



A New Framework for Monetary Policy in the Post Covid-19 Era

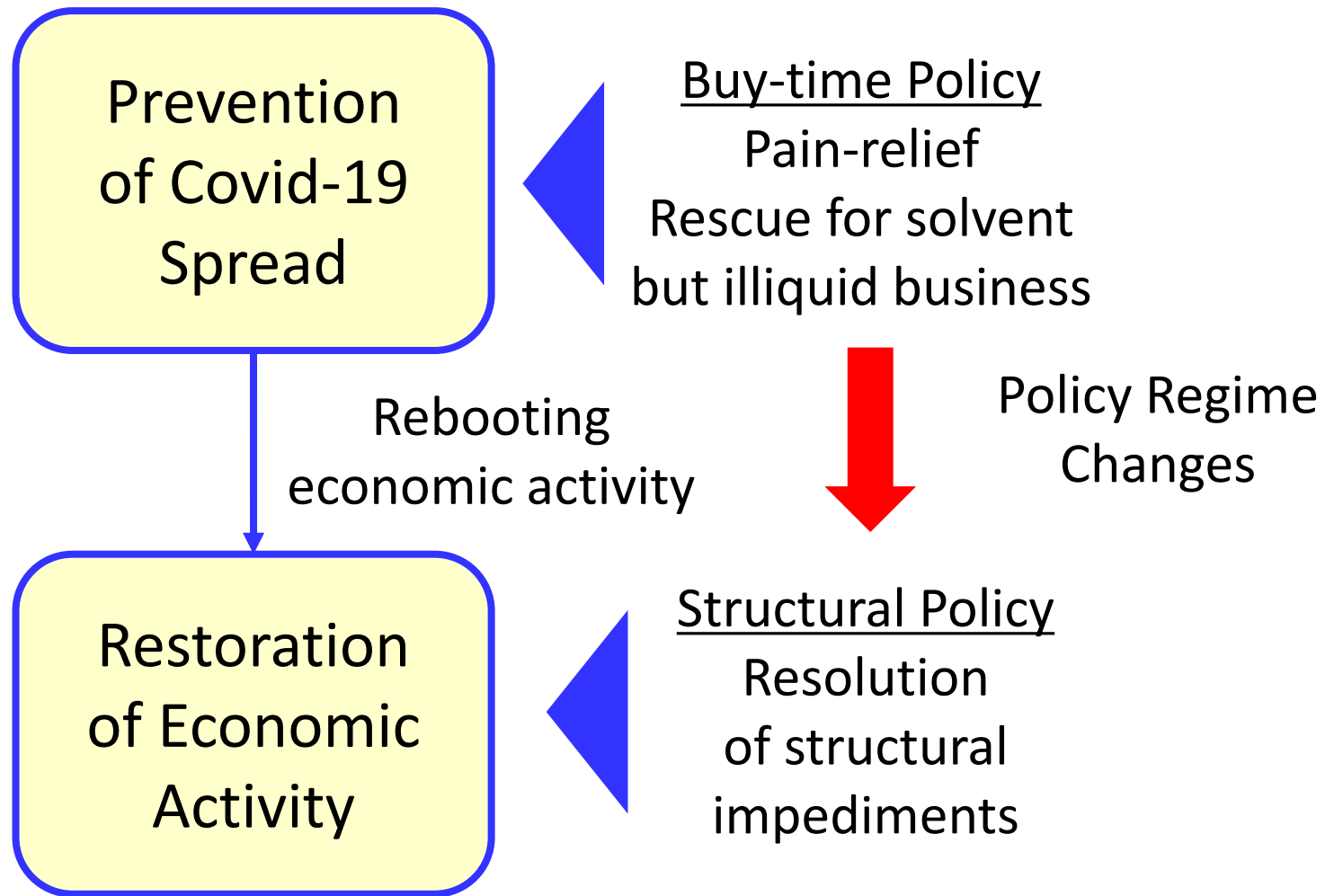
May 15, 2020

Applied Economics Workshop

Keio University

Shigenori SHIRATSUKA

Economic Policy against Covid-19



A Key Takeaway

Macroeconomic Environment

Japanization as a Global Standard

- Declined growth trend
- Declined real rates
- Persistent low inflation
- Persistent low interest rates
- Huge government debts
- Huge CB balance sheet
- Persistent ELB constraints
- Following wind for ICT
- Strong head wind for globalization



Monetary Policy Implications

New Normal for MP Framework

Unconventionals as Normal

In Appearance

Policy target shift from price stability to financial stability

In Reality

Government debt management policy by YCC

Probably not desirable, but inevitable

Monetary Policy Framework

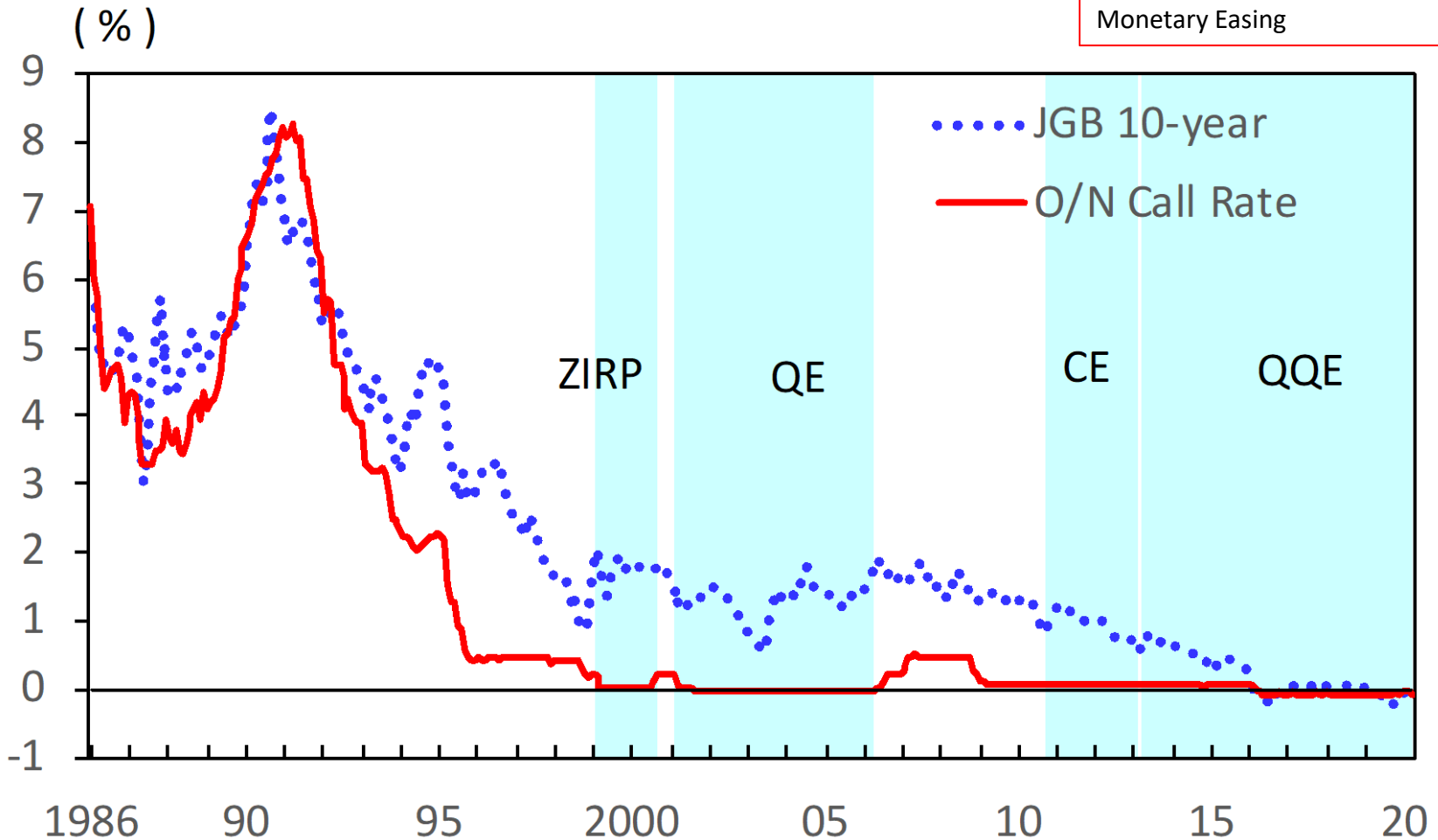
	Conventional	Unconventional		Future
Policy tools	O/N rate control	FG, LSAPs, NIRs, YCC		YCC + α
Determinants of CB B/S size	Liability side (CB money) → No excess reserves	Asset side (unconventional asset purchases) → Massive excess reserves		Asset side (stabilize long rates by YCC + policy interventions)
Intervention to resource allocations	Remain neutral	Pre GFC	After GFC	Intervention as normal (more fiscal policy elements)
		Mkt distortions, Impair MP Transmission	Intentional & massive interventions	
Policy management	Gradualism → High predictability	Gradualism	Gradualism or Surprise	Ultra-Gradualism

Plan of Today's Talk

1. Japan's Experience since mid-1990s
2. New Environment in the Post Covid-19 Era
3. CB B/S under Unconventional Policy
4. Future of Central Banking: New Framework in Appearance vs in Reality
5. Conclusions

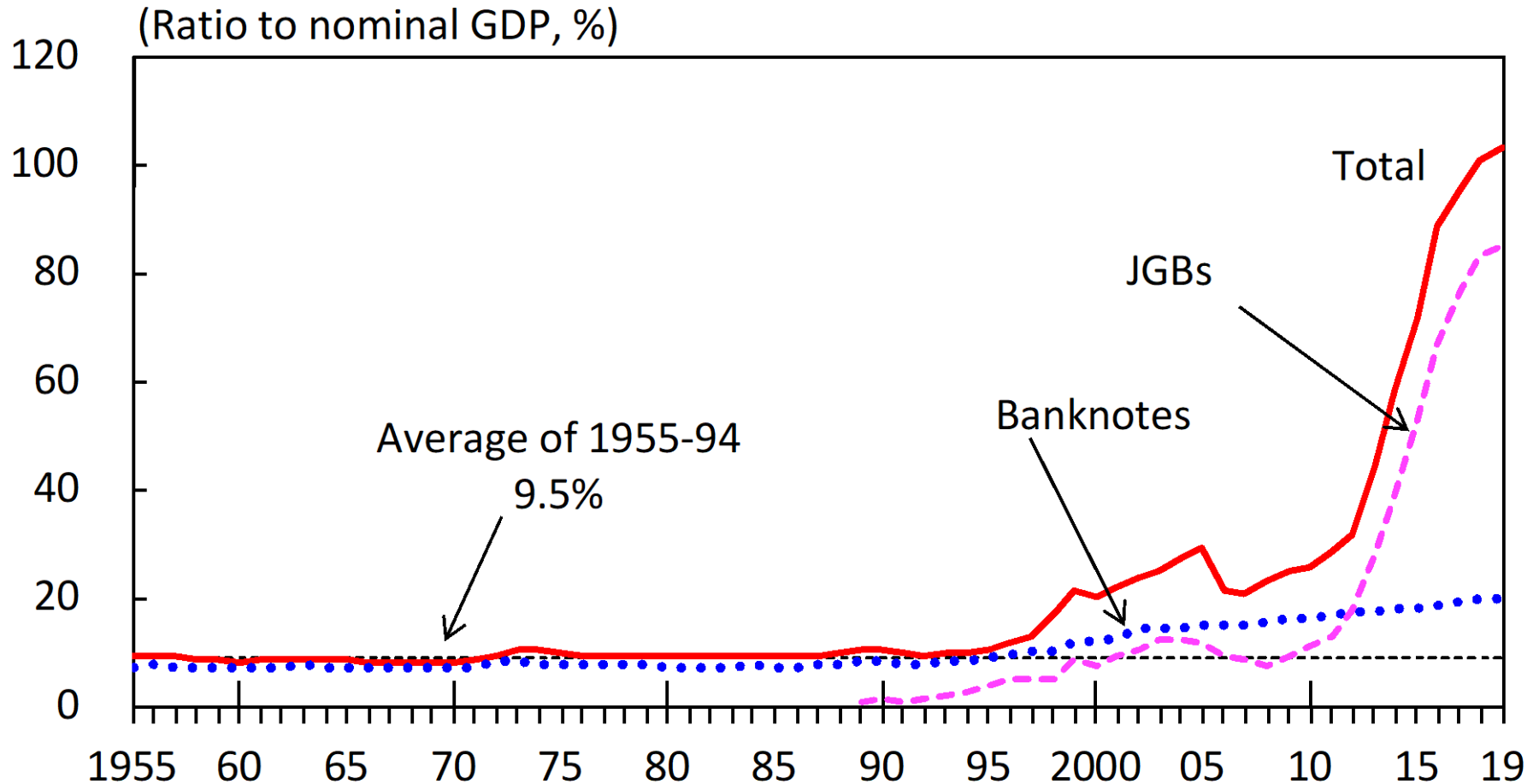
Nominal Interest Rates

ZIRP: Zero Interest Rate Policy
 QE: Quantitative Monetary Easing
 CE: Comprehensive Monetary Easing
 QQE: Quantitative and Qualitative Monetary Easing



