



Policy Panel: What lessons to draw

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Plan of This Lead Speech

- To draw lessons from the Japanese (and European) experience of the past twenty-some years
- Then, to present preliminary assessment of “Abenomics” and the “bold” monetary policy of the Bank of Japan based on these lessons

Three Lessons: A, B, C

- **Avoid wishful thinking – Face the reality**
 - we observed: overly optimistic forecast
 - we observed: waiting for the return to old normal
- **Be Proactive, not Reactive**
 - “evidence” may be too late too inaccurate
 - “reactive” policy leading to “wait and see”
- **Communicate Effectively**
 - growing importance of “long-term” sentiment conditions (“animal spirit”, anxiety over future, etc)
 - counteract excessive pessimism and optimism

1. Avoid wishful thinking

– Face the reality

- Ample evidence of initial under-estimation of problems that later became large and threatening
- Ex. NPL in the balance sheet adjustment
- Ex. Impact of Ageing (though not covered sufficiently in this conference)
 - Even population forecasts are subject to this “initial under-estimation syndrome”
➔ next two figures

Figure 1

Revisions in the Japanese Total Fertility Rate Forecast

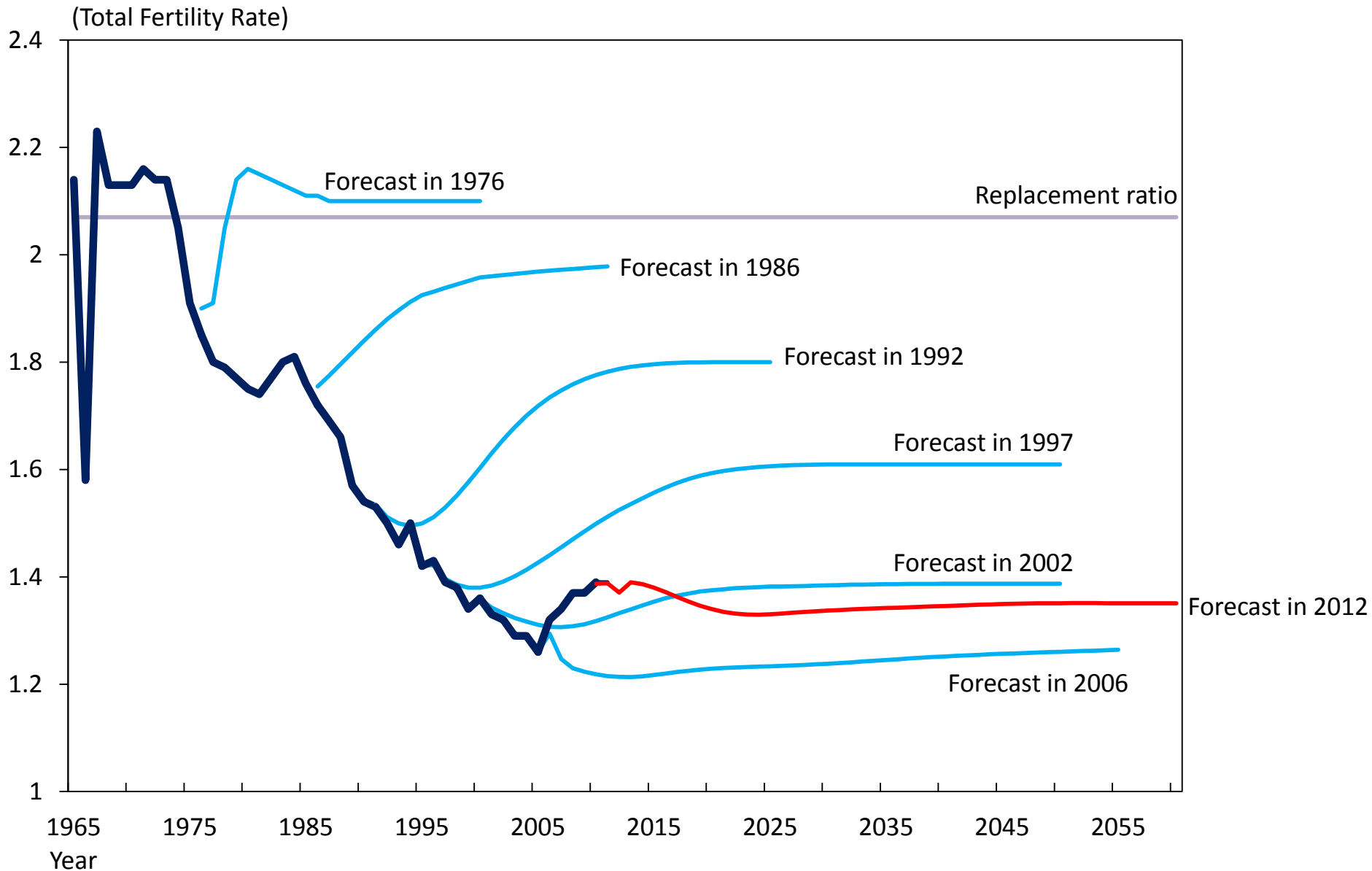
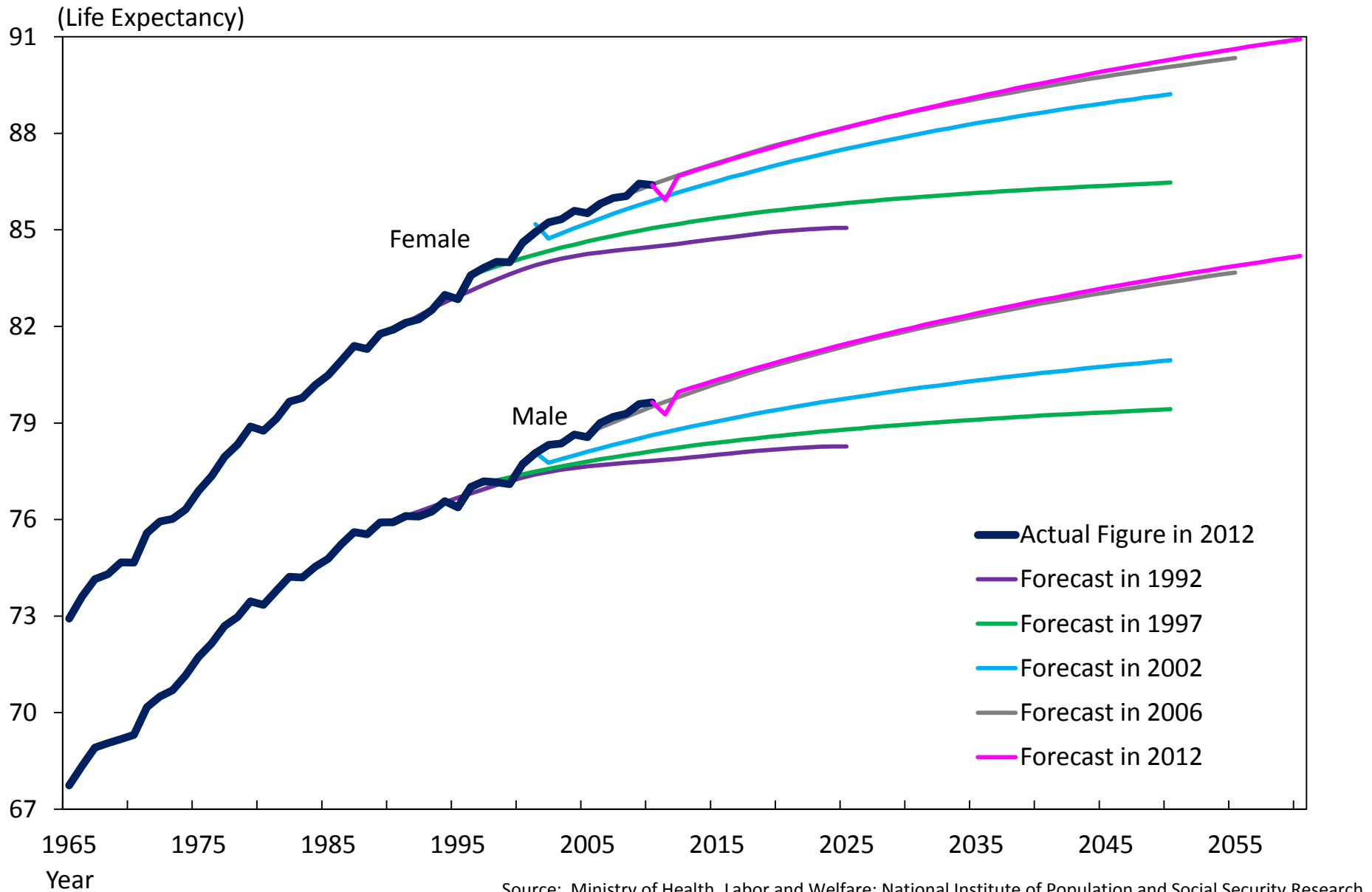


