



May 27, 2024
Bank of Japan

Opening Remarks at the 2024 BOJ-IMES Conference
Hosted by the Institute for Monetary and
Economic Studies, Bank of Japan

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Governor of the Bank of Japan

I. Introduction

It is our great pleasure to welcome distinguished speakers and guests to our 29th BOJ-IMES Conference. We would like to thank you all for your participation. I would also like to thank my old friend, John Taylor, who was the very first Mayekawa Lecturer in 2008, for coming back to our conference to deliver his second Mayekawa Lecture later.

While we hold our research conference almost every year, this year's conference is unique in that it is held as part of our "Broad Perspective Review" of monetary policy. The review aims to further deepen our understanding of various unconventional monetary policy measures over the past 25 years and to gain insights that will be useful for future policy conduct. This conference will cover two main themes: "Price dynamics" and "Effects of conventional and unconventional monetary policy instruments." We very much look forward to lively discussions with you today and tomorrow to gain further insight into these themes. To set the stage, let me start my remarks with the recent changes in our monetary policy framework, followed by my reflection on the past 25 years condensed into 20 minutes.

II. Japan's Zero-Inflation Trap and the BOJ's Large-Scale Monetary Easing

Changes in the Monetary Policy Framework

The Bank of Japan (BOJ) decided on the termination of most of its non-traditional monetary easing measures at its March 19 meeting, in response to the improving inflation outlook. Discontinued measures included: the yield curve control (YCC) involving a negative short-term policy rate and control of the 10-year JGB yield, and purchases of risky assets such as equity-linked ETFs and J-REITs. Additionally, two types of forward guidance were ended: one stating that the BOJ would continue with Quantitative and Qualitative Monetary Easing (QQE) with YCC as long as it was necessary for maintaining the price stability target in a stable manner, and the other indicating that the BOJ would continue expanding the monetary base until inflation exceeded 2% and stayed above the target in a stable manner. For further insights into this decision, please refer to my speech at the PIIE (Ueda, 2024).

The Zero-Inflation Trap and the Zero Lower Bound on the Nominal Interest Rate

Reflecting on the past, the BOJ initiated non-traditional easing measures in the late 1990s, with brief interruptions during 2000-2001 and 2006-2007 when the short-term policy rates

were positive. Having been a BOJ board member during the inception and termination of these measures, I would like to discuss their efficacy and limitations. While extensive literature exists on this topic, the BOJ is currently conducting a "Broad Perspective Review" of its experience, as I mentioned earlier, with results forthcoming. Today, I confine myself to informally addressing the perennial question of Japan's struggle to escape a long period of zero-to-low inflation, also known as the zero-inflation trap, despite extensive non-traditional monetary policy interventions. This discussion also serves as an introduction to this conference.

Chart1 shows a simple 3-year moving average of the rate of change in headline CPI, and vividly illustrates the zero-inflation trap. Inflation, by this measure, remained between -1.0% to 0.7% from 1996 to 2022, a span of 27 years.¹ I think that the primary explanation for this phenomenon lies in the effective zero lower bound on nominal interest rates (ZLB), shown in Chart 2, where the overnight rate fell below 0.5% by late 1995. By the onset of the zero-inflation trap, the BOJ had exhausted its leverage over short-term interest rates as a means of stimulating the economy.

The BOJ's Large-Scale Monetary Easing

I acknowledge potential objections to this assertion. Many central banks, including the BOJ, introduced various non-traditional measures to stimulate the economy, some of which remained in use in Japan until recently, as outlined earlier. I anticipate presentations during the conference will suggest that some of these measures can effectively overcome the difficulties created by the ZLB. Nonetheless, the BOJ's prolonged struggle to escape the zero-inflation trap serves as evidence of the challenges posed by the ZLB.

