I am honored to be invited to this meeting and given an opportunity to address such distinguished guests. I would like to express my personal views on the current monetary policy in Japan in the extraordinary situation of a zero interest rate.\(^1\)

### 1 The Zero Interest Rate Policy and its Components

In February 1999, the Policy Board of the BOJ assigned staff a new guideline for money market operations to “flexibly provide ample funds and encourage the uncollateralized overnight call rate to move as low as possible”\(^2\) and the BOJ adopted the so-called zero interest rate policy. Based on this guideline, the Financial Markets Department, which is the operational unit for monetary operations, started to ease further the stance of money market operations to guide the uncollateralized overnight call rate to zero.\(^3\)

---

\(^{*}\) This is a revised version of a lecture presented by Kunio Okina at the Keizai Koho Center on June 6, 2000. The views expressed here are those of the author and do not necessarily reflect the official views of either the Bank of Japan or the Institute for Monetary and Economic Studies.

\(^1\) Information regarding the Monetary Policy Meeting of the BOJ, such as the Announcement of the Monetary Policy Meeting Decisions, the Monthly Report of Recent Economic and Financial Developments, and the Minutes of the Monetary Policy Meeting, is available both in Japanese and English from the BOJ’s web site (http://www.boj.or.jp).

\(^2\) During the early phase of the zero interest rate policy, which lasted until the Monetary Policy meeting of September 21, 1999, the policy directive for the inter-meeting period contained an additional remark: “the Bank of Japan will provide ample funds if judged necessary to maintain the stability of the financial markets.” However, at the Meeting on October 13, 1999, this remark was regarded as unnecessary given market conditions at the time and was deleted. In addition, at the same Meeting, the wording of the directive was also revised to more explicitly convey the content and aim of the zero interest rate policy.

\(^3\) The announcement of the Monetary Policy Meeting Decisions on February 12, 1999 contained the following two points: (1) “corporate and household sentiments remain cautious and private sector activities stagnant”; (2) “long-term interest rates have risen considerably, and the yen has been appreciating against the dollar.”
Subsequently, in April 1999, the BOJ declared that it was committed to a zero interest rate policy “until deflationary concerns are dispelled.” This policy was intended to work on market expectations so as to stabilize interest rates ranging from overnight to term rates at a low level.4

Under this policy, the uncollateralized overnight call rate, which is a direct operational target rate of the BOJ, has been stable at around virtually zero percent since April 1999 (See the Chart below).

Important components of the ‘zero interest rate policy’ as a policy framework are (1) guiding the call rate to virtually zero percent (net of the transaction cost in the interbank market), and (2) a commitment to the zero interest rate policy “until deflationary concerns are dispelled.” In other words, two aspects are important for the zero interest rate policy to be effective, namely ‘quantitative easing,’ which guides the overnight interest rate to zero, and ‘policy duration,’ which works on the market expectations regarding the future course of short-term interest rates.

4 Governor Hayami, at a press conference on April 13, 1999, stated that “until we reach a situation in which deflationary concerns are dispelled, we will continue the current policy of providing necessary liquidity to guide the uncollateralized overnight call rate down to virtually zero percent while paying due consideration to maintaining the proper functioning of the market.”
1-1 Zero Interest Rate Policy as a Measure for Quantitative Easing

If we focus first on the quantitative aspect of the zero interest rate policy, the BOJ has guided the uncollateralized overnight call rate down to virtually zero percent by providing ample funds which exceed required reserves by ¥1 trillion. In short, the zero interest rate policy is a policy under which the BOJ provides ample funds until interest rates fall to zero. In other words, in order to implement the zero interest rate policy, the central bank needs to provide funds to meet all short-term credit demand, guiding short-term interest rates to zero.

Under this policy, financial institutions are no longer worried about their liquidity positions and their need to hold excess reserves is also diminishing. As a result, around 70 percent of the excess reserves of ¥1 trillion is placed in the accounts of money market brokers (tanshi companies) held at the BOJ, and the remarkable phenomenon of under-subscription of the BOJ’s money market operations has often been observed since the summer of 1999. This refers to the situation in which bids by financial institutions fall short of the total amount tendered.