Figure 2

Revisions in the Japanese Life Expectancy Forecast



2. Be Proactive, not Reactive

- Evidence may be too late too inaccurate
 - Table 1: GDP revision history: Parisbas shock 2007 Q3, the Collapse of Lehman Brothers 2008Q3, 2009Q1--Q3
- Common attitude toward these inaccurate data problems: wait for more data
- However, to wait may lead to lose the window of opportunity (in real terms as well as from the communication policy perspective)

Table 1. History of GDP revision

At the time of crisis, “current” data may grossly be inadequate or misleading

	2007 Q3_1	2008 Q3_1	2009 Q1_2	2009 Q2_2	2009 Q3_1	2010 Q3_2	2010 Q4_1	2011 Q3_1	2013 Q2_2
2007/ 7 - 9.	2.6	2.3	0.8	-1.3	-2.3	-0.6	-0.9	-1.1	-1.4
2008/ 7 - 9.		-0.4	-2.5	-5.1	-6.5	-4.6	-5	-5.2	-4
2009/ 1 - 3.			-15.2	-12.4	-12.2	-19.9	-20.1	-17.7	-15
2009/ 4 - 6.				2.3	2.7	11.3	10.8	8.4	6.7
2009/ 7 - 9.					4.8	-1.2	-1.9	-2.3	0.4

3. Communicate Effectively

- growing importance of “long-term” sentiment conditions (“animal spirit”, anxiety over future, long-term inflationary expectations, etc)
- crucial role of communication policy
 - to reduce uncertainty that may arise in the future course of policy
 - to counteract excessive pessimism and optimism