Some may argue that the evolving policy framework adopted by the BOJ was at certain points not optimal. For instance, during the initial years of the zero-inflation trap, there was no explicit inflation target. In 2000, the BOJ deliberated whether it should define the price stability as some specific inflation rate, such as zero or a small positive number, but did not reach a consensus at that time. Eventually, in March 2006, the BOJ stated that a range of 0 to

¹ The CPI figures are staff estimates and exclude the effects of the consumption tax rate hikes, and others.

2% with a median of 1% was consistent with its understanding of price stability before clarifying further by confirming in December 2009 that the range did not include negative values, and the BOJ finally introduced the price stability target of 2% in January 2013. With hindsight, the introduction of a clear inflation target could have influenced the discussion before the BOJ's decision to terminate the zero-interest policy in August 2000. At that time, core inflation was still -0.5 percent, while forward guidance on the short rate introduced in April 1999 stated that the Bank would continue the zero rate until deflationary concerns were dispelled. Although it is difficult to attribute the subsequent deflation solely to the minor rate increase, the termination may have weakened the efficacy of the forward guidance.

Another aspect worth considering is the timing of asset purchases. The BOJ's active acquisition of long-term JGBs happened relatively late compared with the observed inflation dynamics (Chart 1). While the BOJ began buying more long-term JGBs with the onset of quantitative easing in March 2001, there was no significant increase in its holdings of JGBs until 2013, as shown in Chart 3. By contrast, the Fed's holdings of US Treasury securities began to rise sharply in early 2009, in response to the global financial crisis.

Having said that, it should be noted that, as shown in Chart 4, the 10-year JGB yield was already below 2% in the late 1990s, while the 10-year Treasury yield was close to 4% when the Fed initiated its large asset purchases. This prompts the question of how much impact larger-scale JGB purchases would have had in the early 2000s.

The Zero-Inflation Trap and the Entrenched Nature of Low Inflation Expectations

Let me now turn to a second possible explanation for the BOJ's difficulties. I think the entrenched nature of low inflation expectations played a key role; it led to changes in economic agents' behavior, especially the strategic pricing behavior of firms, and, in turn, prolonged the period of the zero-inflation trap. As my colleagues will elaborate later, when firms do not think their peers will raise prices, they think it is best to keep their prices (and wages) unchanged, even in the face of small changes in costs or demand, making overall inflation or inflation expectations more entrenched at around zero. An economy in this situation may need a large shock to move from one equilibrium to another.

The BOJ conducted extensive surveys among firms regarding their price-wage-setting behavior. Chart 5 shows some notable findings. Many firms answered that, during the period of the zero-inflation trap, they were not able to raise prices because their competitors were not doing so, while over the past couple of years, the opposite trend has emerged. While there is an element of circular reasoning in this observation, the important point is that such strategic interactions can give rise to multiple equilibria, or, at least diminish the response of prices and wages to positive shocks.² Chart 6 shows the rate of change in wages set in the annual spring wage negotiations, which astonishingly remained at virtually zero during 1999-2013, reflecting the entrenched nature of the zero-inflation trap. However, there is evidence of changes after 2013: first, wages started to rise modestly in response to the new easing policy framework introduced in 2013 and the emerging labor shortage; then they rose sharply in 2023-2024, probably in response to the recent global inflation and the continuation of the easing framework.³

III. Challenges Ahead

Let me briefly outline the challenges that lie ahead. Our primary objective is to achieve 2% inflation in a sustainable and stable manner. Thus far, we have made progress in moving away from zero and lifting inflation expectations, but we must now re-anchor them, this time at the 2% target. We will proceed cautiously, as do other central banks with inflation-targeting frameworks. While many of the challenges we face are similar to those encountered by our counterparts, some are uniquely difficult for us.

One prime example of such challenges is determining the neutral interest rate (r^*). Estimating it accurately is challenging for any central bank, but it is particularly so in Japan, given the prolonged period of near-zero short-term interest rates over the past three decades. Although real interest rates have exhibited some fluctuations, the absence of significant interest rate movements poses a considerable obstacle in assessing the economy's response to changes in interest rates.

