

Advising Abenomics

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- **February 15, 2013**

PIIE and the Japanese Economy

- I am a great beneficiary of the PIIE, a valuable milieu to discuss international policy issues.
- President Adam Posen is an sympathetic critique of Japanese macro problems. (Mikitani and Posen eds.)
- Michael Mussa contributed much to the issues of the balance of payments and the real exchange rate. I may have now different opinions on these issues from

The Turn of Fortune

- A Telephone Call from Premier Abe when I was proofreading the manuscript of a new trade book, The US knows how to revive the Japanese Economy (Kodansha, 2013).
- Suddenly being visible to the public.
- The importance of having a great political leader!
- Ideas or political interests.

Who named “Abenomics”?

- Hidenao Nakagawa (LDP politician) named it.
- Who conducted the education of the new born Prime Minister.
- Kikuo (Kick) Iwata, Kozo Yamamoto, Yoichi Takahashi and Etsuro Honda.

What are Ingredients of Abenomics?

- People point out three arrows of the Abenomics:
- (1) Audacious monetary policy,
- (2) Expedient Fiscal Expenditures, and
- (3) Efficient Growth Strategy.
- Monetary policy is effective for bringing the economy on the full employment path. Fiscal expenditures **may help**.

Who support these ingredients?

- (1) We, reflation oriented or standard economists, understand the proper roll of monetary policy in an economy where prices and wages are sticky.
- (2) Politicians who are accustomed to the old fashioned Keynesian Economics.
- (3) Most economists once the trajectory reaches the full capacity path. Kozo Kaikaku (Structural Reform) is always needed.

1. An Overview of the Current State of Affairs before the Start of Abenomics.

- **During the past 15 years under the BOJ Law (1998), deflation, the yen appreciation, excess capacity, economic hollowing of the country and unemployment continued. Even though the Japanese still enjoy high quality of life and possess a large amount of foreign assets, something is wrong.**
- **Japan's GDP trajectory trailed almost at the tail end of advanced and emerging economies**

Its Particular Features

- **Deflation continued for a long time since the start of the (new) Bank of Japan (BOJ) Law in 1998.**
- **Until the start of the Abe-nomics, nominal as well as real exchange rates were kept as very high. Consider the hurdle exporters face as well as what import competitors face. (Jorgenson and Nomura 2009)**

2. Diagnosis

- **Deflation and the yen appreciation are essentially monetary phenomena. (Consider the Walras Law in the monetary economy) Asset prices are determined by the relative quantity of assets and their expected returns. The price level is the relative price of money and goods in general, and exchange rates are relative prices among currencies.**