“Abenomics” and “Bold” Monetary Policy: A Very Preliminary Assessment

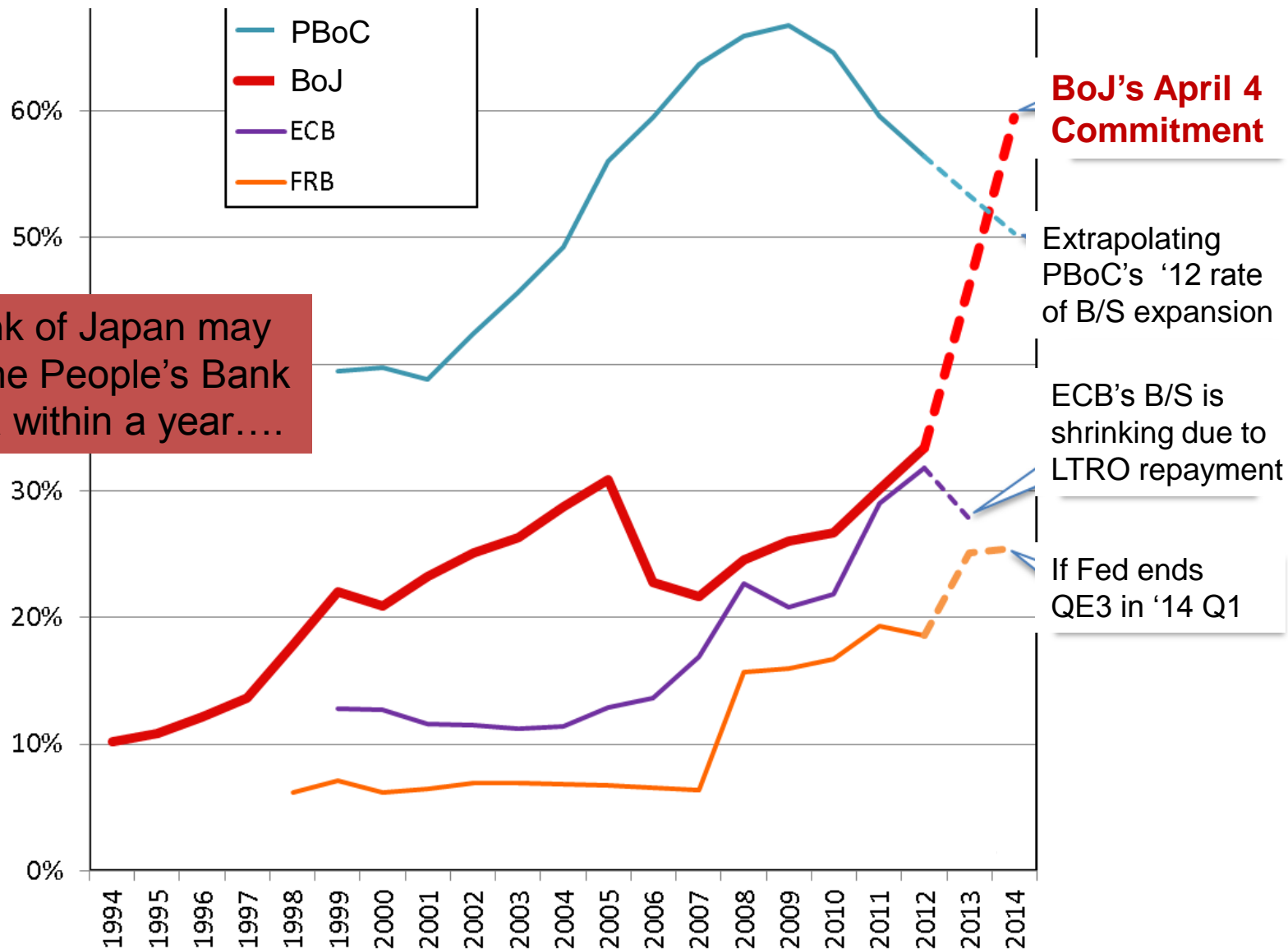
- Background: Four Woes
 - Series of Bad Lucks
 - Lehman shock’s unprecedented real-side effects
 - earthquake, tsunami, Fukushima, Thai flood and supply-chain disruption
 - Over-valuation of Yen
 - yen as “safe-parking lot” during financial turmoil
 - market was slow to recognize impacts of energy costs on current account surplus
 - “Reactive” Policies
 - Political instability and lack of decisive leadership
 - Prevalent Pessimism

“Abenomics” and “Bold” Monetary Policy

- Abenomics’ “Three-Arrow” Promises of December 2012
 - 1st Arrow: “Bold” monetary policy
 - 2nd Arrow: “Flexible” fiscal policy
 - 3rd Arrow: Investment-enhancing structural reform
- “Bold” monetary policy change of April 4, 2013
 - “Q-squared Easing”
 - “Doubling” the size of the central bank’s balance sheet
 - More than doubling the ETF (Stocks) purchase; purchasing longer-maturity JGBs
 - “2% in 2 years” commitment

Magnitude of New Bank of Japan's Policy (1)

Central Bank's B/S to Nominal GDP Ratio Projected at around April 4



The Bank of Japan may topple the People's Bank of China within a year....