² Taylor (2000) makes a similar point with regard to US inflation dynamics. Lagarde (2023) argues that the global inflation of 2021-23 acted as a coordination mechanism in changing expectations and pricing behavior.

³ See, Ueda (2024) and Uchida (2024).

Last, but certainly not least, I hope the discussions at the conference today and tomorrow will offer some valuable takeaways for the central bank community and be of some help going forward.

Thank you for your kind attention.

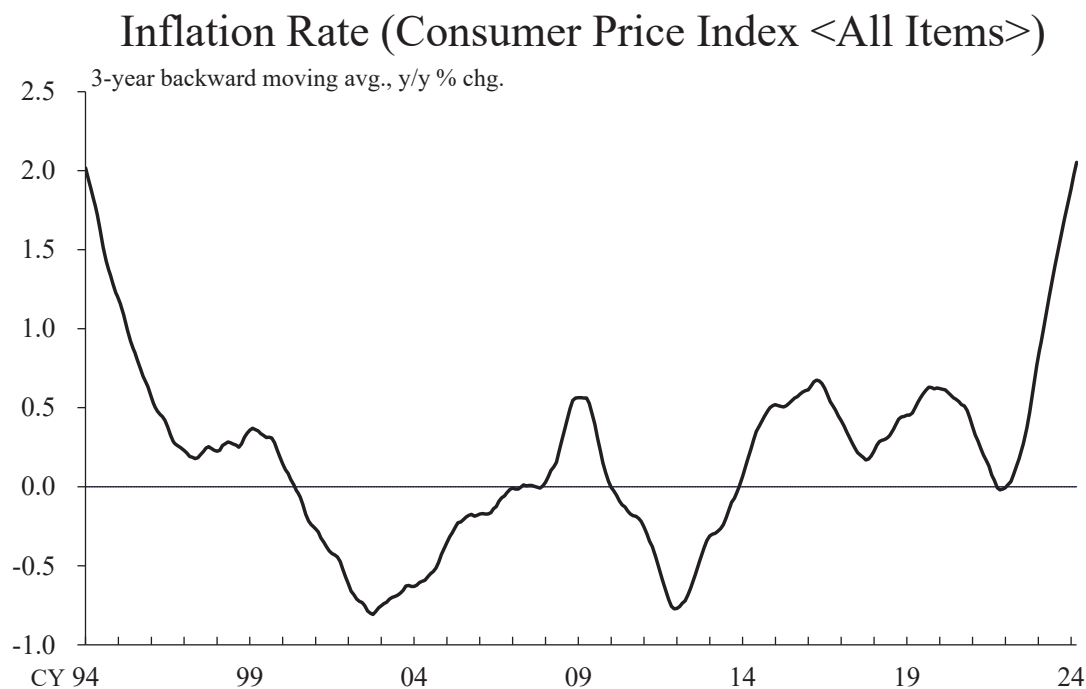
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Chart 1