At the time of the Y2K problems which arose at the end of 1999, at the end of February 2000 (because of the irregular leap year) and the end of the 1999 fiscal year, the demand for reserves increased, and the BOJ had to supply additional funds to meet this increased demand for reserves in order to maintain the zero interest rate. This suggests that, in a situation in which there was zero opportunity cost for reserve holdings, demand for reserves increased markedly in such extreme situations as the increased liquidity risk caused by the Y2K problem, and the BOJ automatically supported this huge demand in order to maintain a zero interest rate. Apart from such extreme periods, under-subscription to BOJ’s operations has became nothing special, indicating that financial institutions are confident in their ability to raise funds at low cost and at all times. It is thus apparent that private financial institutions’ demand for excess reserve is limited.
1-2 ‘Policy Duration’ Effects of the Zero Interest Rate Policy

Next, considering the ‘policy duration’ of the zero interest rate policy, interest rates on longer-term instruments, such as 3-month, 6-month, and 1-year rates, as well as long-term interest rates, are important. Whether or not such interest rates can be maintained essentially depends on how long the current abundant provision of funds will last rather than on how abundantly funds are provided.

The ‘policy duration’ effects are underpinned by the ‘expectation theory’ of interest rate determination. In general, long-term interest rates are the sum of market expectations regarding the future course of short-term interest rates and a term premium, which is based on risk caused by uncertainty or by the preferences of market participants. Premiums being constant, fluctuations of interest rates on term instruments reflect changes in expectations in this case.

Currently, as a condition for terminating the zero interest rate policy, the BOJ does not give a definite time frame, but only says that such a termination will not occur “until deflationary concerns are dispelled.” As a consequence, term interest rates have declined substantially to very low levels. Such a decline in short-term interest rates has worked as an anchor for medium- and
long-term interest rates through the inter-market arbitrage function which is based on expectation theory.

Hence, the zero interest rate policy, including announcements regarding the duration of this policy, is highly effective in enhancing monetary easing, thus affecting the yield curve.

It is worthwhile to note that the effects of the zero interest rate policy vary in accordance with market conditions. For example, if the economy is on a downward trend, market participants believe that termination of the zero interest rate policy will be put off, thus bringing longer-term interest rates down to flatten the yield curve. On the contrary, if the economy is on an upward trend, market participants believe termination to be closer, thus raising longer-term interest rates to steepen the yield curve rise, acting as a brake on the easing effect.5

In order to promote the smoother formation of market expectations regarding the future course of monetary policy, Members of the BOJ’s Monetary Policy Meeting discuss deflationary concerns at every Monetary Policy Meeting and the BOJ publishes the minutes of such meetings as well as a Monthly Report of Recent Economic and Financial Development. Current policy can be regarded as a forward-looking monetary policy framework under the zero interest rate policy taking into account market participants’ expectations by indicating the policy duration embodied in the condition: “until we reach a situation in which deflationary concerns are dispelled.”6

2 The Problems in the Short Run

5 Depending on the cause of a deflationary shock, under the zero interest rate policy additional monetary easing is possible by increasing operational instruments. For example, in the case of the deflationary impact caused by financial system troubles in autumn 1998, the BOJ was able to respond by securing liquidity through CP and corporate bond operations without itself shouldering any credit risk.

6 See Ueda (1999, 2000). Taking into account that the economy continuously faces structural change, forward-looking monetary policy management is not necessarily the same as automatic policy management using forecasts based on past experience. This is discussed in the latter part of this paper when we refer to Greenspan (1997).
Next, let us consider the problems for monetary policy at the moment. Problems can be divided into two. First is the short run problem --- possible and plausible policy reactions to the occurrence of two major scenarios regarding the economic outlook the BOJ is likely to encounter in the not-too-distant future, i.e. an economic downturn or an upturn. Second is the longer run problem --- the formulation of the future framework for implementing monetary policy in Japan in the medium to long run. Although these two problems are closely related, for the time being, let me examine each problem in turn.