BoJ's April 4 Commitment

Extrapolating PBoC's '12 rate of B/S expansion

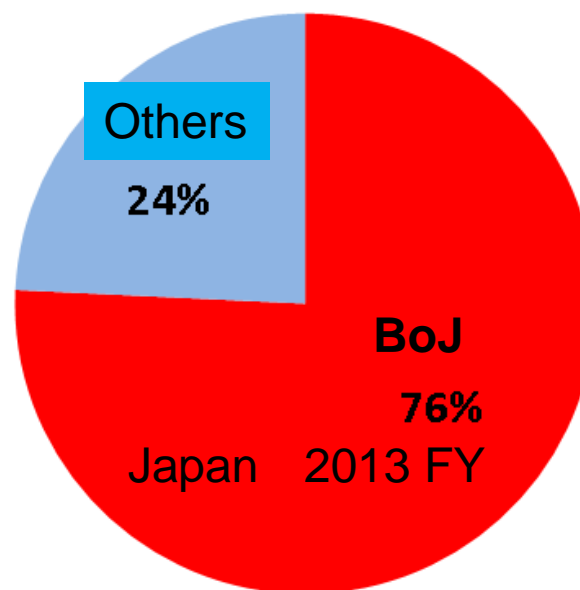
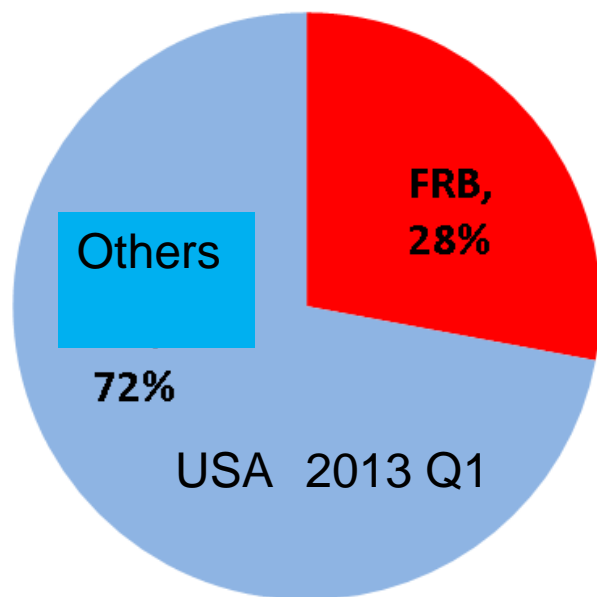
ECB's B/S is shrinking due to LTRO repayment

If Fed ends QE3 in '14 Q1

Magnitude of New Bank of Japan's Policy (2)