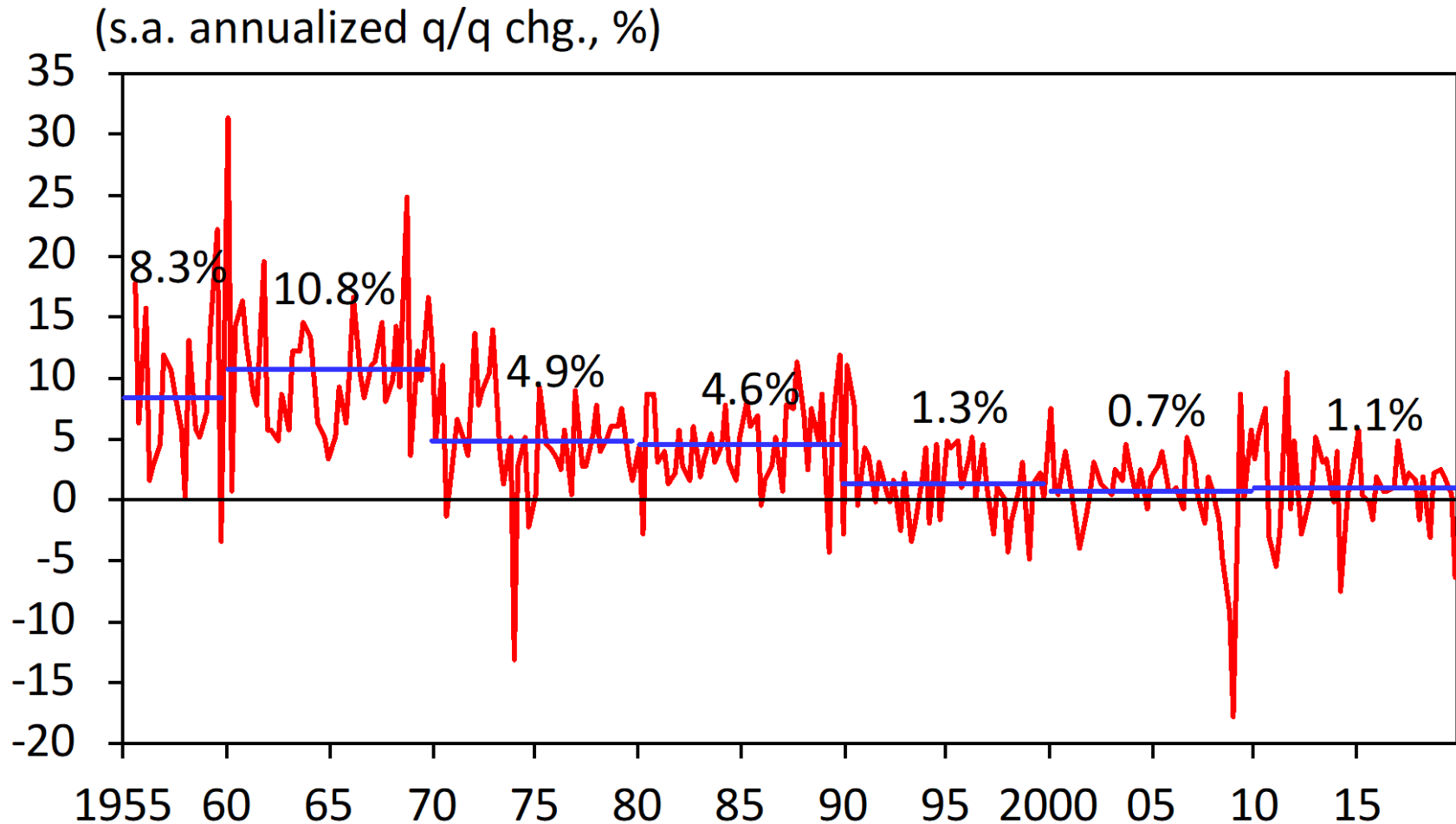
Sources: Ministry of Finance; Bank of Japan.

BOJ's B/S Size



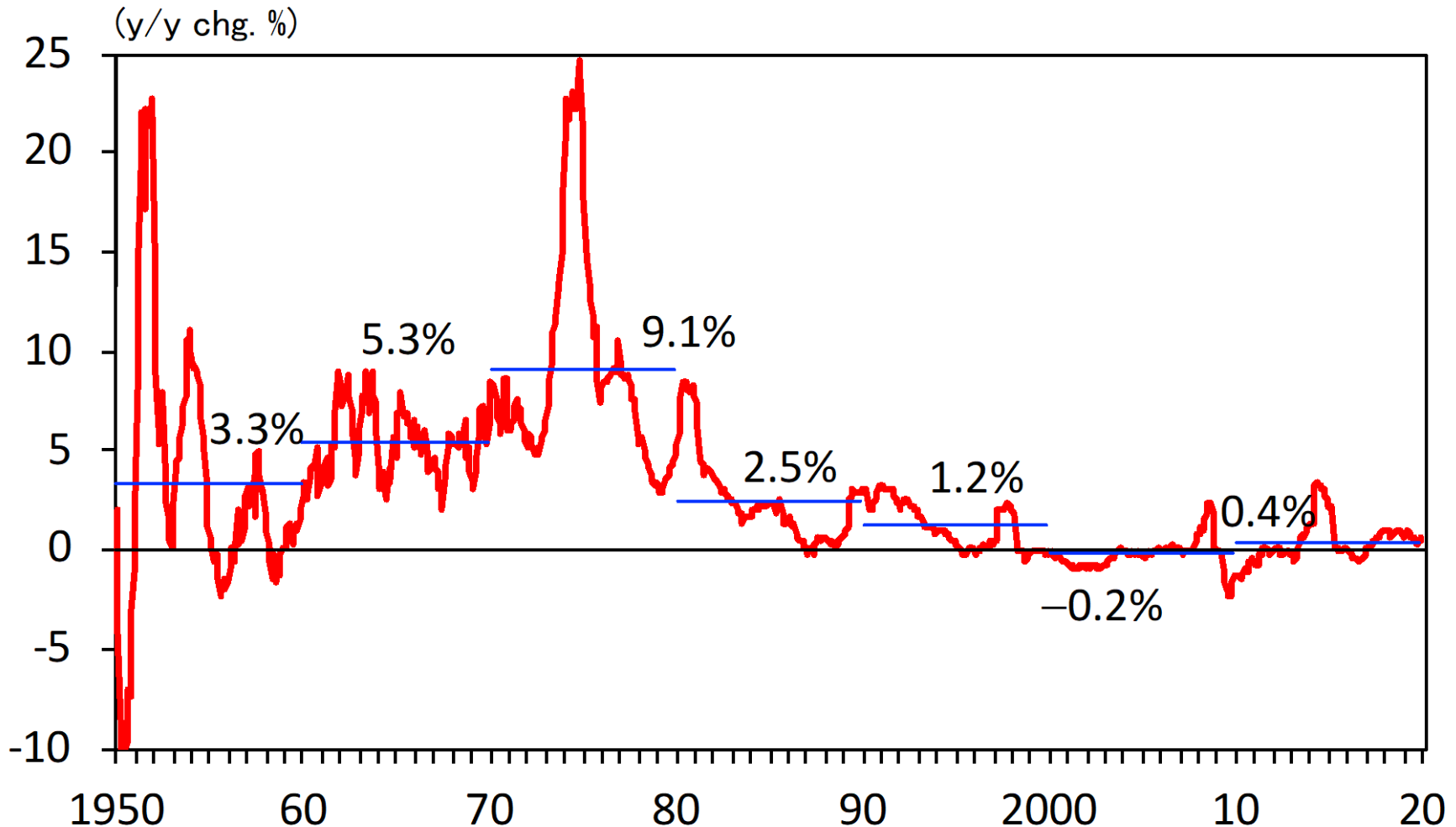
Sources: Cabinet Office, *National Accounts*; Bank of Japan.

Growth Rate in Japan



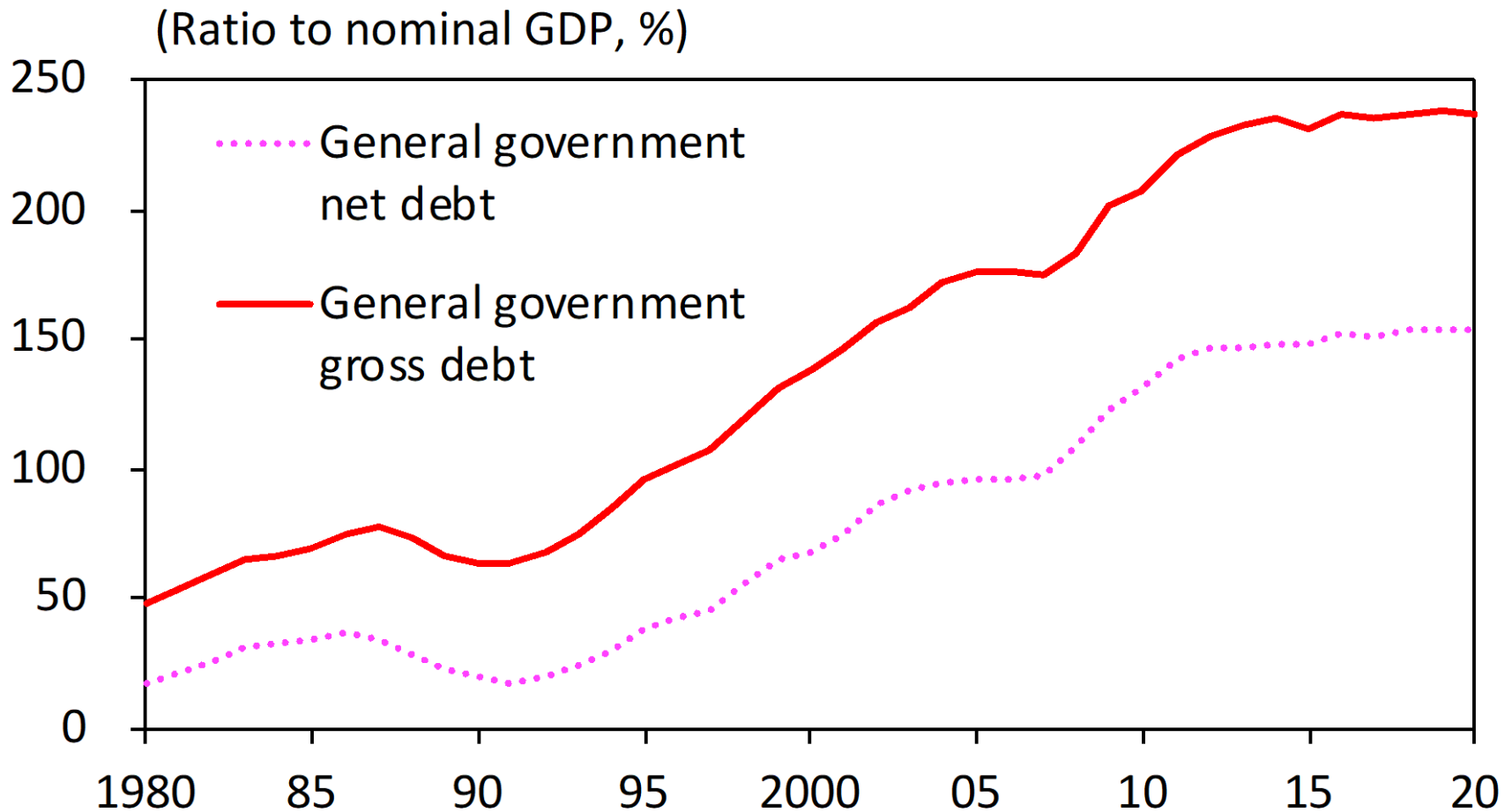
Source: Cabinet Office

CPI Inflation in Japan



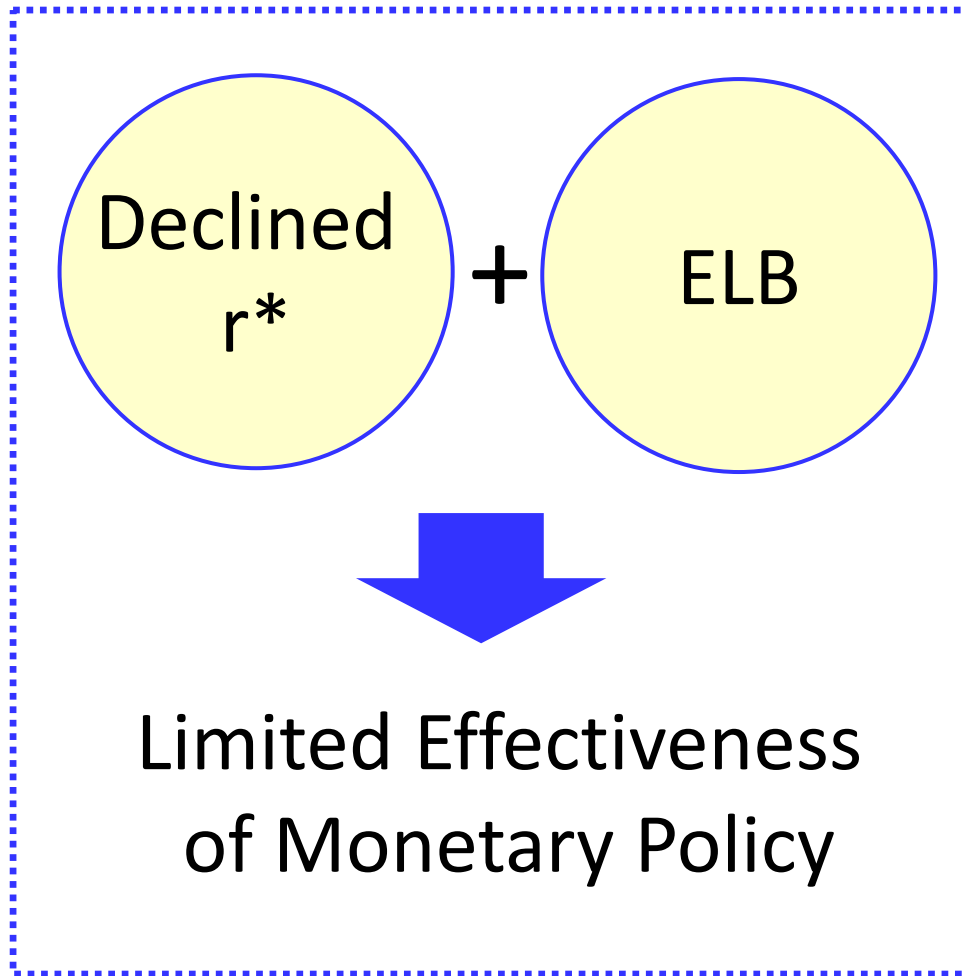
Source: Ministry of Internal Affairs and Communications, "Consumer Price Index."


