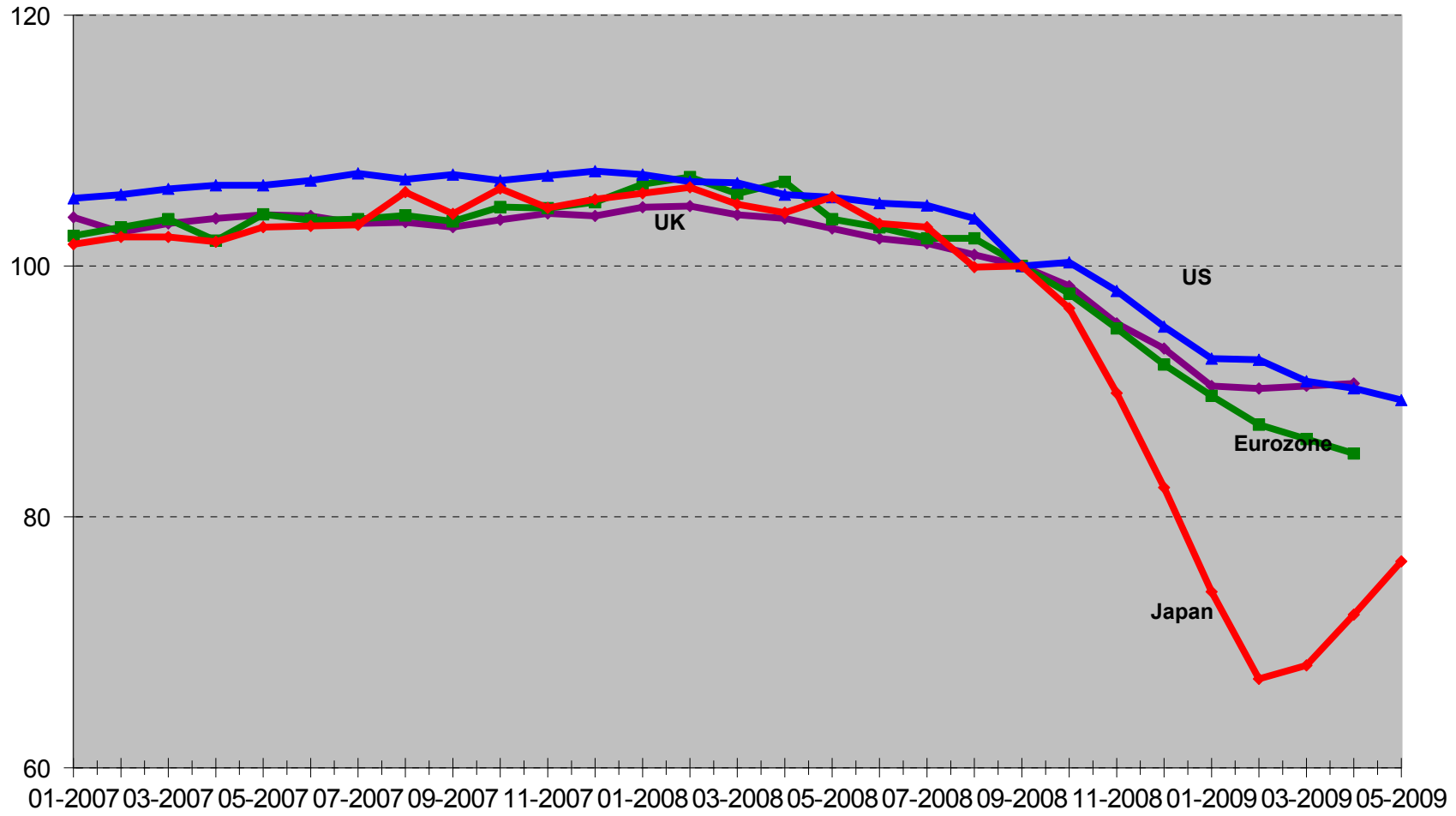
出所: 各国中央銀行バランスシートから月中平残を推計

Real Exchange Rates (1-2007 =100)



Source: BIS

Industrial Production (2008-09 =100)



Source: Bloomberg Terminal