Central Bank Purchases and Total Government Bond Issuance

Projected at around April 4

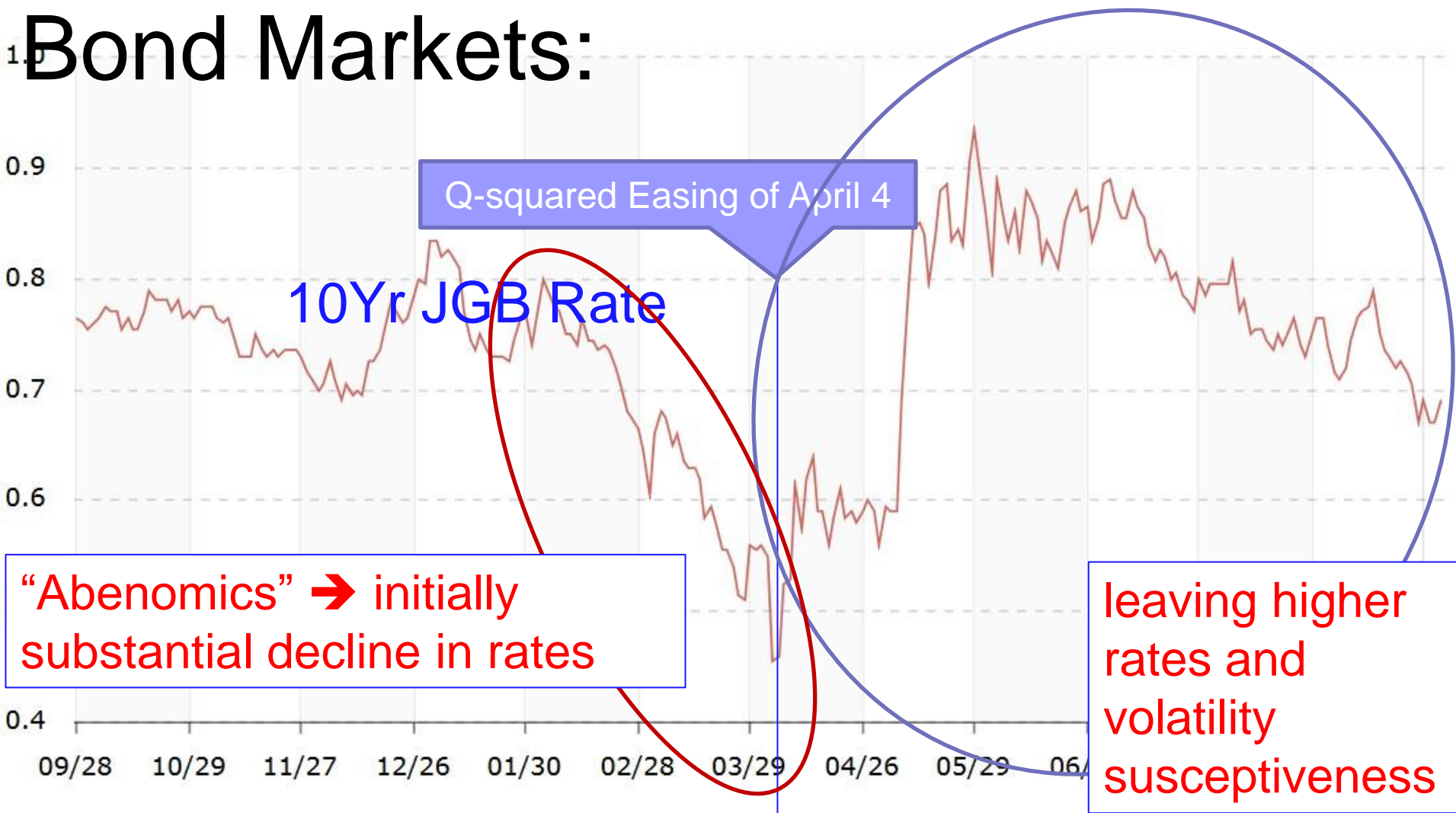


The Bank of Japan becomes a real Gulliver in JGB markets

Spectacular Initial Success...

- Spectacular initial five-month success in changing market sentiments (expectations)
- From pessimism [“glass-half-empty”] to optimism [“glass-half-full”]
- Especially successful in changing international perception of Japanese politics
 - One international security expert describes Abe as one of three “true leaders” remaining in the globe (Ian Bremmer, Reuter Column, Aug 16, 2013)
- However, after the April 4 policy change of BoJ, Abenomics momentum has been faded while volatility is increased in financial markets

Bond Markets:



