Opening Remarks

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I. Introduction

Good morning, ladies and gentleman. It is my great honor to say a few words to mark the opening of the 2014 BOJ-IMES Conference.

The theme of this year's conference is "Monetary Policy in a Post-Financial Crisis Era." Around six years have passed since the outbreak of the recent global financial crisis, and following the Great Recession the world economy has been recovering only moderately on the whole. Both during and after the financial crisis central banks took various policy measures, including unconventional ones. In the realm of academia, there is a growing number of studies on these policy responses taken by central banks. Sharing and debating the experience of different countries and the results of such studies is crucially important in considering the management of monetary policy in the future. Thus, the theme of this year's conference is a timely one that is likely to have attracted the participation of senior officials from central banks around the world and international organizations as well as prominent academics. On behalf of my colleagues at the Bank of Japan and myself, I would like to renew my heartfelt welcome to all of you.

II. Evolution of the Debate on Central Bank Policy up to the Recent Global Financial Crisis

History does rhyme. Looking back in history, there are many examples where major events—just like the recent global financial crisis and ensuing recession—have provided lessons and spurred the thinking on central bank policy. In academia, it has been said that the focus of central banks' policy has evolved as a result of the experience of the Great Depression, the Great Inflation, and the Great Moderation.

Initially, when central banks were first established, their major role was that of a lender of last resort to financial institutions when liquidity dries up due to a financial crisis. This role was based on the classical lender-of-last-resort theory put forward by Walter Bagehot. He proposed what has come to be called the Bagehot rule, namely that in times of crisis central banks should act as a lender of last resort, providing unlimited funds at punitive rates.[1]

Central banks' major role shifted from this lender-of-last-resort function to economic stabilization as the world experienced the Great Depression, the collapse of the gold standard, and the rise of policies to manage aggregate demand proposed by

1. For the Bagehot rule, see Begehot (1873).

John Maynard Keynes and others. However, as central banks put too much priority on maintaining favorable economic conditions, the world came to face the period of Great Inflation that began in the 1970s.

Against this background of high inflation in countries around the world, Milton Friedman's argument that "inflation is always and everywhere a monetary phenomenon" gradually gained support and the focus of central bank policy shifted to price stability.[2] A representative example is the disinflationary policy adopted by the U.S. Federal Reserve under then Chairman Paul Volcker.

This era was followed by the Great Moderation, a period of stable growth and low inflation that continued until the recent global financial crisis. During this period, the view became dominant that monetary policy could contribute to economic stability without jeopardizing medium- to long-term price stability through anchoring inflation expectations. One monetary policy framework within this broader view was inflation targeting, which was adopted in many countries. In contrast, financial stability was an issue that did not receive much attention in central bank policy. Some central banks, in fact, came to focus exclusively on the management of monetary policy, with financial supervisory functions being separated and entrusted to other bodies. It is against this backdrop that the recent global financial crisis erupted, resulting in the ensuing Great Recession.

This simple overview provides a brief summary of views regarding the role of central bank policy up to the recent global financial crisis. As I hope became clear, central banks' role has constantly evolved through meeting the particular challenges of the time. I believe that, as in the past, lessons from the recent crisis and its aftermath will lead to the further evolution of central bank policies.

III. Lessons Learned from the Recent Global Financial Crisis and Its Aftermath and Issues Going Forward

In my view, there are three major lessons to be learned from the recent global financial crisis and its aftermath.

The first lesson is that stability of the economy as a whole cannot be achieved just by stabilizing prices and the real economy. Stabilization of the financial system also matters. Based on this recognition, there have been moves since the recent global financial crisis to strengthen central banks' financial supervision function, and some central banks have been newly granted supervisory power.

The second lesson is that it is possible to implement monetary easing even in a situation where the policy rate is around zero percent. After exhausting conventional policy measures by lowering the policy rate virtually to the zero lower bound, central banks in advanced economies have been underpinning economic recovery in the wake of the recent global financial crisis by using unconventional policy tools, such as asset purchases and forward guidance.

The third lesson, which is related to the second, is that expectation management

2. Friedman (1963).

through communication with the market is critical to guiding the economy toward recovery.

These were the lessons learned from the recent global financial crisis and its aftermath. At the same time, the lessons have revealed new issues that need to be resolved in the future. While there are a number of such issues, here I would like to point out the following three issues that many participants here today are facing.

The first issue is how to achieve both price stability and financial stability. Put into a policy context, this can be rephrased as the issue of the division of roles between monetary policy and macroprudential policy. That is, the question is whether we should consider macroprudential policy as the first line of defense for financial stability and monetary policy aiming at ensuring price stability as the last line of defense, or whether we should take account of both price stability and financial stability in the management of monetary policy.

The second issue relates to the effectiveness of forward guidance in expectation management. Since the recent global financial crisis, central banks in advanced economies have introduced various kinds of forward guidance. These include open-ended guidance, which does not clearly specify a period or conditions concerning the duration of a policy, calendar-based guidance, which specifies the duration of a policy, and state-contingent guidance, which clearly specifies conditions based on specific economic indicators. The effectiveness of forward guidance depends on the strength of the commitment and future policy flexibility, but how to strike a balance between the two is a critical point in discussing forward guidance.

The third issue concerns differences between the international spillover effects of conventional and unconventional monetary policy. While we know quite a lot about the international spillover effects of conventional policy and how monetary policy should take them into account, research on the international spillover effects of unconventional monetary policy has only just begun. Yet, a better understanding of and further studies on these spillover effects are highly desirable.

IV. Concluding Remarks

Central banks have faced a variety of challenges, but—thanks in part to support from the world of academia—have overcome these challenges and evolved their policies. While the three issues I just mentioned cannot be resolved overnight, I hope that discussions with you during this conference will provide some clues toward their resolution.

In closing, let me share with you a quote from the German poet Heinrich Heine: “Every age has its problem, by solving which, humanity is helped forward.”

Thank you for your attention.

References

Bagehot, Walter, *Lombard Street: A Description of the Money Market*, Charles Scribner's, Sons, New York, 1873.
Friedman, Milton, *Inflation: Causes and Consequences*, Asia Publishing House, New York, 1963.