Various proposals have been raised with respect to a desirable framework of monetary policy under the current zero interest rate in Japan. The variety of opinions may well stem from differences in: the understanding of the factors behind the Japan’s ‘lost decade,’ the assessment of Japan’s current economic conditions, or understanding of transmission mechanism of monetary policy. One representative view is that the side effects of the zero interest rate policy are so strong that the BOJ must terminate it as soon as possible. The other representative view is that some additional quantitative easing must be executed. Between these two views, there is another view that the BOJ should watch economic and financial conditions carefully and continue to implement the zero interest rate policy for the moment, thus implying that further easing is not needed.

The Minutes of Monetary Policy Meetings held since the beginning of 2000, which are now available, show that considerable time has been spent discussing whether or not the BOJ is reaching the stage where it can confidently say deflationary concerns are disappearing. If the recent recovery in the Japanese economy is sustained, the question concerning the point at which it can be said that deflationary concerns have been dispelled is likely to occupy center stage in Monetary Policy Meeting deliberations.

However, today I would like to discuss the termination of the zero interest rate policy as well as the question of the need for additional monetary easing under the zero interest rate policy. The reason for this can be found in the possibility, albeit quite remote, that some external shock might occur and necessitate the exploration of further monetary easing. Assuming that the
BOJ cannot entirely rule out this downside possibility and given that it is pursuing an unprecedented monetary policy within the zero interest rate framework, it is worthwhile to consider the costs and benefits of additional easing thoroughly.

In the following, taking account the aforementioned framework of the zero interest rate policy, I would like to comment on risks or side-effects of the BOJ’s policy options: (1) termination of the zero interest rate policy; (2) continuation of the zero interest rate policy; and (3) the implementation of additional monetary easing measures.

2-1 Termination of the Zero Interest Rate Policy

Arguments for an early termination of the zero interest rate policy focus on its side effects as an emergency measure. The incentive for proceeding with structural reform has been weakened. Contraction of the interbank money market has eroded the functioning of financial markets. A realized distortion of income distribution, such as lower returns from financial assets, has adversely affected retired people.

However, looking at the minutes of the Monetary Policy Meeting, it is clear that Board Members have persisted with the zero interest rate policy fully knowing its side effects. This is solely because it is judged necessary to take a drastic measure for monetary easing in order to dispel deflationary concerns, implying that the beneficial effects outweigh the side effects. Thus, whether the zero interest rate policy can be terminated depends crucially on whether or not it can be said that deflationary concerns have been really dispelled.

It should be noted that the side effects would not all disappear immediately even if the zero interest rate policy were terminated and the short term interest rate is set at some low level. On the one hand, the function of interest rates as a signal to allocate funds and liquidity would be restored to some extent by the termination of the zero interest rate policy. On the other hand, the adverse effects on structural adjustment and the distortion of income distribution negatively affecting retired people would continue to work,
inasmuch as extraordinarily low interest rates would be sustained.

2-2 Continuation of the Zero Interest Rate Policy

The view that the zero interest rate policy should be sustained is based on the assessment that the positive policy effects are still larger than the side effects. Considering the aforementioned effects of policy duration, if the economy is on an upward trend, market participants believe that termination should get closer, thus raising longer-term interest rates to steepen the yield curve rise. Then, if the economic recovery does not induce inflationary expectations, the rise in real interest rates will automatically act as a brake to limit the overheating of the economy. Thus, according to this view, the BOJ should not necessarily hasten to terminate the zero interest rate policy.

2-3 Further Monetary Easing

On the contrary, further monetary easing requires taking a stronger drug and therefore having to accept greater side effects or risks.