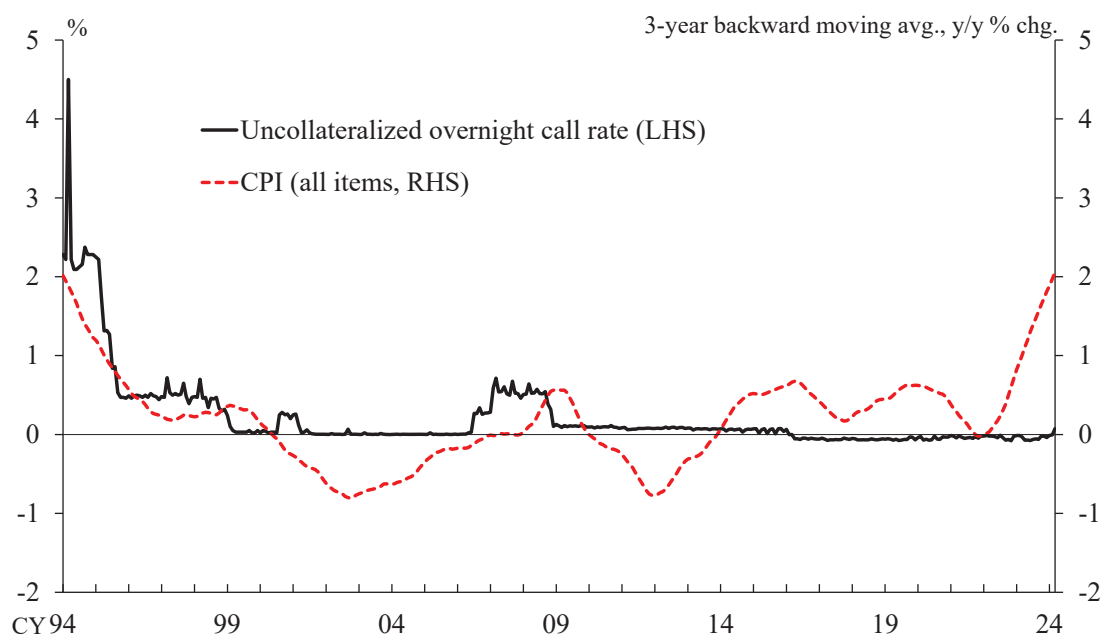


Note: Figures are staff estimates and exclude the effects of the consumption tax hikes, policies concerning the provision of free education, and travel subsidy programs.

Source: Ministry of Internal Affairs and Communications.

Chart 2

Short-Term Interest Rate and Inflation Rate



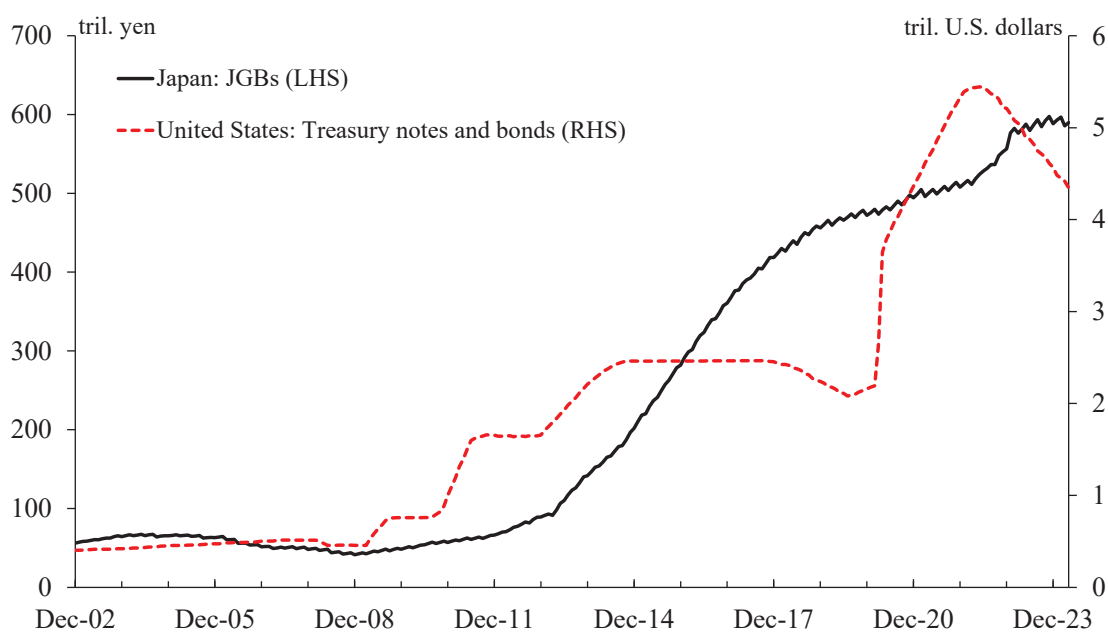
Note: The CPI figures are staff estimates and exclude the effects of the consumption tax hikes, policies concerning the provision of free education, and travel subsidy programs.

Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

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Chart 3

Central Bank's Government Bond Holdings



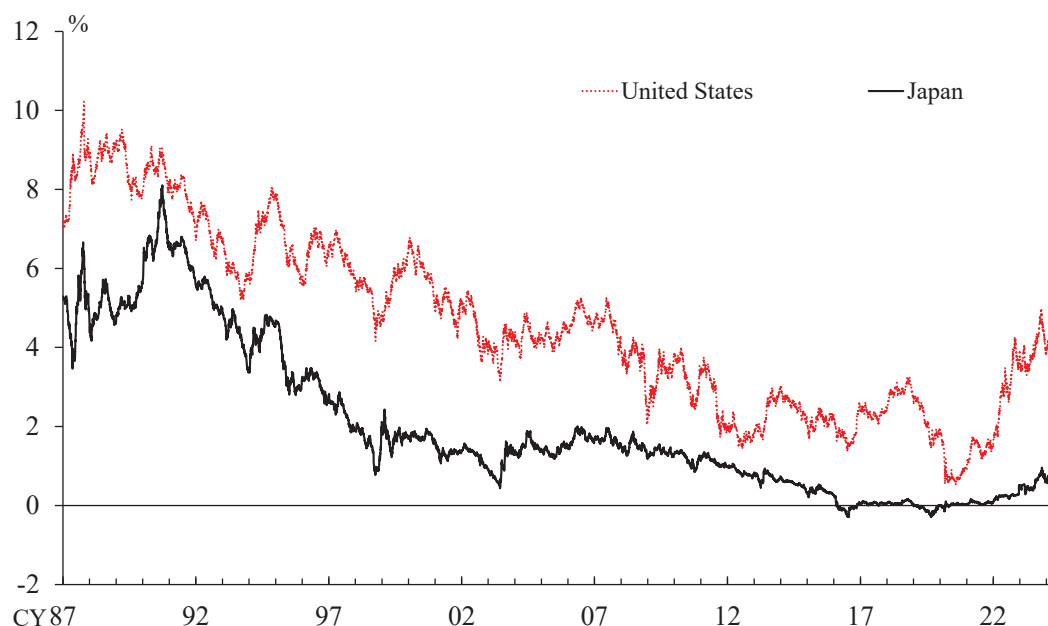
Note: Figures are monthly data for Japan and data on last Wednesday of each month for the United States.

Sources: Board of Governors of the Federal Reserve System; Bank of Japan.

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Chart 4

Long-Term Interest Rates



Note: The long-term interest rates are market yield on U.S. Treasury Securities and JGBs at 10-year constant maturity.

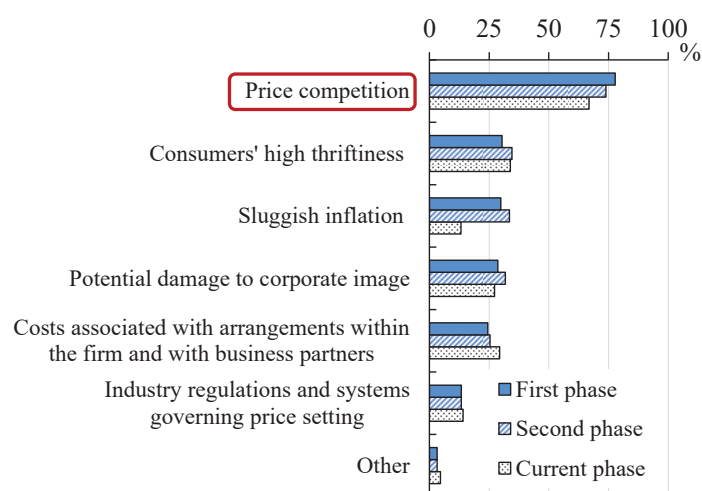
Sources: Board of Governors of the Federal Reserve System; Ministry of Finance.