“Abenomics” → initially substantial decline in rates

leaving higher rates and volatility susceptibility

Stock Markets

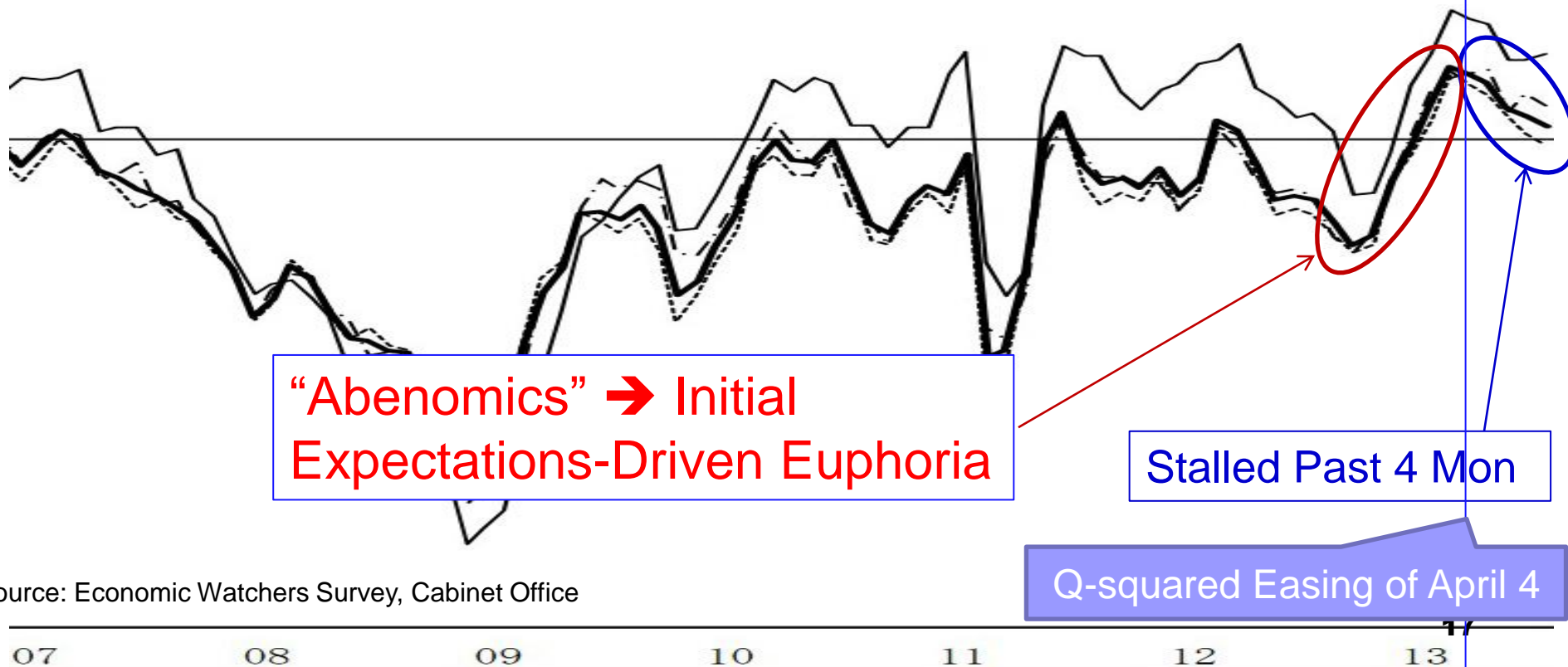
“Abenomics” → Initial Expectations-Driven Euphoria



Higher but volatile prices.
Strong upward momentum faded.

Economy Watchers Survey

- Known for high correlation with GDP growth
- Moved upward until April (BoJ policy change), but then stalled May, Jun. Jul. Aug