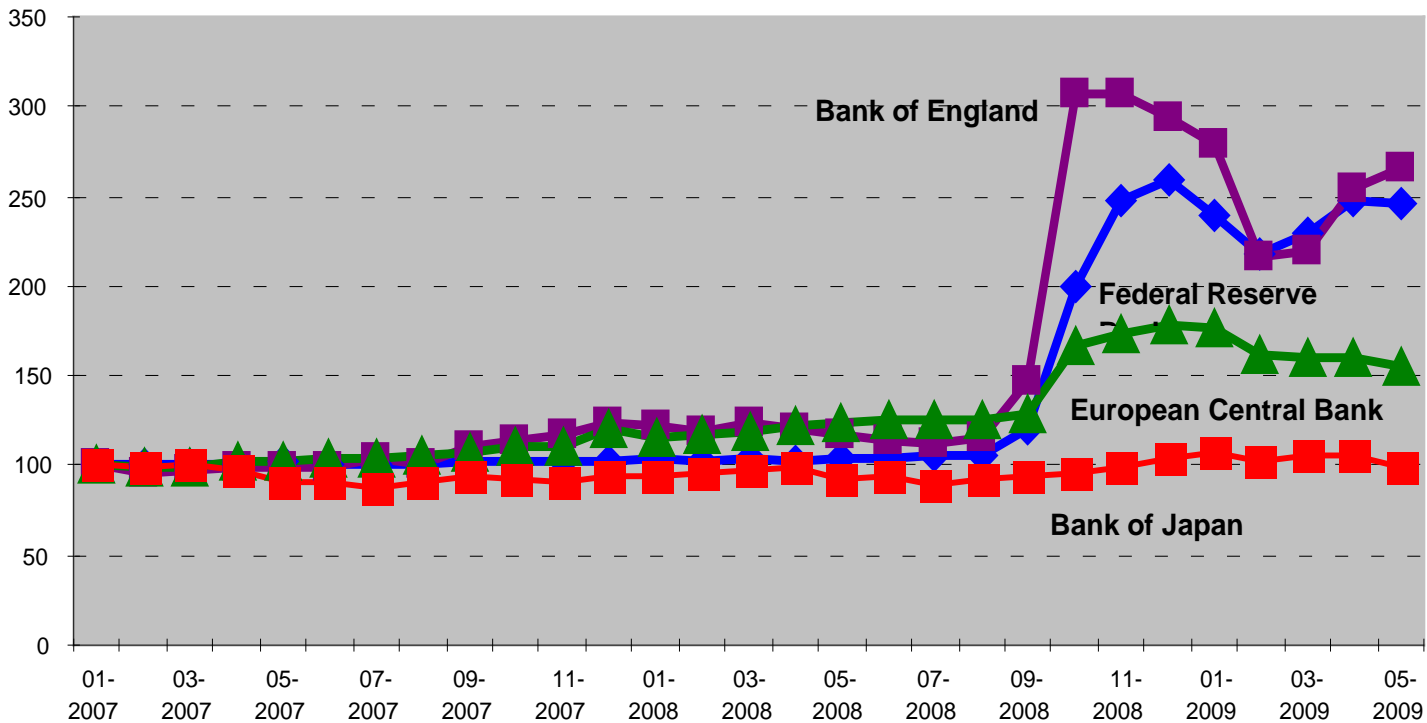
3. Prescriptions for Policy

- **Thus natural policy prescription is the use of monetary expansion in a proper way, i.e. not only by the purchases of traditional short-term government debt but also by the purchases of longer term and wider ranging securities, including, in my opinion, the purchases of foreign assets.**
- **This is what Janet Yellen called the Yale approach to monetary economics. Acceleration effect on the credit channel will reinforce the mechanism.**

Money, (Real) Exchange Rates and Industrial Production

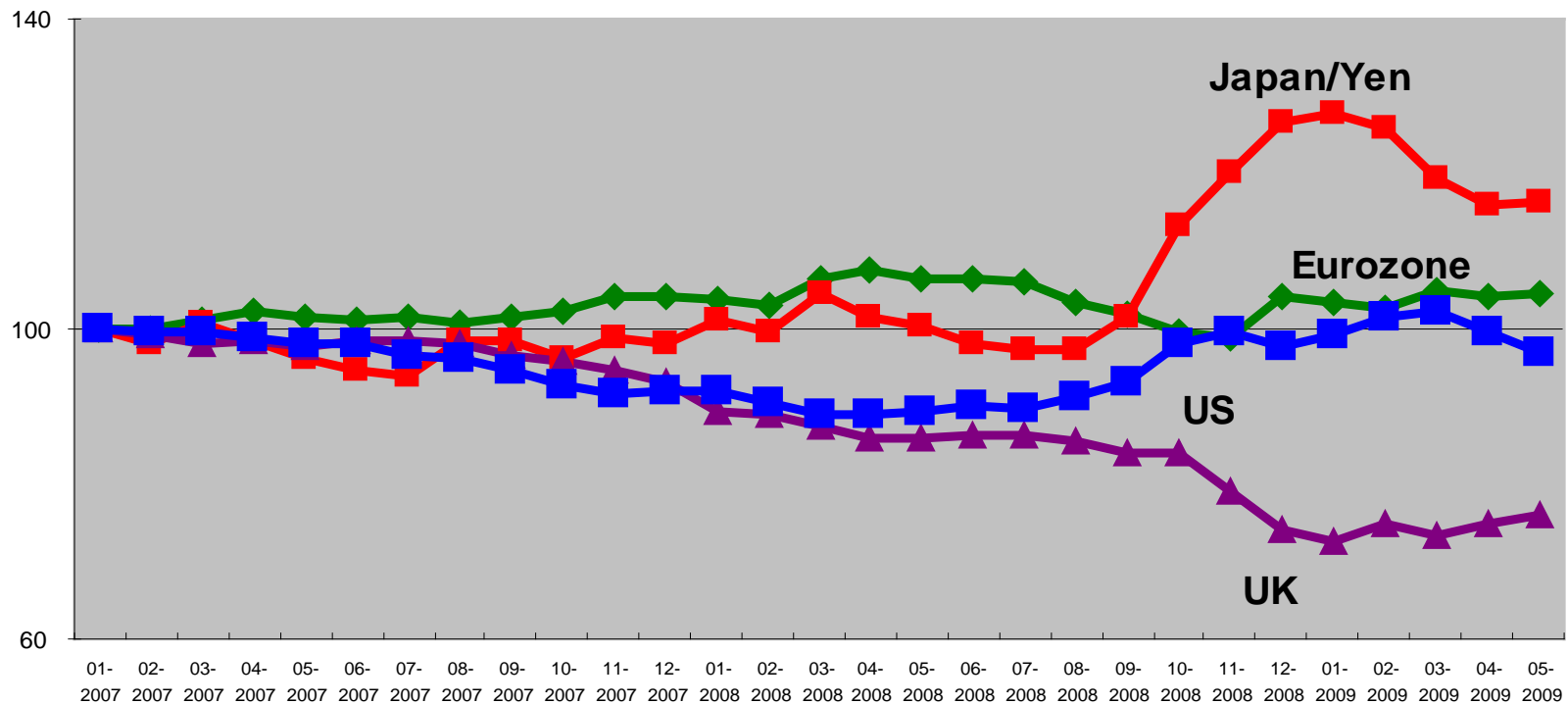
- Here are three graphs in excel.