Government Debt in Japan



Source: International Monetary Fund, *World Economic Outlook*.

Secular Stagnation: Demand-side View

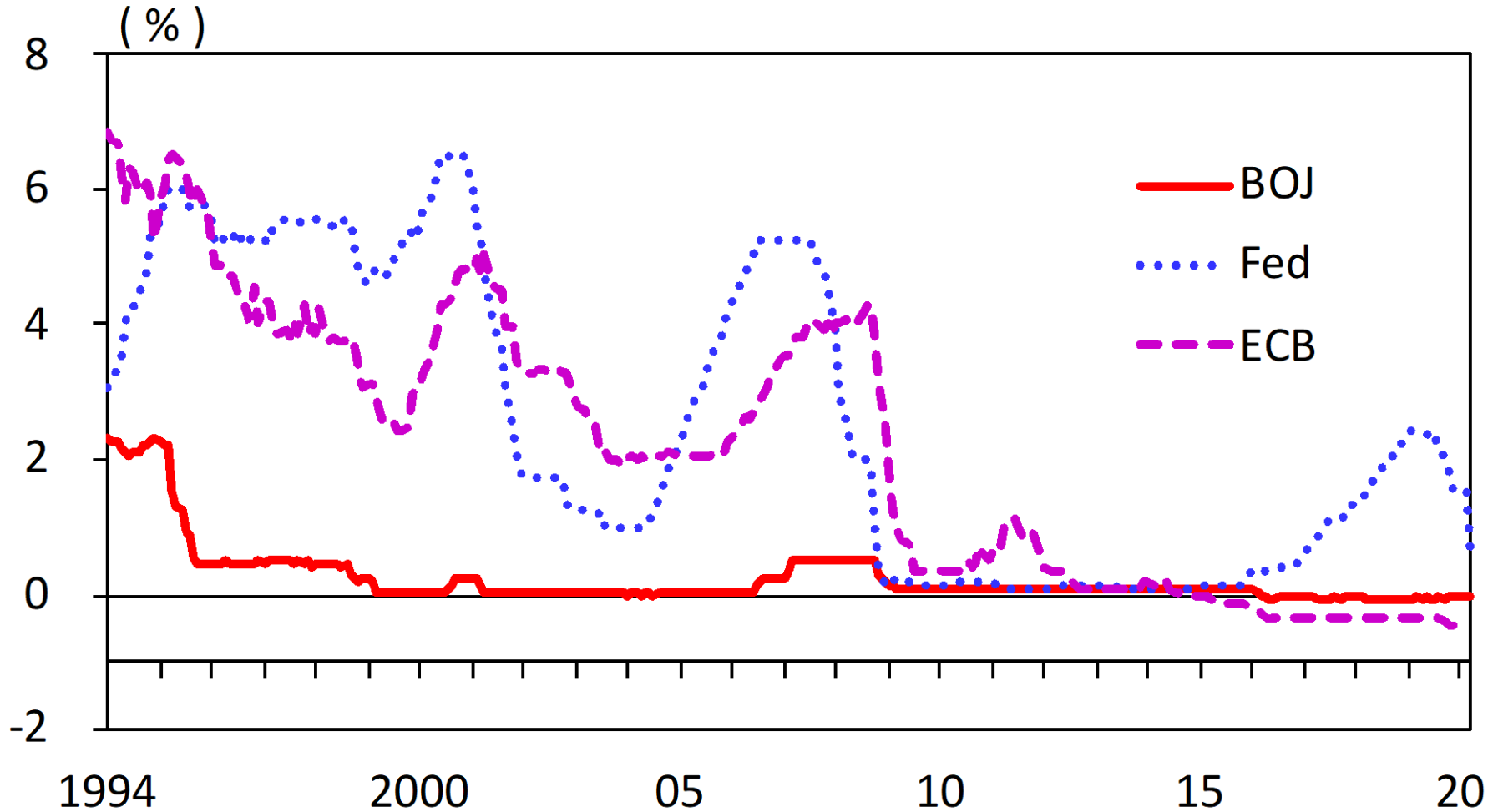


- 
1. Prolonged low nominal interest rate environment
 2. Declined potential growth
 3. Weak economic recovery

Plan of Today's Talk

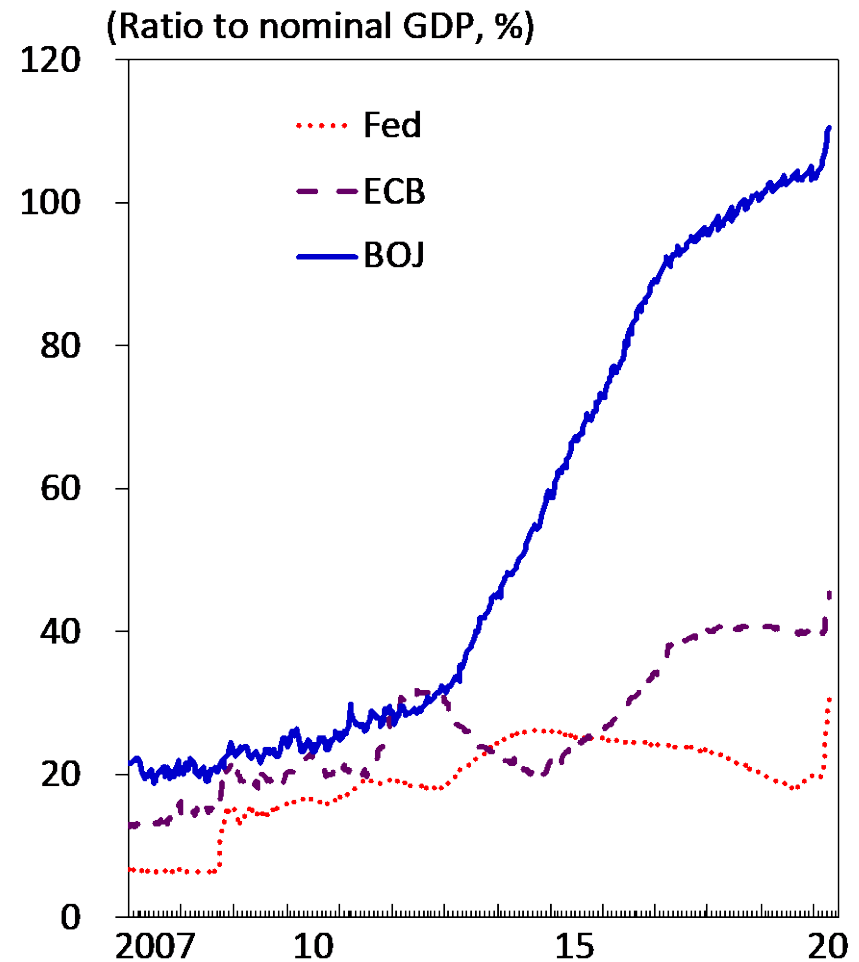
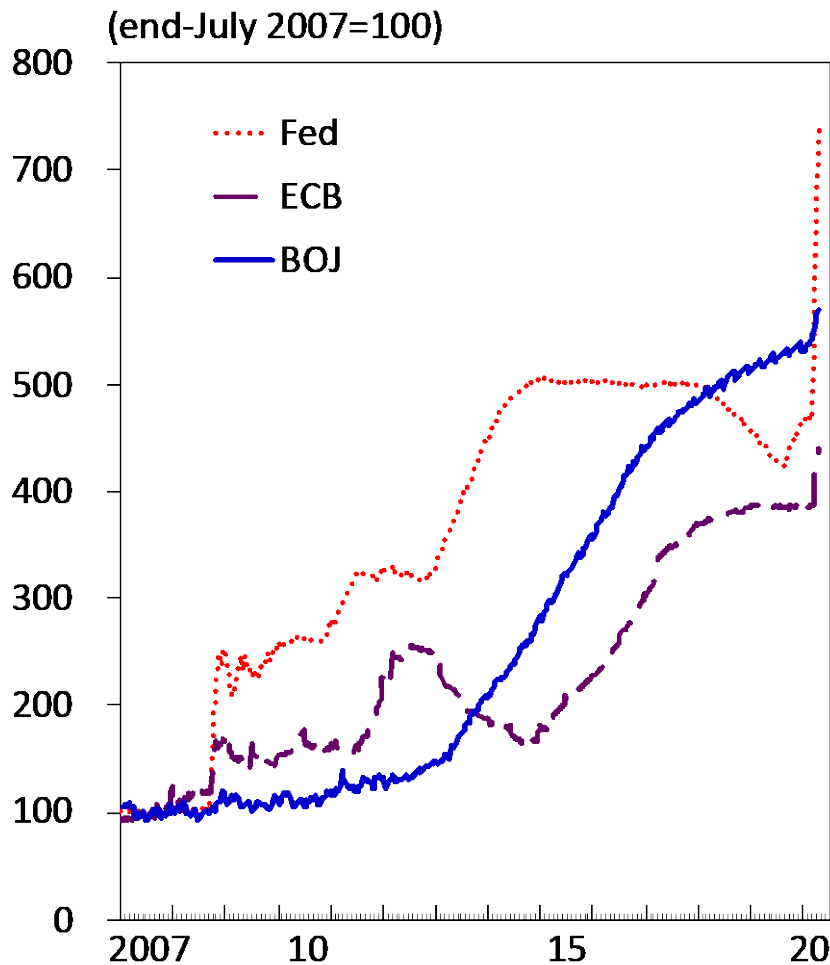
1. Japan's Experience since mid-1990s
2. **New Environment in the Post Covid-19 Era**
3. CB B/S under Unconventional Policy
4. Future of Central Banking: New Framework in Appearance vs in Reality
5. Conclusions