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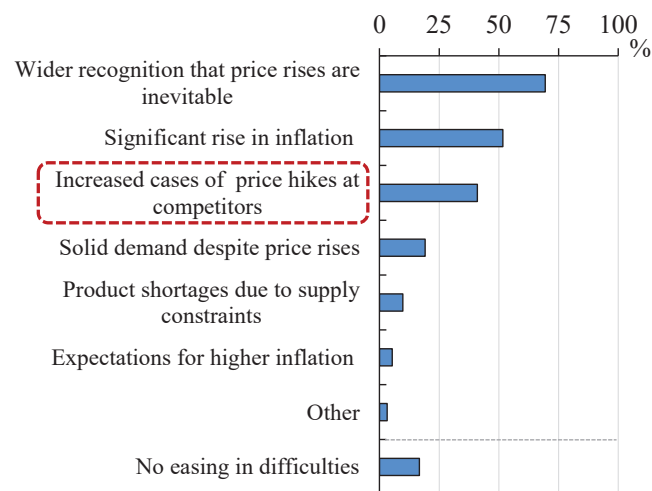
Chart 5

Large-Scale Survey on the Corporate Sector

Reasons why raising prices was difficult



Reasons why the difficulties in raising prices have eased

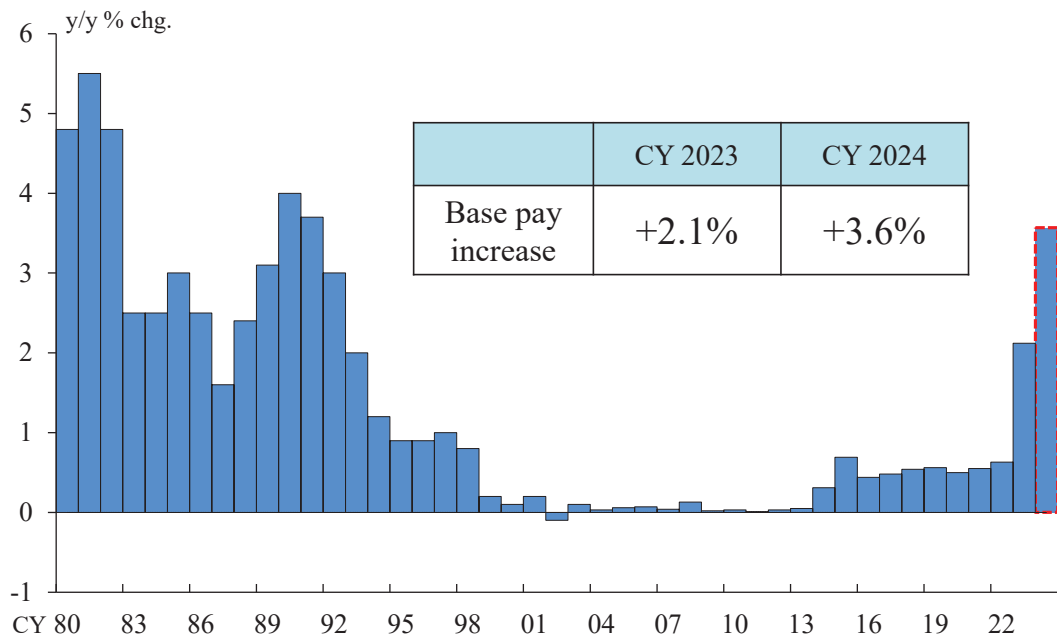


Note: In the left-hand chart, firms were asked to respond to the question by dividing the past 25 years since the mid-1990s into three phases, which comprise (1) the "first" phase, defined as the period from the mid-1990s to the 2000s, (2) the "second" phase, defined as the 2010s, and (3) the "current" phase, defined as the period over the past one year.

Source: Bank of Japan.

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Base Pay Increase (Spring Wage Negotiation)



Note: Figures from 1980 to 2014 are those published by the Central Labour Relations Commission, while those from 2015 to 2024 are figures released by Rengo.
The figure for 2024 is from Rengo's fifth aggregation.
Sources: Japanese Trade Union Confederation (Rengo); Central Labour Relations Commission.