Balance Sheets of Major Central Banks (1-2007=100)



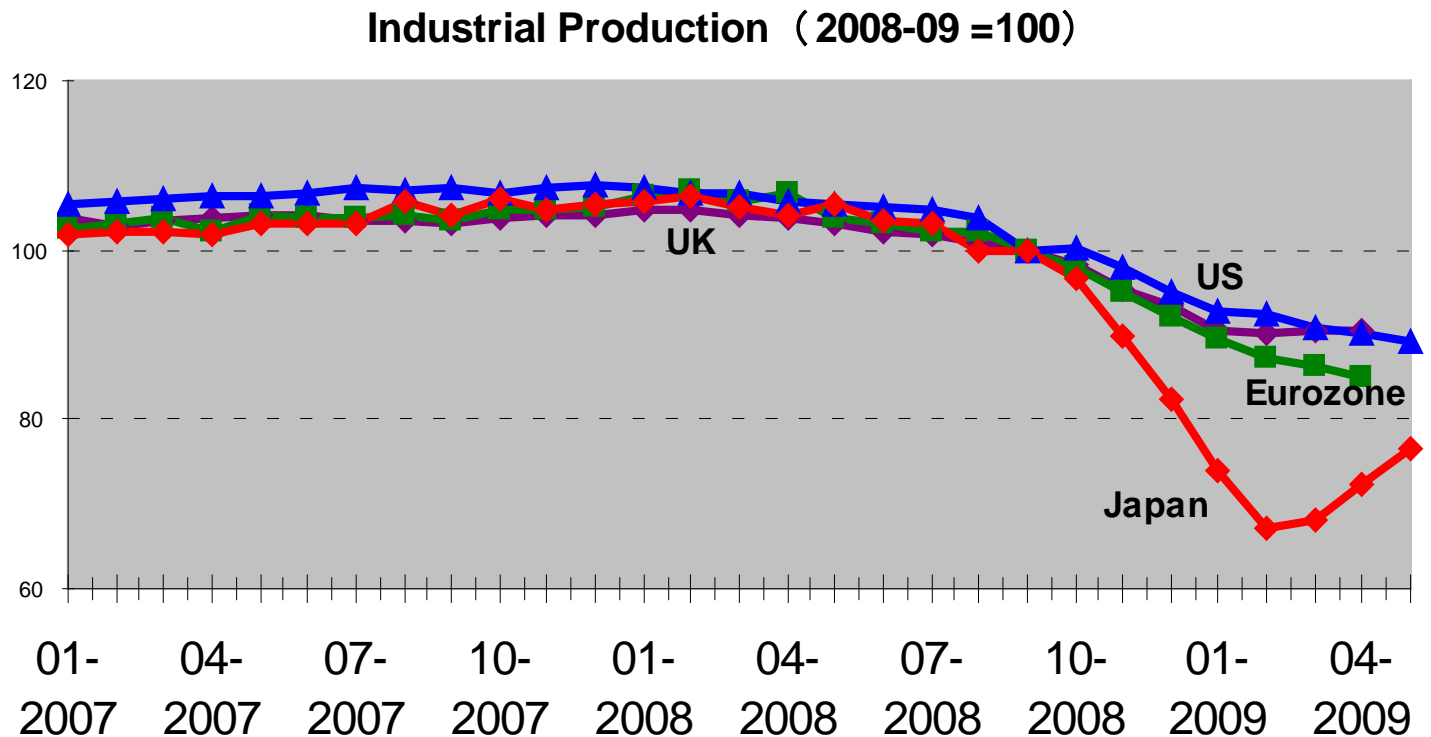
Money, (Real) Exchange Rates and Industrial Production (contd.)

Real Exchange Rates (1-2007 = 100)



Source : BIS

Money, (Real) Exchange Rates and Industrial Production (contd.)



Source : Bloomberg Terminal

The Myth of Currency Wars under Flexible Exchange Rates

- The importance of monetary interdependence and a case of monetary coordination under the fixed exchange rate

(Cooper, Hamada, etc.)

Non-existence of beggar-thy-neighbor phenomenon under flexible exchange rates by Eichengreen-Sachs (1984), Cooper (1984), and Hamada-Okada (2009).

Countries that are complaining can fix the situation by their own monetary policies. Or, Germany could help Greece.

“When UK, US and EU expanded money precipitously, Japan was silent. Why do European countries complain now/”

Issues of Fiscal Deficit

- **The Japanese are still rich in terms of their net foreign assets, but the government is poor. Fiscal reconsolidation will be necessary in the medium or in the long run.**
 - **Under the present circumstances, raising the consumption tax rate does not recover the budget equilibrium. It will most likely worsen it.**
- The right order is to stop deflation, and then recover the government budget.**