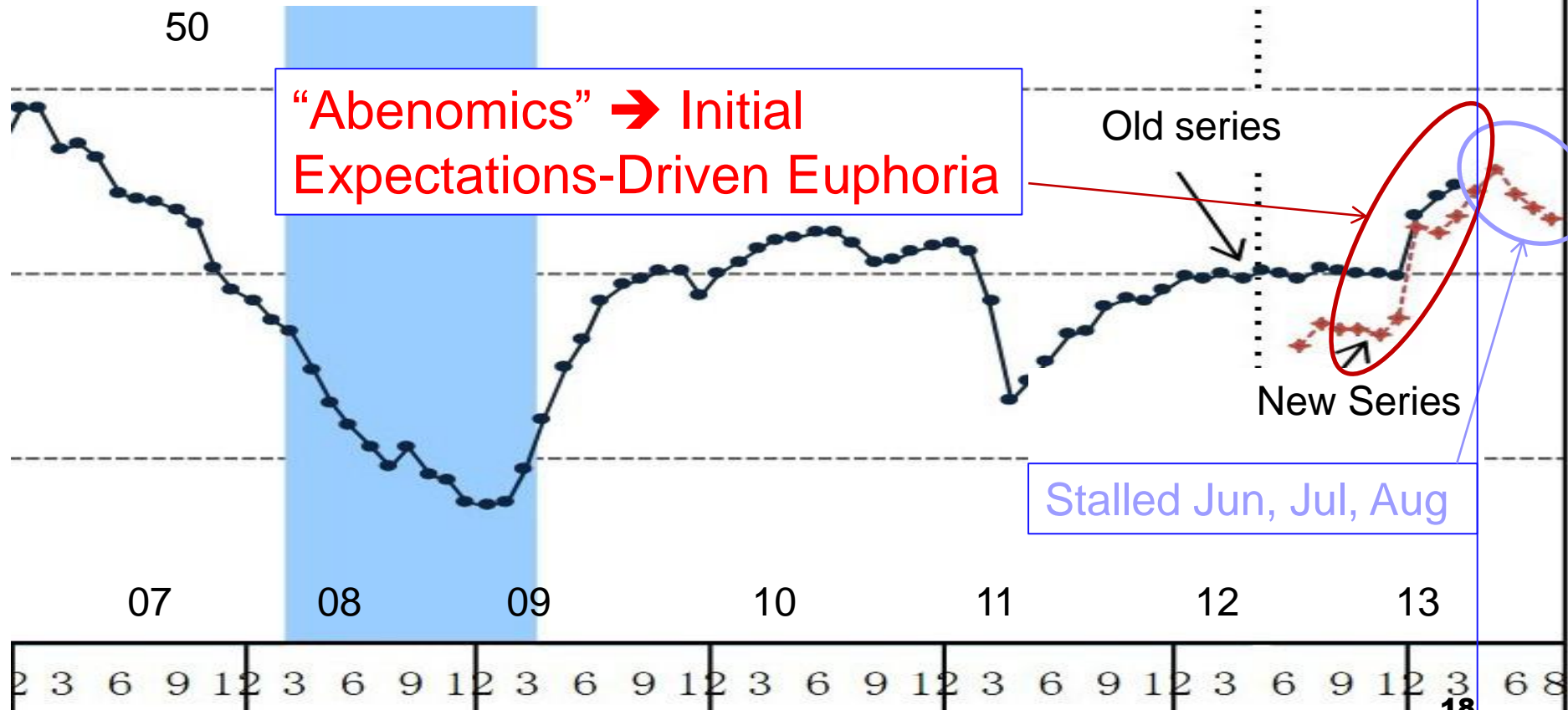
Source: Economic Watchers Survey, Cabinet Office

Q-squared Easing of April 4

Consumer Confidence Survey

- Moved upward until May
- But then stalled in June, July, Aug

Q-squared Easing of April 4



“Abenomics” → Initial Expectations-Driven Euphoria

Stalled Jun, Jul, Aug

Recapitulation 1

- Abenomics has a spectacular initial success in changing the nation's mood (which particularly matters in politics)
 - ← Proactive, not reactive, policy initiative
 - ← Successful communication policy

Recapitulation 2

- However, its momentum faded with increased financial volatility after the BoJ's policy change
 - Increased uncertainty about monetary policy
 - Two lingering questions to be answered
 - How can BoJ raise inflationary expectations substantially in 2 years, even though most market participants remain doubtful?
 - What financial conditions (esp. long-term JGB rates) is to be expected in 2 years from now, if BoJ is successful in achieving "2% in 2 years"?
 - ← Need to have persuasive communication policy
 - ← Need to show BoJ is free from wishful thinking₂₀

Recapitulation 3

- Abenomics' faded momentum so far is partly due to re-recognition of uncertainty in the future
 - As it stands now it is largely still a promise, especially with respect to its most important “third arrow” of (investment-enhancing) structural reform
- Need to show the prime minister is free from wishful thinking and an effective communicator
 - Explain: what structural reform will the Abe Government implement, which is effective to raise growth potentials (investment) and to counteract population ageing (labor)?
 - Explain: what is the road map of the financial consolidation, which is bold to be effective and realistic to be persuasive?

Concluding remarks

- There is a good chance of ultimate success
 - No additional bad luck so far
 - Natural recovery phase from the Earthquake etc
 - Some new good lucks
 - Still favorable perception
- However, avoid wishful thinking, be proactive, and communicate effectively
 - Be flexible enough to follow these three dicta.
 - Garner the perception that the policy maker actually follows these three dicta.