Some argue that since the Japanese economy has operated far below potential, further stimulative measures are needed, even though the economy is already starting to recover. However, the effects of such measures are extremely uncertain, although it is clear that the side effects would, as I point out below, become greater as the economy recovers. It is difficult to think that the BOJ would dare to implement further monetary easing in a situation in which economic recovery is becoming more clearly established.

On the contrary, even in the upward leg of the business cycle, the BOJ cannot rule out the possibility that some serious external shock might occur, necessitating the exploration of further monetary easing, for example, by purchasing dollar-denominated financial assets and Japanese government bonds. It is worthwhile thoroughly considering the costs and benefits of any such additional easing, depending on the cause of the deflationary shock.

So what are the side effects of additional monetary easing, and why will such
side effects become greater as the economy recovers?

2-3-1 Depreciation of Yen

First, let me consider the proposal that tries to lead yen to depreciate drastically by a massive intervention in the foreign exchange market. Professor Komiya points out that such a policy is primarily against the IMF Agreement (Komiya [2000]), but, even if it were not, it should be noted that Japan has been running a large external surplus. The question is whether such tactics are a practical option. This would not only provoke strong opposition from the US but also be criticized by those Asian countries that compete with Japan. In view of this, such a strategy seems difficult to be adopted.

2-3-2 Increase in Outright Purchase of Long-term Government Bonds

Next, it is probable that a massive increase in the outright purchase of government bonds is seen by the public as a loss of fiscal discipline or recognized as virtually equivalent to a step in the direction of a so-called ‘inflation policy.’

Proponents of ‘inflation policy’ expect the following two effects. First, an increase in expected inflation will reduce real interest rates, even in a situation of zero nominal interest rates. Second, inflation reduces the fiscal burden on government and on private debtors in real terms. These effects assume that the risk premium will not change even if there is a dramatic change in monetary policy. In other words, the policy prescription of ‘inflation policy’ neglects the possibility of an increase in risk premium.

However, if the public recognized the decisive purchase of government bonds as ‘inflation policy,’ i.e. a temporary suspension of the pursuit of price stability, uncertainty about the outlook for inflation would increase.

---

7 ‘Inflation policy’ is not a well-defined concept. Most typically, as Professor Krugman of MIT advocates, it is a policy which aims at a somewhat high inflation rate of 4 to 5 percent and mobilizes all possible measures to achieve this target. There is a variation of inflation policy that says a moderate inflation rate of 2 to 3 percent is tolerable and it may vitalize economic activity.
Moreover, if such a policy action is seen by the public as a loss of fiscal discipline, government bonds would be downgraded, and their prices would decline. Therefore, the central bank’s commitment to a massive increase in the outright purchase of government bonds would rapidly cause long-term interest rates to rise more than expected inflation and force fiscal conditions into an even more difficult situation.

If we were still in the closed and regulated economy of post-war Japan, the debt-reducing effects of unanticipated inflation would probably be more certain. It might then be the case that debt-reduction could be more efficiently pursued through one-shot inflation than through tax increase and expenditure reduction. Nevertheless, it is hard to imagine that a country with highly developed capital markets could engineer unanticipated inflation to reduce public debt effectively. The post-war hyperinflation resulted in a tremendous burden on industries, banks and depositors, and such a drastic measure could only be enforced because in the special circumstances of the post-war occupied and regulated economy.

Against the aforementioned views, it could be suggested that a combination of ‘inflation policy’ with the adoption of inflation targeting might restrain the risk of inflation running out of rein.

However, any kind of ‘inflation policy’ is expected to raise the inflation rate, something which has never been tried before. It seems impossible for the central bank to reduce the inflation rate at will even in a period of disinflation. Furthermore, if the central bank tried to inflate the economy at any cost, excessive easing would result, and the resulting stop-go policy would lead to a higher variability of interest rates and inflation expectations. Higher uncertainty regarding future inflation would increase long-term interest rates, reflecting the increased risk premium.