Money Market Rates



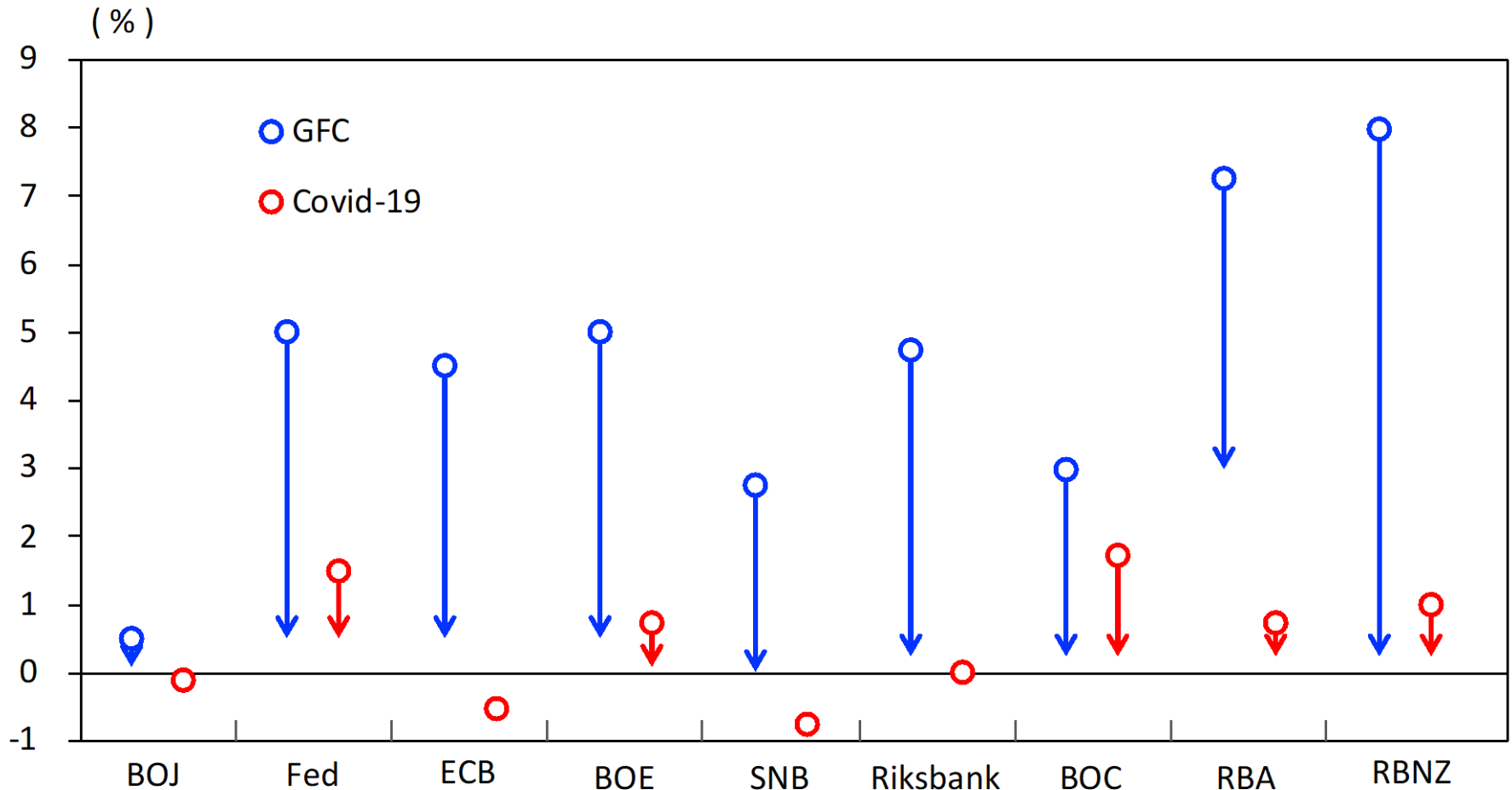
Sources: Board of Governors of the Federal Reserve System, European Central Bank, Bank of Japan

CB B/S Size



Sources: Board of Governors of the Federal Reserve System, European Central Bank, Bank of Japan

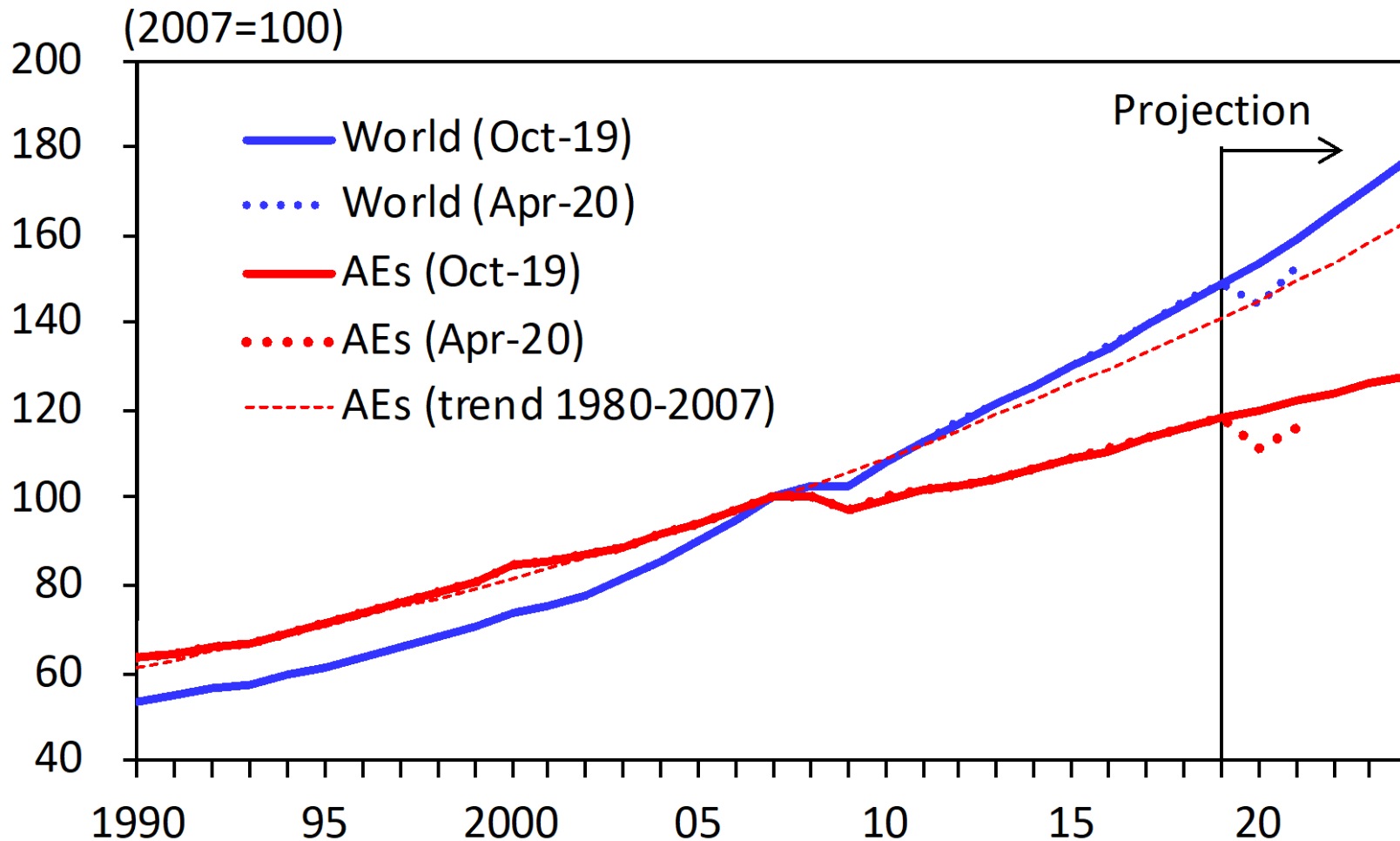
Policy Rate Reduction



Note: Circle to the end of arrow indicates the policy rate reduction before and after the crisis: GFC (from end-July 2008 to bottom in 2009-10; Covid-19 (from end-Jan 2020 to the current level))

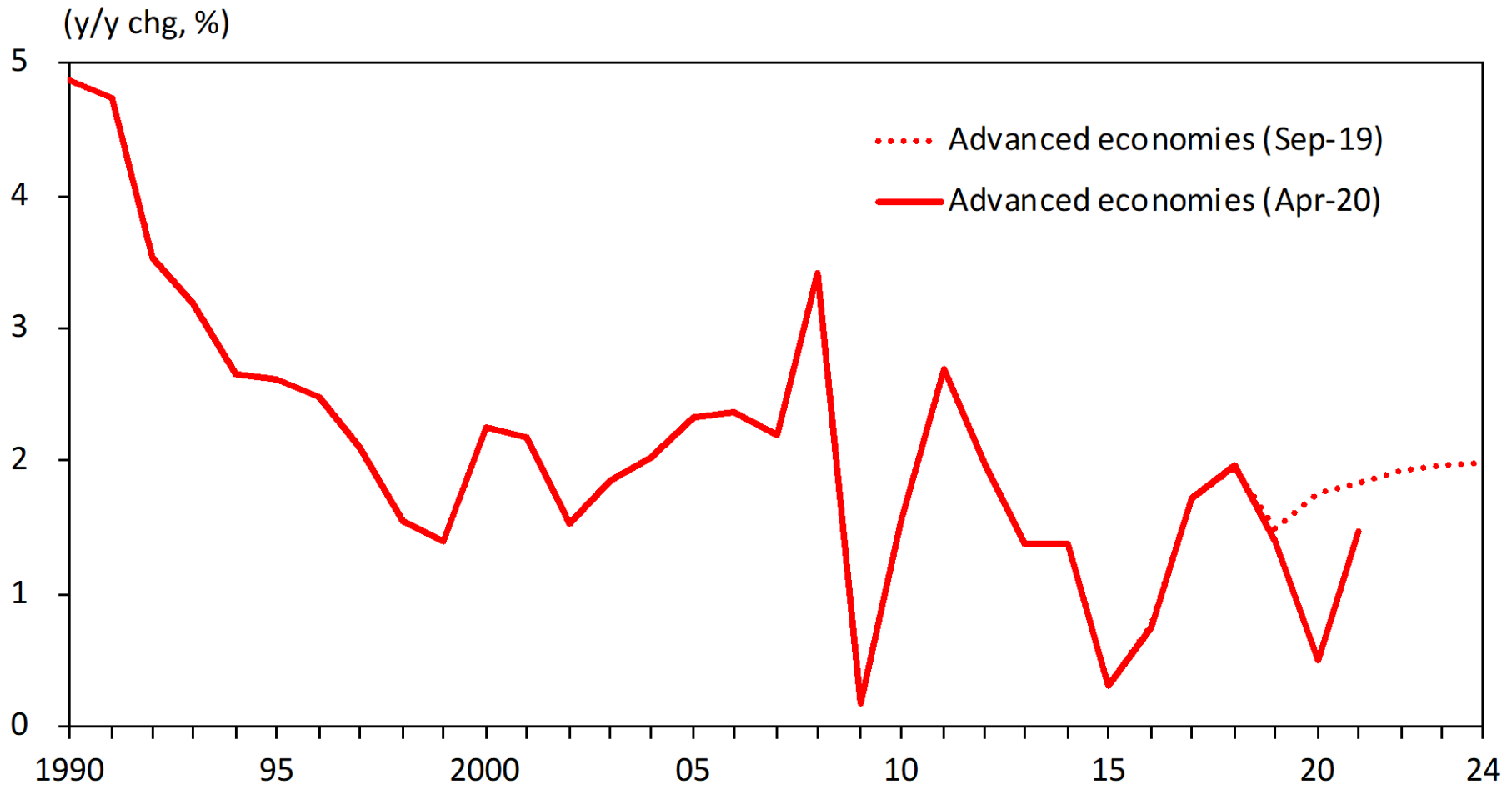
Sources: Central banks' websites.

