ITOH MOTOSHIGE

Emeritus Professor at the University of Tokyo, Professor at the Gakushuin University, Member of the Council on Economic and Fiscal Policy, Japan

Since I only have eight minutes, I will try to be very brief. I will speak chronologically on this. In 1997, we had a very serious financial crisis, and the lesson we learned is that our actions were too small and too late. The political factor was the most important. At that time, it was almost impossible to persuade the politicians to introduce a very big capital injection or bail-out process. Our failure at this time provided some lessons to other countries after the 2008 crisis.

Secondly, around 2000, in the period of the IT bubble crash, Japan was just on the edge of entering into deflation. For some reason, the Bank of Japan introduced very problematic or controversial policy rate increases. Maybe the Bank of Japan was very unlucky because we had the IT bubble crash and 9/11 the next year. Anyway, what happened was, it took almost 12-13 years for us to get out of the deflationary trap. Once we get into the deflation trap, it is very difficult to get out of the trap with traditional policy. Just so you remember, the Bank of Japan already had a zero-interest rate policy for this period. Drastic monetary policy is very important when we are in a critical position of deflation.

Number three is Abenomics, especially when Mr. Kuroda came in. He introduces the so-called unorthodox monetary policy. It is a combination of the two. One is a very dramatic expansion of the base money, and the other is a very explicit inflation targeting of 2%. That was very successful in changing the mindset of the people overnight. You can confirm how the market has changed by looking at GDP, employment numbers or corporate profitability, exchange rate, and so on and so forth. That kind of unorthodox, non-traditional monetary policy may sometimes be difficult. Sometimes, it may be necessary when the economy is in a serious deflation trap.

However, number four, although that kind of policy can be very effective to get out of the deflationary trap, we could not achieve the target inflation level. The original target level is 2%, but we are still around or below 1%, so something is missing here. There are many discussions here, but one of the most important things is that we have to think both of the supply side and the demand side of the macro economy.

The monetary expansion is a very typical demand-side policy. Since we had a very good and expanding demand, we hoped the supply side would catch up, but this did not happen, for many reasons that you know very well. However, one reason why this is very important is that wages have not increased in Japan, and without an increase in wages, you cannot expect the inflation rate to get higher. You can find various kinds of so-called malfunctioning labour market in the case of Japan, which is reflected in the wage.

This is also very important for us in thinking about the future of the international economy. I mentioned yesterday that unfortunately, the potential growth rate of mature countries, including the United States, is not very high. Robert Gordon just mentioned that the total factor productivity has been very low, but at the same time, many countries increased, like Japan, the United States, and Europe. They have stimulated a lot of demand. As long as the demand is going up, the economy is good but when that demand is being lost, there is a very big backlash. This is because we depend so much on demand. Demand may be going down, maybe because of the US-China trade conflict or maybe because of the crash of the overheated United States market or whatever.

Lesson five is what is most important now in Japan. That is that unfortunately, the quantitative theory of money is not working in the short period. It may be true that if we just expand money supply, the prices will eventually go up, but it is an avalanche according to Keynes. We have already passed six years that it is not going on. Then as time goes on and goes on, the cost from untraditional monetary policies become bigger and bigger, and we are now having that kind of discussion.

You can think of many distortions. One is the market for government bonds and the stock market. BOJ buys so much of these assets, and you can identify many difficult problems coming from it. Possibly also, the deficit of the Bank of Japan may cause some problems. The second distortion of the very prolonged monetary expansion is long-term interest rates. For some reason, the Bank of Japan introduced what we call yield curve control, by which they mean the 10-year government bond loans should be around 0%. It may be good for stimulating purposes. However, you can easily imagine that this is a very big hurt happening to the banking sector. It is not only the problem of the profitability of the banking sector. It is a problem of the channel for the credit.

It also has very important implications for fiscal consolidation. You know our debt-GDP ratio is about 200% in some categories. However, if you look at just the debt service of the Japanese government, it is surprisingly low. This is because interest rates on the marginal issue of the government bond is zero, so they can borrow money for nothing. That is a very good story in a short period, but that has provided less and less incentive for politicians to think seriously about fiscal consolidation. The political effect is very important, so this is the lesson we learned from our experience.