Let me show you an example, which occurred during a period of disinflation. In October 1979, the Fed adopted a new framework for daily money market operations, which focused on monetary aggregates, and allowed increased volatility in short-term interest rates. In the early 1980s, real long-term interest rates stayed at an extremely high level. These two facts are
reconciled into a presumption that money market operations to induce higher uncertainty in short-term interest rates resulted in an increase in the risk premium for long-term interest rates.

In light of such kind of experience and of as well as theoretical insights, it is deemed rather optimistic to expect that an ‘inflation policy’ involving a break with inflation targeting would avoid an overshooting of long-term interest rates, thus mitigating balance sheet problems such as government debt.

2-4 Relation of Additional Monetary Easing and Fiscal Policy

In this regard, I would like to make comments on the view that “Given the government debt situation, fiscal policy has reached its limit. Therefore, when the economy deteriorates or, as some argue it is below the potential growth rate, monetary policy should step in to take risks and we should decide on further monetary easing.” In short, it is difficult to separate fiscal and monetary policy in a further monetary easing exceeding the zero interest rate policy. Then monetary policy would bear the fiscal burden and monetary and fiscal policies would become united. For example, a central bank’s direct lending to the private sector would be sure to have the effect of further monetary easing. However, the BOJ is highly likely to bear a loss corresponding to its risk, and, as a result, the BOJ would allocate funds which primarily belong to the public to firms as subsidies. Instead of emphasizing the orthodox function of providing aggregate liquidity, such policy will effectively act through monetary policy as fiscal policy in disguise. The massive outright purchase of long-term government bonds will, even if successful in rescuing the economy from a deflationary shock, probably result in the central bank incurring a capital loss. In this case, if the government tries to avoid the additional fiscal burden, monetary policy will fail to absorb the excess monetary base after the economic recovery, thus leading the BOJ to lose control over inflation.

As discussed, the massive outright purchase of long-term government bonds will, even if successful in rescuing the economy from a deflationary shock, probably result in the central bank incurring a capital loss and lead to an increase in the private sector holding of government debt. In such a case,
the view that fiscal and monetary policy should be kept separate, such as “Given the government debt situation, fiscal policy has reached its limit. Therefore, when the economy deteriorates or, as some argue, it is below the potential growth rate, monetary policy should step in to take risks and decide on further monetary easing,” would not be relevant. In this case, if the government tries to avoid the additional fiscal burden, monetary policy would fail to absorb the excess monetary base after the economic recovery, thus leading the BOJ to lose its control over inflation.

So should we avoid taking these kinds of additional monetary easing measures? I do not think this is always the case. Professor Bernanke criticize the BOJ, referring to Former President Roosevelt who was elected with a mission of escaping from the Great Depression, as follows: “In the end, the most effective actions he took were the same that Japan needs to take--namely, rehabilitation of the banking system and devaluation of the currency. But Roosevelt's specific policy actions were, I think, less important than his willingness to be aggressive and to experiment--in short, to do whatever it took to get the country moving again. Many of his policies did not work as intended, but in the end FDR deserves great credit for having the courage to abandon failed paradigms and to do what needed to be done. To this outsider, at least, Japanese monetary policy seems to be suffering from a self-induced paralysis. Most striking is the apparent unwillingness of the monetary authorities to experiment, to try anything that isn't absolutely guaranteed to work. Perhaps it's time for some Rooseveltian resolve in Japan” (Bernanke [2000]).

In this context, there seems to be a significant difference in perception of the current situation of the Japanese economy between Professor Bernanke and me. If Japan was confronting a Great Depression, the BOJ might be allowed to take such a large risk. However, the Japanese economy is far from being in such a desperate situation. I do not think that the BOJ would be allowed to experiment with a risky option that might provoke a sudden rise in the risk premium, resulting in an adverse interest rate rise, just to give further support to an economic recovery that has already begun.

12
3. Styles of Monetary Policy in the Medium to Long-run

Next, I would like to turn to discuss the monetary policy framework or style after the termination of the zero interest rate policy, taking account of the debate regarding inflation targeting.