Slow Recovery in AEs



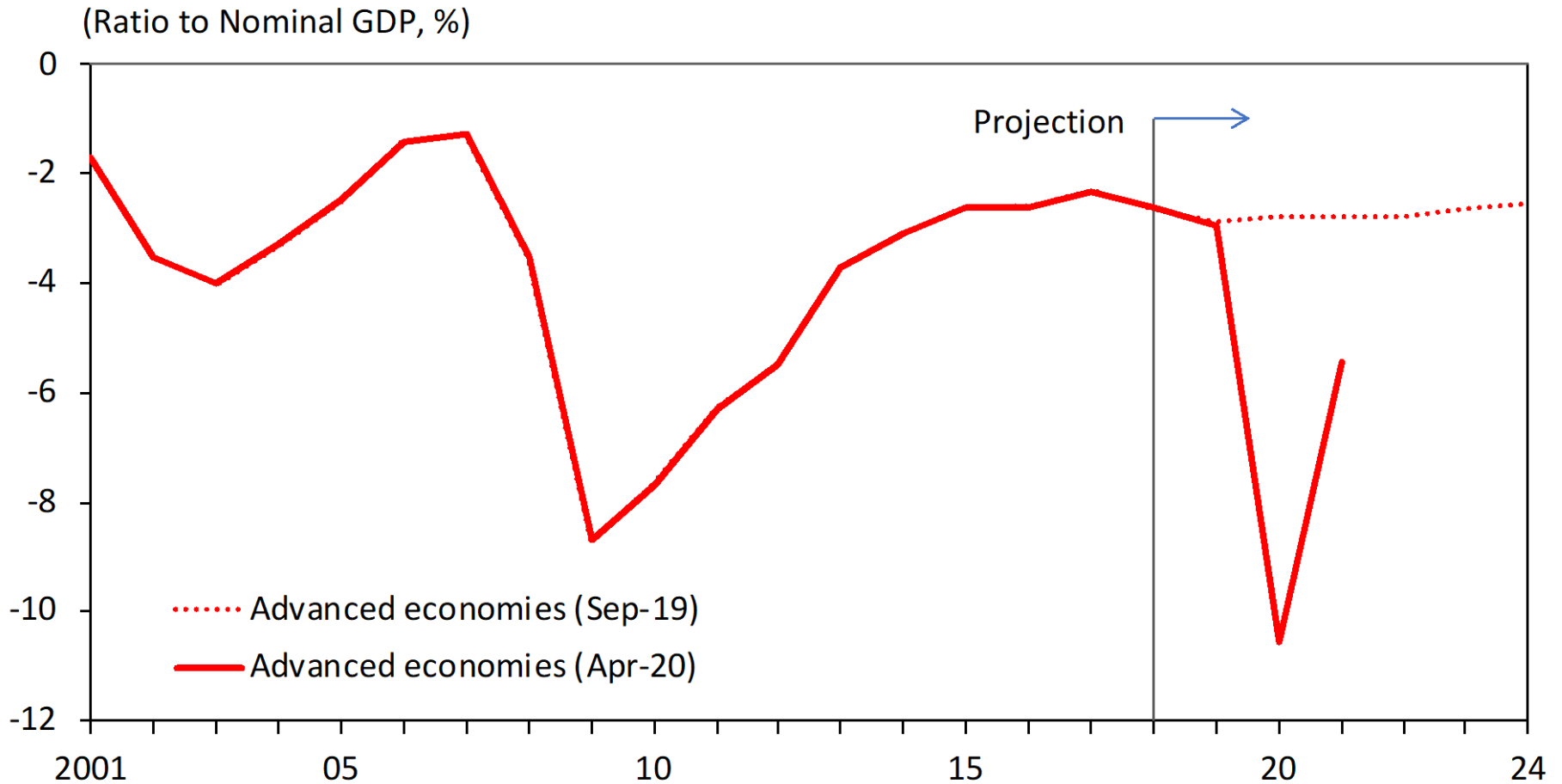
Source: IMF

Core CPI Inflation in AEs



Source: IMF

Government Debt in AEs



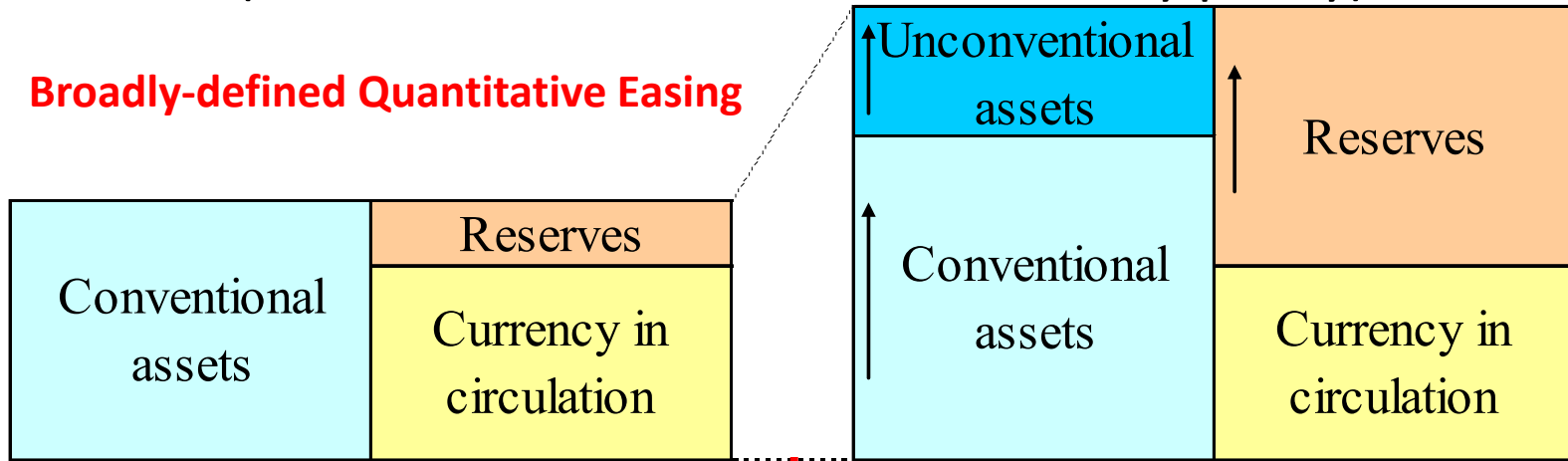
Source: IMF

Plan of Today's Talk

1. Japan's Experience since mid-1990s
2. New Environment in the Post Covid-19 Era
3. **CB B/S under Unconventional Policy**
4. Future of Central Banking: New Framework in Appearance vs in Reality
5. Conclusions

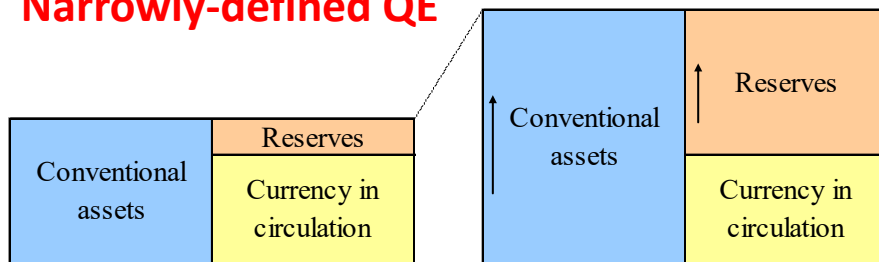
CB B/S under Unconventional Policy

(Observed unconventional monetary policy)



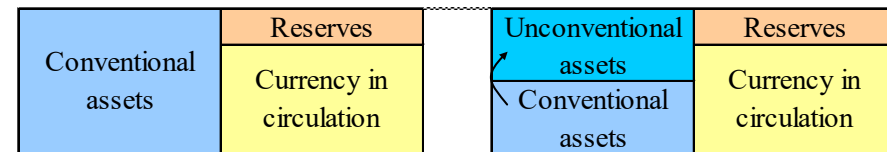
(Size)

Narrowly-defined QE



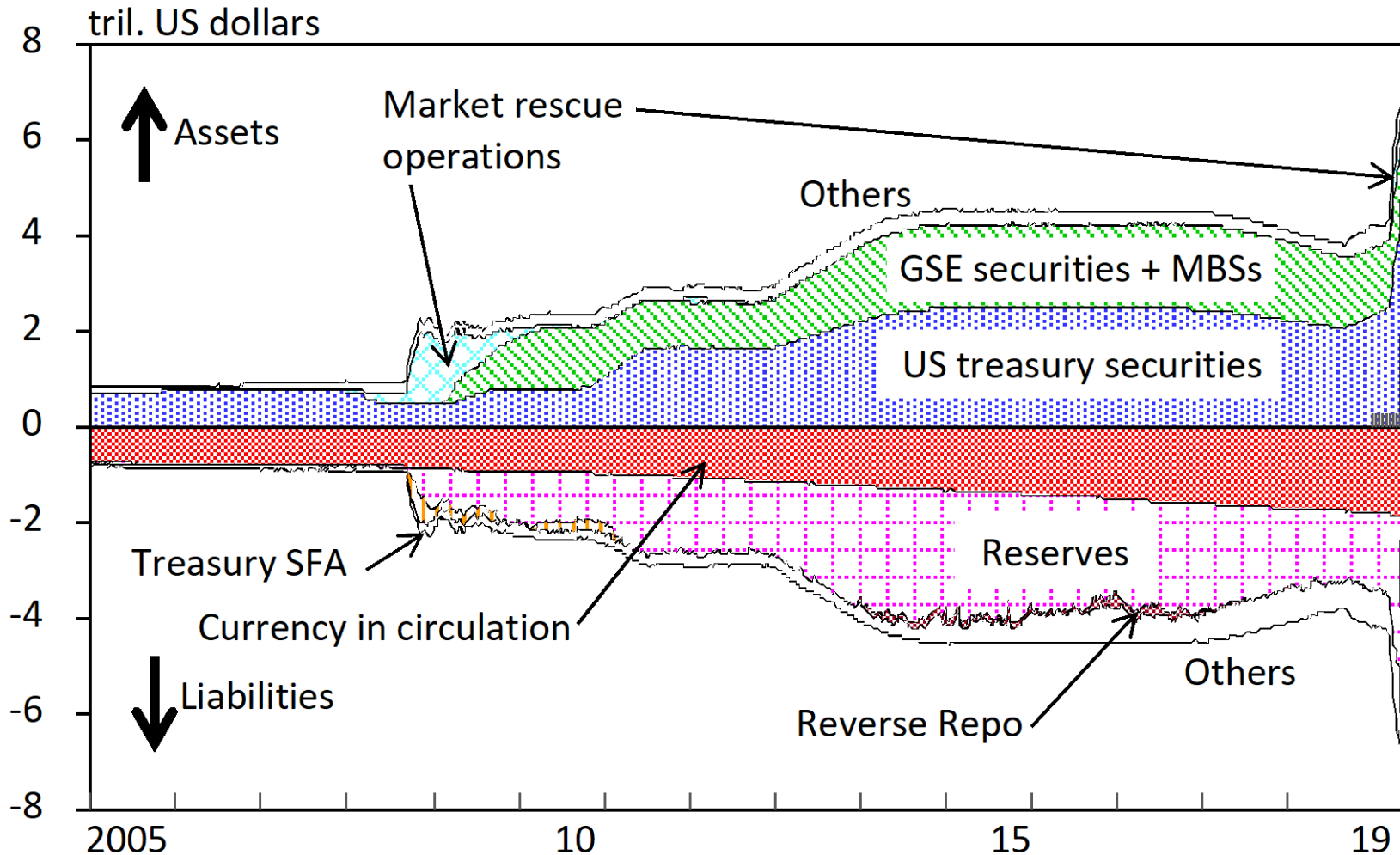
(Composition)

Narrowly-defined Credit Easing



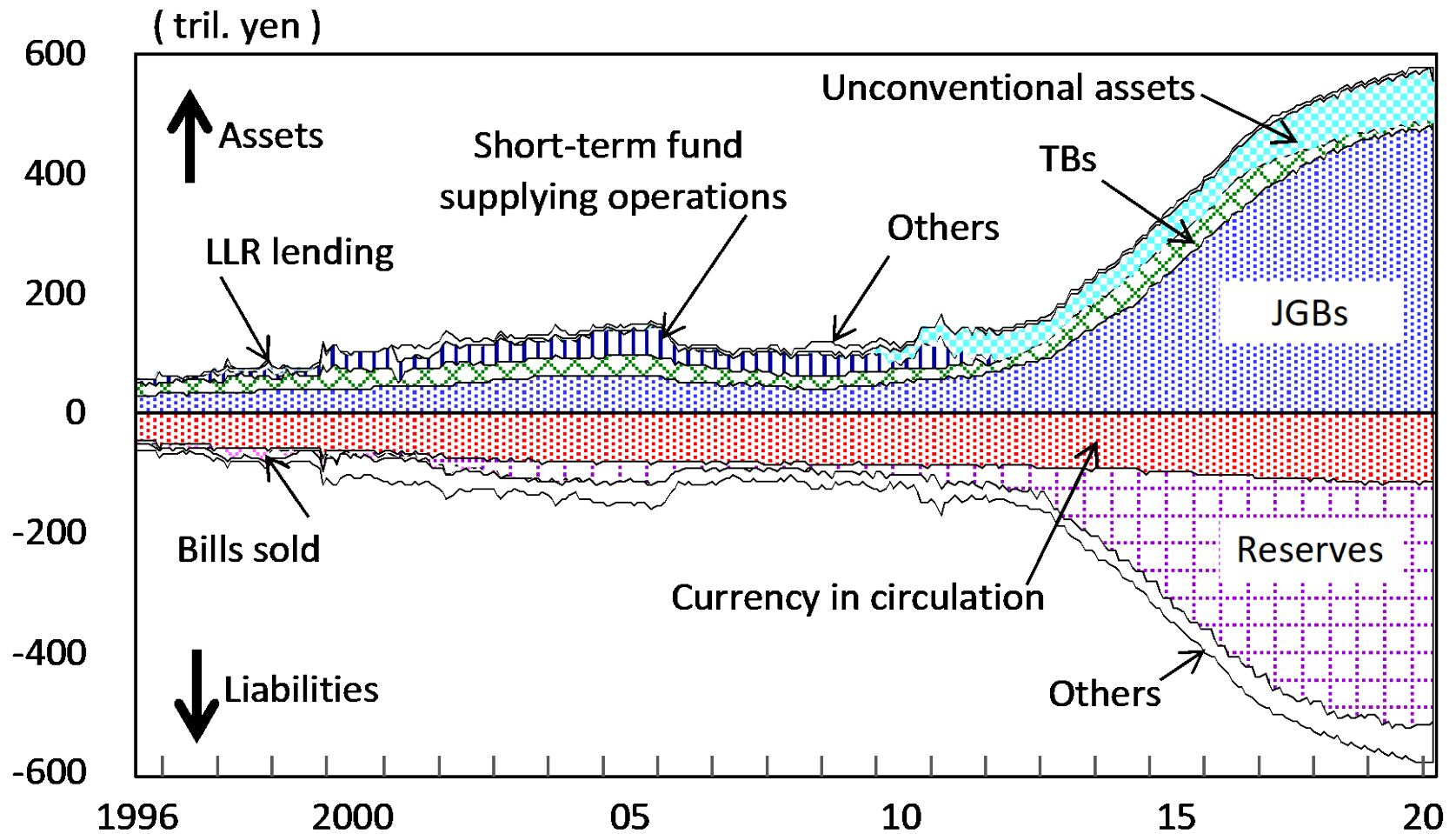
Source: Shigenori Shiratsuka (2010), "Size and Composition of the Central Bank Balance Sheet: Revisiting Japan's Experience of the Quantitative Easing Policy," *Monetary and Economic Studies*, 28, pp. 79-105.

