Notes on Financial Markets Vol.71

Press conference by Governor Shirakawa — Gift for successors

20 March 2013

Introduction

Readers may have been aware that the press conference was intended to be a ceremonial one on the day when Governor Shirakawa left the BOJ. However, large part of the discussion was insightful for those who will live under a new regime of monetary policy.

A senior press reporter who is a long friend of mine asked a relevant question: whether Mr. Shirakawa would like to revise his textbook of monetary policy (only available in Japanese) that he wrote before his term as Governor. Let me review the major points of Mr. Shirakawa's reply to this question.

Fiscal dominance

In light of our fiscal condition, it was not a surprise that Mr. Shirakawa raised this issue at the top of his discussion. Mr. Shirakawa insisted that there would be only two kinds of solutions to the worst fiscal conditions, unless the government makes substantial efforts for fiscal consolidation; either the outright default or the elimination of real values by inflation. In either cases, two important goal of a central bank's policy - stabilities of inflation and financial system – should be abandoned.

Even before the economy falls into such extreme corner solutions, as Mr. Shirakawa implied, the independence of monetary policy could face risks if and when a central bank would need to take excessive account of the potential costs of policy effects on the fiscal condition. Mr. Shirakawa would like to add this line of argument to his textbook, because such degree of fiscal dominance is common to major economies.

Nevertheless, Mr. Shirakawa acknowledged that the government bond is the rational choice as the major instrument for the asset purchase by the BOJ. This is why he referred to a "narrow path" for our monetary policy. (In fact, it was the topic for the most recent meeting of our Financial Markets Panel whose minutes will be released shortly.)

Moreover, Mr. Shirakawa's comments reminded us of the recent line of discussion in our markets: whether some commitment by the government to fiscal consolidation is desirable (or required) when the BOJ would expand the scale of JGB purchase by a substantial degree.

Local and global equilibrium

We recently observed a number of press reports reviewing the performance of the BOJ under the leadership of Governor Shirakawa for these five years.

Interestingly, their lines of arguments have more or less converged: almost all the authors appreciated the skill and flexibility of the crisis measures by the BOJ. In fact, we experienced two major tragic events. "Lehman-shock" and the great earthquake. At the same time, most of the authors criticized the BOJ not to take appropriate attention and effective measures to the considerable appreciation of the JPY.

In reply to the questions by press reporters including my friend, Mr. Shirakawa claimed that the important features of the current foreign exchange markets including the impacts of "carry trade" and its unwinding are not properly addressed by the economics. While Mr. Shirakawa agreed to the idea that conducting monetary policy to address domestic problem would be an optimal strategy in the long-run, he insisted that it almost surely accompanies the spillover effects on overseas economies under our interconnected financial system. Discrepancies of local and global equilibrium, according to the term by Mr. Shirakawa, has been a tough challenge for monetary policy in the major economies.

Although his reference to his idea of "internalizing" the international economic externalities of monetary policy was insightful, there has so far been few concrete proposals against this kind of problem both from policy makers and academic economists. While frequent exchange of views among central banks at international meetings including those by the BIS could be helpful as Mr. Shirakawa implied, ultimate solution of such conflicts would require the discussion on the re-design of international currency system.

In relation to the policy effects through the markets, Mr. Shirakawa also showed strong skepticism to the idea of controlling the markets. He insisted that a central bank should make independent policy decision from the markets by referring to the famous discussion by Professor Alan Blinder. It was interesting because his dialogue with the markets has been a focus of criticisms by the market participants.

In any case, smooth normalization is an indispensable part of the success of policy measures and at such stage a good conduct of dialogue with the markets will become a much harder task for a central bank, as Mr. Shirakawa mentioned.

Independence in democratic societies

While Mr. Shirakawa spent nearly forty years at the BOJ, the policy debates in most recent months may become most impressive memories for him.

As the reply, Mr. Shirakawa emphasized that communicating the backgrounds and reasons of a specific policy decision not only to the financial markets but also to the general public has become much more important. Furthermore, he explained that he has always been mindful of this communication strategy and made substantial efforts along this line.

Mr. Shirakawa, nevertheless, admitted that the knowledge and information to which a central bank could access is bounded, and this is why the central bank should be behave modest . Furthermore, he expressed concerns about the risk of "accountability trap" when a central bank depends on an inappropriate theory of economy.

It was quite reasonable for Mr. Shirakawa not to make comments on the possible revision of the BOJ law. He, however, required the careful and deliberate discussion on this important issue, since the central bank law is a fundamental base of a national economic system.

All in all, the BOJ could face more political pressures when the inflation hits much lower than the target . In light of such risks, supports from the general public by good practices of accountability would become much more important.

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