3-1 Inflation Targeting

It is a fact that inflation targeting has been successful in small open economies. But inflation targeting is merely one of several options among various styles of monetary policy. Neither the Federal Reserve System (Fed) nor the European Central Bank (ECB) has adopted inflation targeting. Even though the ECB defines price stability in terms of the CPI growth rate, it is not aiming at committing itself to this numerical value as a target. In considering the adoption of inflation targeting in Japan, there are some problems in adopting inflation targeting, and whether they are regarded as technical, or indeed significant, problems is crucial to judging inflation targeting.

Surmounting the technical problems, adopting inflation targeting and setting a medium-term inflation rate objective could be one option for alleviating the shock stemming from terminating the zero interest rate policy. Consumers and corporate managers who correctly understand the BOJ’s incentive to achieve a targeted inflation rate will believe the BOJ’s commitment to the target and thus would be expected, in theory, to serve as an anchor to alleviate the shock of ending the policy. In this sense, it seems attractive for the BOJ to introduce such a policy framework.

3-1-1 Some Issues related to Inflation Targeting

Regarding the practical issues involved in inflation targeting, there does not seem to exist a clear and practical guideline for considering upward biases in the consumer price index and the zero boundary of nominal interest rates in setting such a target at small but positive number. Taking into account Japan’s experience since the late 1980s, it is apparent that keeping a measured inflation rate within a certain range is not sufficient to lead the
economy on to sustainable growth path. Moreover, when the environment surrounding prices is likely to experience dramatic changes against the backdrop of various revolutionary changes, including the information technology revolution, we have to examine carefully whether or not it is possible to set an appropriate target for inflation based on existing price indexes (see, for example, Hayami [2000]).

In fact, when the environment surrounding prices is likely to experience dramatic changes, reflecting the information technology revolution, it seems that there is no consensus in either academic or central bank circles regarding how to define the desirable inflation rate in a manner consistent with sustainable economic growth. Note that standard theoretical models on inflation targeting do not discuss explicitly the adjustment process of the economy towards long run equilibrium, since it is assumed that the inflation target is set under the condition that the economy is at the natural unemployment rate (see, for example, Shiratsuka and Fujiki [1997]).

Of course, the argument outlined above does not necessarily imply that inflation targeting is inappropriate. Surmounting the technical problems, adopting inflation targeting and setting a medium-term inflation rate objective could be one option to serve as an anchor for the conduct of monetary policy.

However, from the viewpoint of establishing a framework for implementing monetary policy by restricting discretion under open independence, it is not essential to announce a numerical target for inflation. This should be clear in light of the US experience. Inflation targeting itself should be understood as a framework that balances transparency and flexibility, combined with various measures to increase accountability, such as publishing inflation reports and minutes of policy decision meetings.

The current policy framework of the BOJ, centering on the commitment to a zero interest rate policy “until deflationary concerns are dispelled,” is also aimed at balancing transparency and flexibility. On the one hand, the BOJ has been trying to increase accountability by, for example, publishing the minutes of monetary policy meetings. On the other hand, the BOJ could extrapolate market expectations regarding the future course of short-term
interest rates, reflected in the term structure of market interest rates.

3-1-2 Risks in the Adoption of Inflation Targeting

In this regard, there is an argument that inflation targeting will automatically increase the accountability of the central bank, thus improving the transparency of monetary policy. However, adopting inflation targeting could be dangerous, having side effects stemming from ‘single-minded targeting.’ The central bank is required to pursue ‘stability of price in itself’ and, through its accomplishment, is also required to contribute to sustainable economic growth. In this sense, price stability, which monetary policy should aim at, is not stability at any particular point in time but rather a sustainable stability that can support economic growth over the medium to long term. Article 2 of the Bank of Japan Law stipulates that “Currency and monetary control shall be aimed at, through the pursuit of price stability, contributing to the sound development of the national economy.” The BOJ is supposed to conduct monetary policy with an emphasis on maintaining an environment conducive to the sustainable economic growth that is the ultimate goal of price stability.