Fed's Balance Sheet



Source: Board of Governors of the Federal Reserve System, *Factors Affecting Reserve Balances*.

BOJ's Balance Sheet

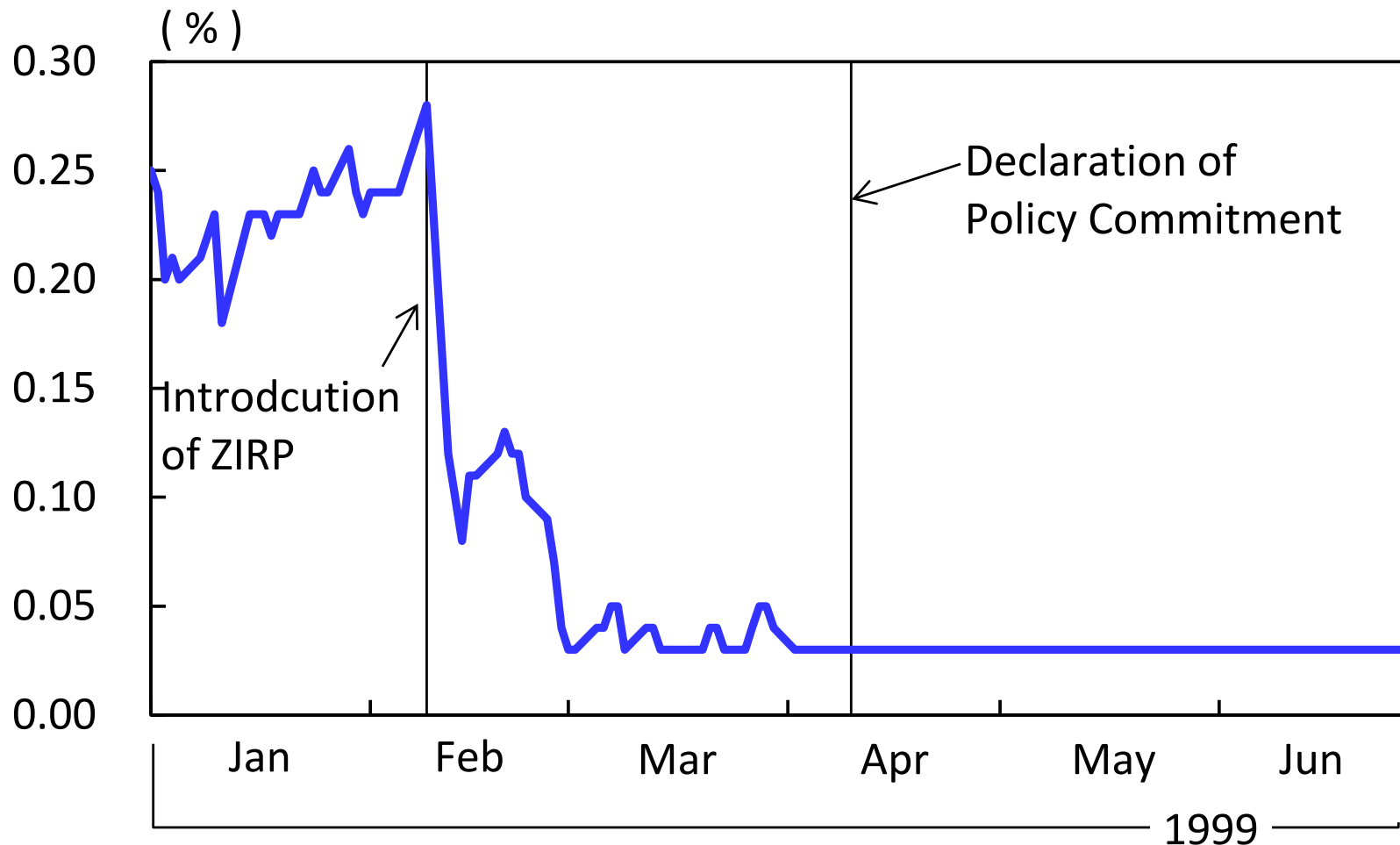


Source: Bank of Japan, *Monetary Base and the Bank of Japan's Transactions*.

Role of Excess Reserves

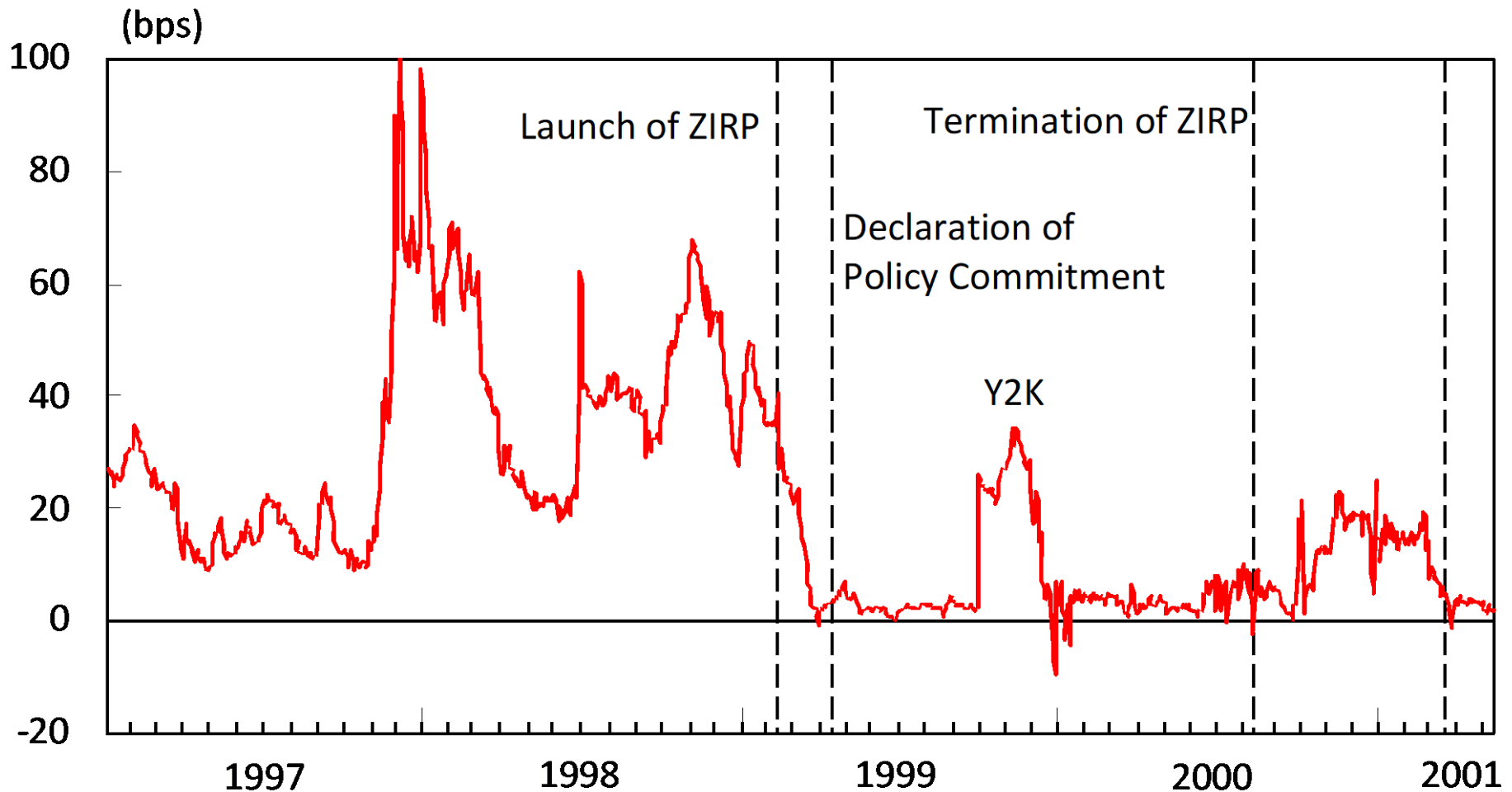
- Creation of Zero Rates:
 - No need to provide a huge amount of reserves
- Liquidity Effects:
 - Accommodating precautionary liquidity demand
 - Negative side effects: Direct dealing Mkt w/ CB
 - Almost no role in reserve reallocation
 - Stop functioning as risk-sharing devices
- To Huge Excess Reserves:
 - Negative side effects >> Positive liquidity effects

O/N Call Rate



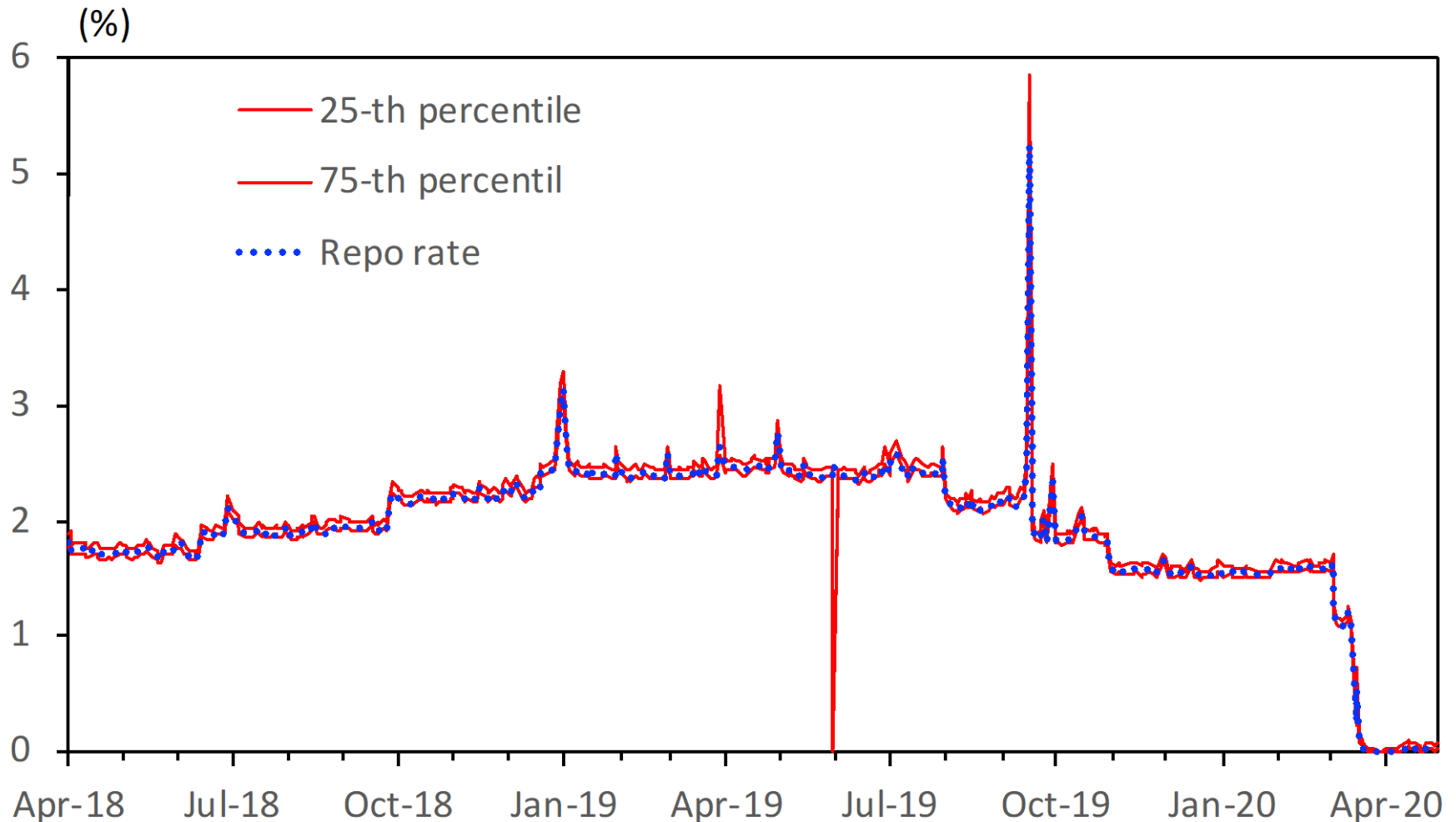
Source: Bank of Japan

CD-TB Spreads



Source: Bank of Japan

US Repo Rates



Source: Federal Reserve Bank of New York

Role of Asset Purchases

- Emergency Measures in Crisis Time:
 - Intervention to malfunctioning markets
 - Restoration of MP transmission channels
 - Make stimulative measures more effective in rebooting the economy
 - But just buy-time policy
 - Difficult to differentiate illiquidity from insolvency

