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Japan’s economy is in an excellent shape: the labor market is tight and corporate profits are high, but inflation is subdued.

The Phillips Curve is not a straight line but a curve on which there is an inflection point beyond which inflation accelerates. In the case of Japan, the inflection point appeared in history when the unemployment rate was below 3%. An acceleration of inflation was often triggered by events like a chemical plant accident, which made people reassess inflation prospects.

I have deep concerns over the functioning of financial markets. Market-making capability of securities dealers as well as FX dealers has declined significantly because of Dodd-Frank Act and Basel III. Credit risk-taking has also been restrained in the banking sector and pushed to shadow banking. Passive investors have grown and so have indexed products while active managers have become fewer. The dearth of active mangers makes the market prone to herd behavior, which could induce runs in the market when a shock is applied to it. Despite this risk, the Federal Reserve’s capability in addressing non-bank crises has been curtailed.