Inflation targeting is a flexible policy framework that allows the central bank to deviate from the target in order to stabilize the economy in the short run. However, whether Japan can enjoy the theoretical benefits inherent in inflation targeting largely depends on how well the central bank avoids the possibility that the single inflation target number that is announced would mislead the public, so restricting its flexible management of monetary policy.

The experience of New Zealand during 1994-96 can be cited as an example of the attachment of institutional incentives leading directly to the loss of flexibility in the central bank’s ability to make policy changes. In this case, the Reserve Bank of New Zealand pursued drastic monetary tightening because the inflation rate diverged from the then target range of 0-2%, which

---

8 Former FRB Vice Chairman Blind stated, in this context, “[W]hen people suggested to me that the Fed should be content with 3% inflation, I answered that the Federal Reserve Act calls for ‘stable prices,’ not ‘pretty low inflation.’ If citizens think that’s wrong, they should get the law changed” (Blinder [1998]).
only resulted in destabilizing the economy and expanding the target rate range to 0-3%.

Such kind of difficulty would become more eminent if inflation targeting was adopted in Japan, where ‘inflation policy’ is often proposed. Once the BOJ adopts the inflation targeting, it cannot be denied that this is interpreted as ‘single-minded targeting’ pressure, requiring the BOJ to focus very rigidly on achieving an inflation target in the short term. Some mass media, which support adoption of an ‘inflation policy,’ would demand such conduct of the BOJ.

Since a numerical target for the inflation rate is generally easy for the public to understand, once public opinion is tilted toward ‘single-minded targeting,’ it would be extremely difficult for the BOJ to enjoy the benefits of inflation targeting, which include flexible policy management and the ability to pay proper attention to the development of the economy and employment over the medium term. If the BOJ deviated temporarily from its target to stabilize the economy in these circumstances, such a policy reaction would be incompatible with market expectations, since financial market participants are highly likely to expect that the BOJ should take all available measures to achieve the targeted rate. In this case, as our experience of September 1999 shows, it could be the case that market would become unstable if the BOJ were not to accommodate such misguided expectations. Considering the possibility that the announcement of a numerical target would be misleading to the markets, it is not sufficient to state that the inflation targeting would automatically improve the accountability and transparency of the conduct of monetary policy.

3-2 Need for Establishing the Style of Monetary Policy

So how should the central bank conduct monetary policy in the medium and long runs? ECB Governor Padoa-Schioppa pointed out at the BOJ conference in 1995 that the focus of monetary policy has shifted to the

---

9 ‘Inflation policy’ is a policy proposal to inflate the economy to reduce the government debt and cooperate debt in real term, and repeatedly advocated by various economists and columnists in Japan. See, the review of former proposals, Itoh and Shimoi (1999).
methods of implementation and dissemination of information necessary to better enable central banks pursue price stability, which has been widely regarded as a mandate for central banks based on the experience of the 1970s. These methods are divided according to ‘styles’ (Padoa-Schioppa [1996]).

In this context, styles are behavioral patterns which central banks may adopt in various situations and are a much broader concept than the policy rules suggested by some economists. Styles can be divided into two types: one type is a commitment for a period of time to a single numerical target such as the foreign exchange rate, money supply, or inflation; and the other is a ‘classical’ one, the acquisition of confidence by conducting monetary policy based on an overall consideration without prior commitment to a specific target.

It is important for the BOJ to establish its own style in order to improve its strategy for communicating with market participants and the public. Inflating targeting could be an option, but not an absolute one. Comparing the advantages and disadvantages of various styles, the BOJ is required to develop and improve its own style appropriate to the economic situation and Japan’s central banking system.

References

Komiya, Ryutaro, “Hyakki Yakou no Kawase Kin’yu Seisaku Rongi wo Tadasu” (Pandemoniac Debates regarding Foreign Exchange and