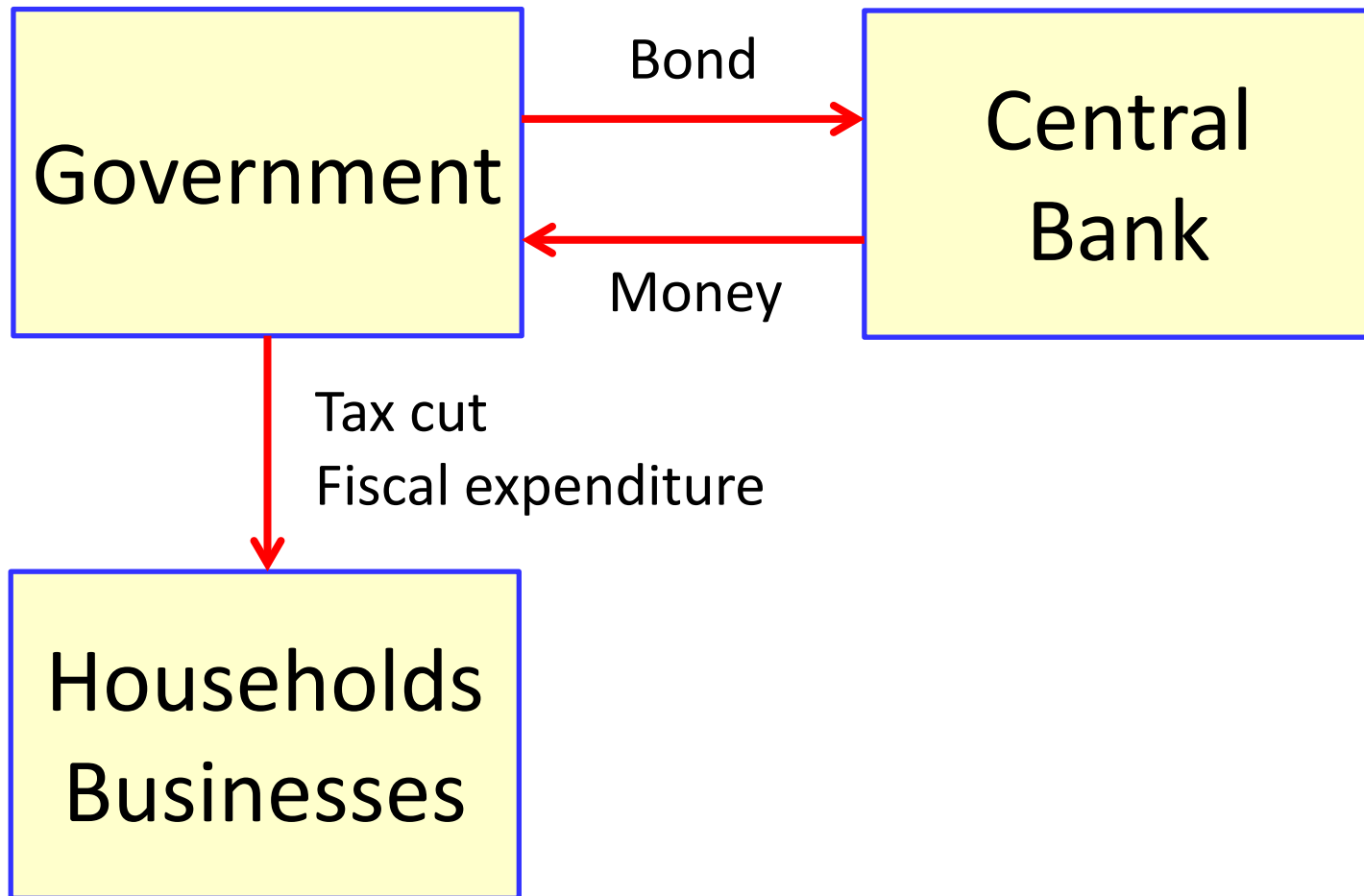
Role of Asset Purchases (cont'd)

- Transition from Crisis Time to Recovery:
 - Need to implement policy measures to more chronic deficiency of the economy (not MP)
 - Difficult to exit from once-introduced emergency MP measures (esp. in Japan)
 - Implications to monetary policy measures
 - More fiscal policy aspects
 - More intentional policy intervention to economic resource allocation

A Case for Helicopter Drop

- Milton Friedman, “The Optimum Quantity of Money,” 1969:
 - A hypothetical case for one-off transfer by CB money creation
- Ben S. Bernanke, “Deflation: Making Sure ‘It’ Doesn't Happen Here,” 2002:
 - A money-financed tax cut
- NOT Monetary Policy, But Fiscal Policy

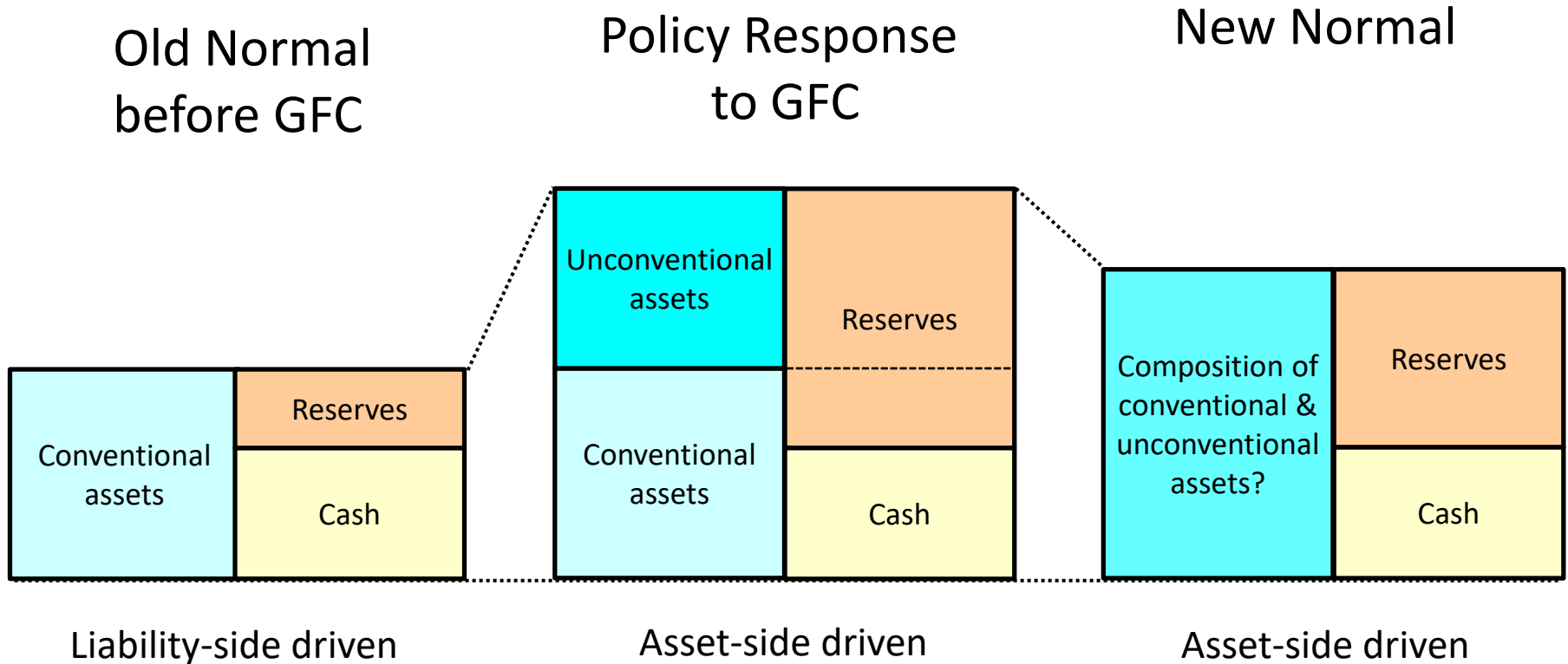
Money Financed Fiscal Expansion



Plan of Today's Talk

1. Japan's Experience since mid-1990s
2. New Environment in the Post Covid-19 Era
3. CB B/S under Unconventional Policy
4. Future of Central Banking: New Framework in Appearance vs in Reality
5. Conclusions

Future of CB B/S



CB Objectives: BOJ's Case

Price stability

A state where various economic agents may make economic decisions without being concerned about the fluctuations in the general price level.

Monetary Policy

Financial stability

A state where various economic agents may make economic decisions without being concerned about the state of the financial system.

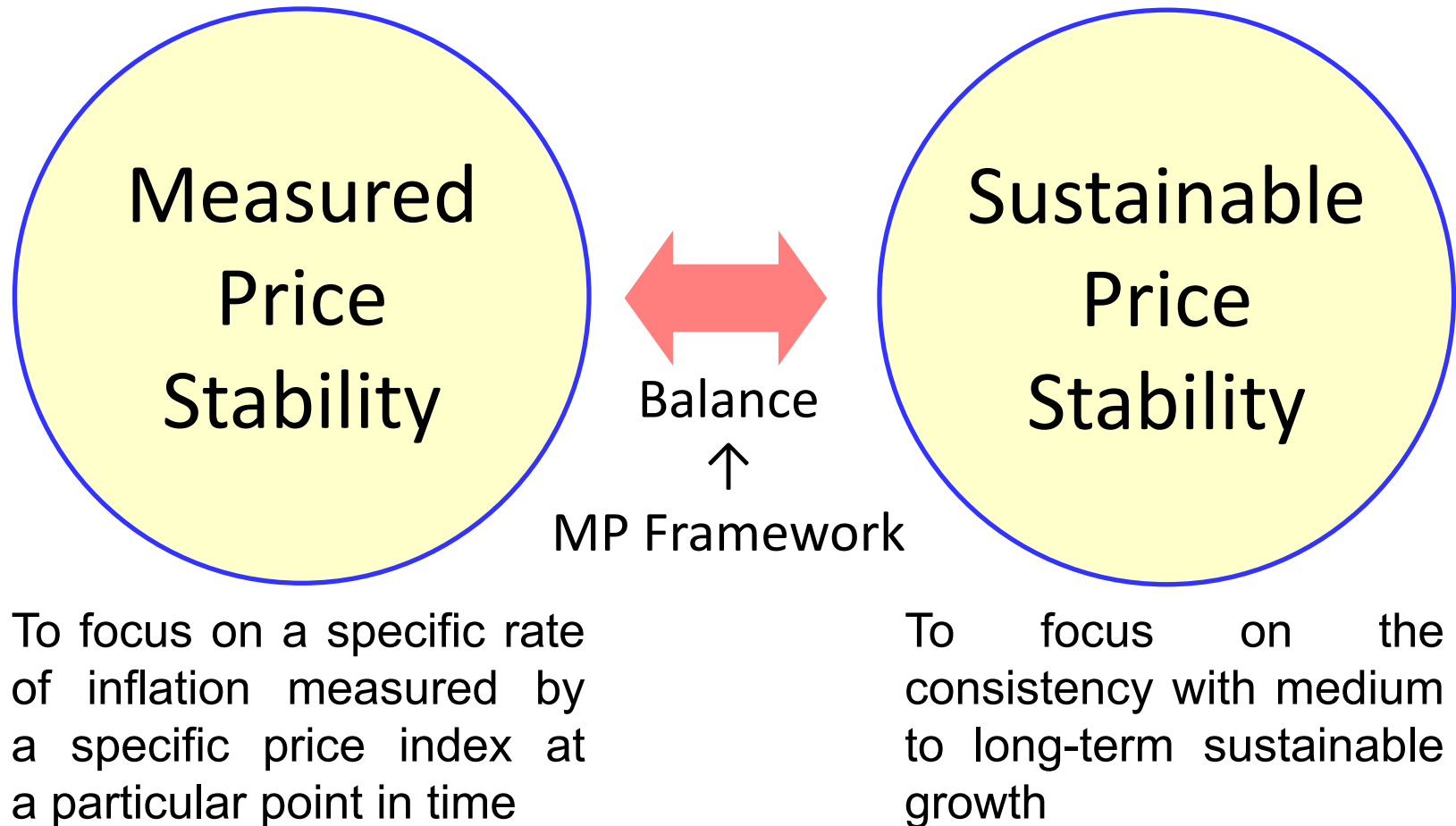
Prudential Policy

Simultaneous achievement of two stabilities in a sustainable manner

Maintenance of economic and financial environment that is consistent with promoting efficient resource allocation in the economy in the long term

To ensuring public confidence on money in a broad sense

Conceptual Basis for Price Stability

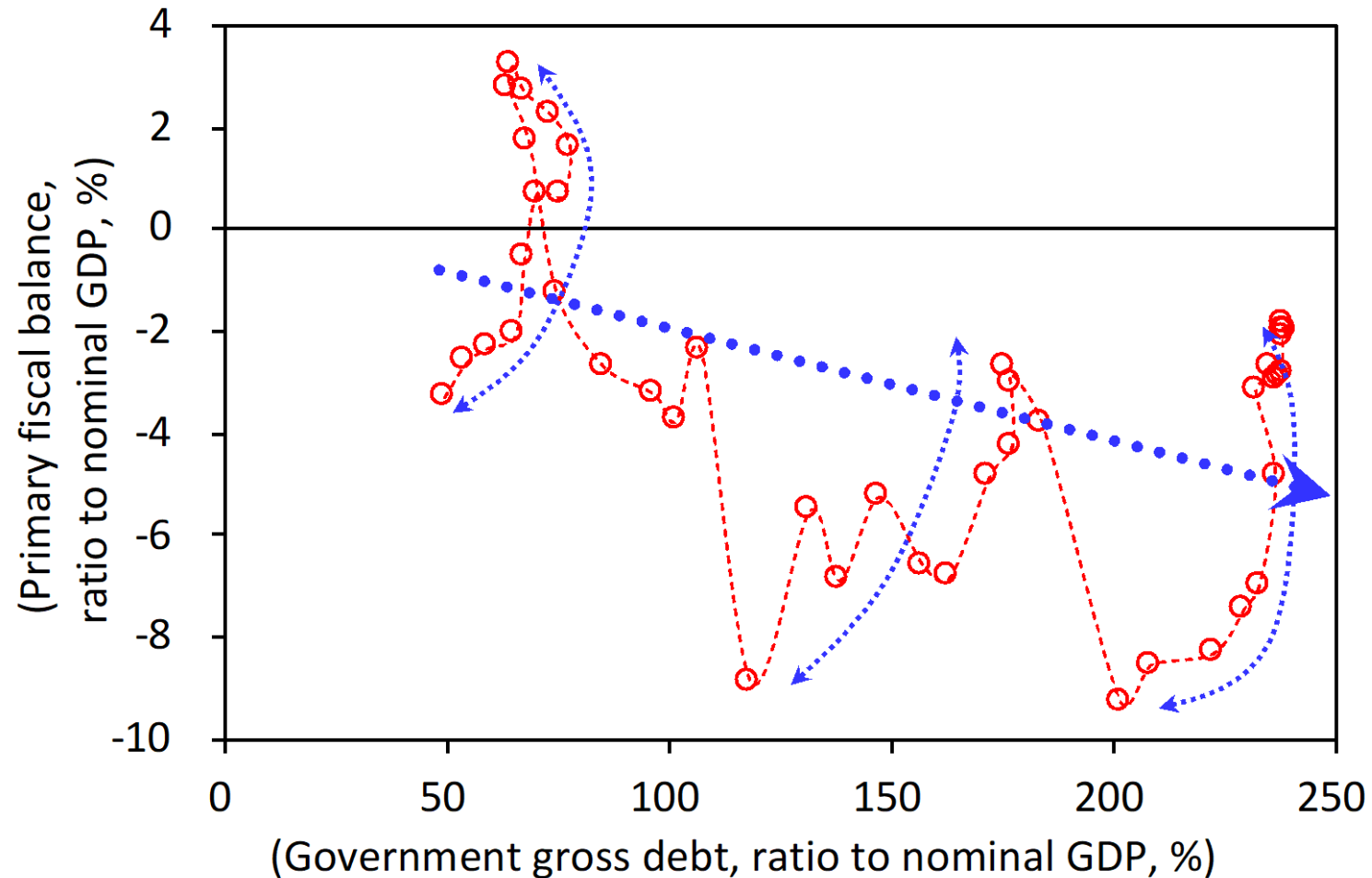


Shigenori Shiratsuka (2001), "Is There a Desirable Rate of Inflation? A Theoretical and Empirical Survey," *Monetary and Economic Studies*, 19(2), Institute for Monetary and Economic Studies Bank of Japan.

CB Objectives in Post-C19 Era

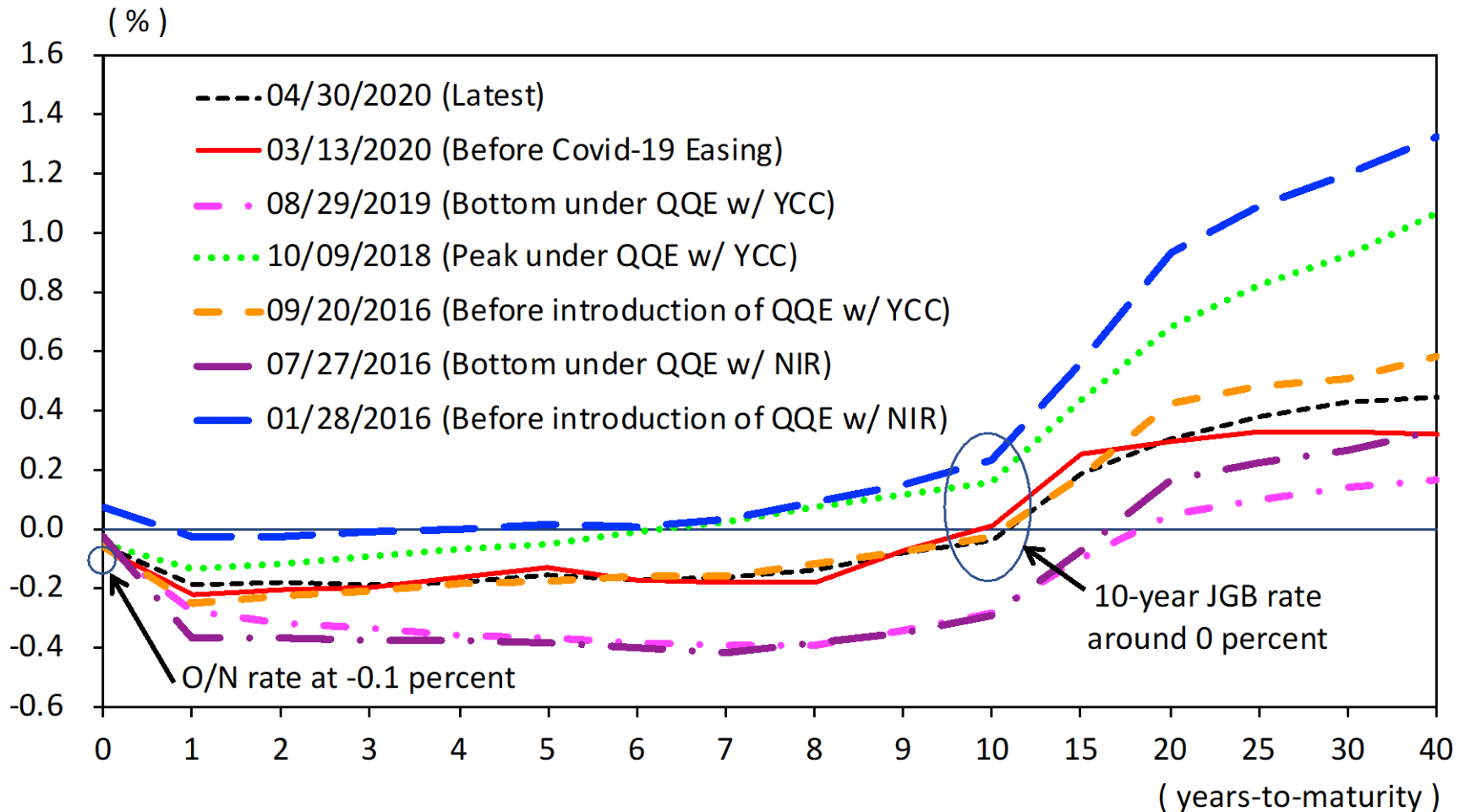
- To Maintain Credibility on Currency:
 - Under huge government debts
 - With virtually no inflation pressure under ELB
- Monetary Policy Framework:
 - High priority for maintaining stable low long rates
 - Use CB B/S for gov. deb management policy
 - Explanation: Put more importance on financial stability, rather than price stability
 - Price stability target → Exit strategy, if time comes

Fiscal Sustainability in Japan



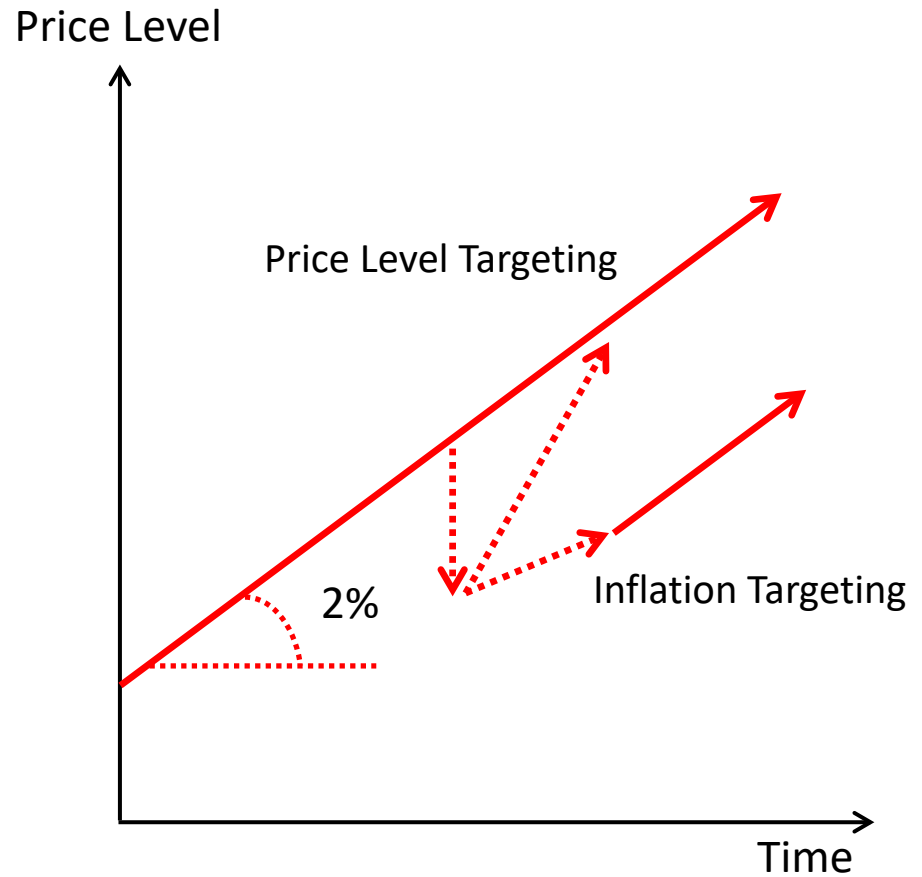
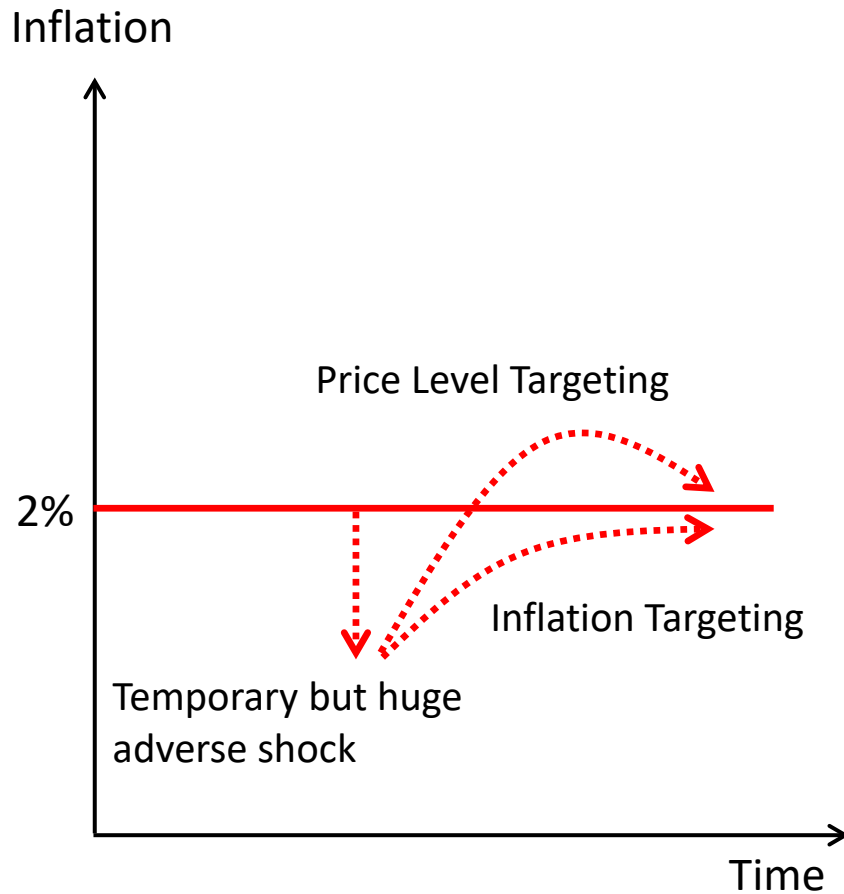
Source: International Monetary Fund, *World Economic Outlook*.

Yield Curve Control



Sources: Ministry of Finance, Bank of Japan.

PLT as an Exit Strategy



Plan of Today's Talk

1. Japan's Experience since mid-1990s
2. New Environment in the Post Covid-19 Era
3. CB B/S under Unconventional Policy
4. Future of Central Banking: New Framework in Appearance vs in Reality
5. Conclusions

A New Monetary Policy Framework

- What “NEW”?:
 - Monetary policy tool: Unconventional becomes conventional and normal
 - Policy objectives: Maintain credibility on currency
 - Not price stability but Gov. debt sustainability
 - Monetary Policy implications: Massive intervention to resource allocation
 - No border w/ FP
- New Monetary Policy Framework
 - Probably not desirable, but inevitable