



# GETTING MONETARY POLICY BACK ON TRACK

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# INFLATION TARGETING IN JAPAN, 2013-2023

# 9

## Inflation Targeting in Japan, 2013–2023

*Haruhiko Kuroda*

Japan started targeting 2% inflation in 2013 and continued to do so until 2023. And yet, the 2% inflation target has not yet been achieved in a sustainable and stable manner. The current inflation of 3–4% is almost wholly caused by the import price hike and will slow down to less than 2% by the middle of fiscal year (FY) 2023. However, the “no price increase and no wage increase” norm is changing (long-term inflation expectations are rising), and further labor supply increases are unlikely, because female labor participation is already higher than in the United States. Therefore, by continuing accommodative monetary policy so that firms can continue to raise wages by around 3%, the 2% inflation target will be achieved in a sustainable and stable manner in the near future.

### Adoption of the 2% Inflation Target

The Bank of Japan adopted the 2% inflation target in January 2013, when it also agreed to the Joint Statement of the Government on Overcoming Deflation and Achieving Sustainable Economic Growth, in which the bank committed to achieving the 2% inflation target “at the earliest possible time” by executing monetary easing. This agreement was made before I joined the bank in March 2013.

## Quantitative and Qualitative Monetary Easing (QQE)

Actually, the Bank of Japan was under continued deflation since 1998 and introduced quantitative easing (QE) in 2001, expanded it step-by-step in 2003–6, and began to include long-term Japanese government bonds (JGBs) as well as commercial paper, corporate bonds, and exchange-traded funds (ETFs) between 2008 and 2013. But deflation persisted with low growth and high unemployment (see table 9.1).

So, in April 2013, the Bank of Japan substantially expanded QE by doubling the purchase of JGBs and the monetary base to achieve the 2% inflation target “at the earliest possible time, with a view to achieving it in two years.” The bank called this quantitative and qualitative monetary easing (QQE).

The initial reaction from the economy was significant: economic growth recovered and the stock market rebounded, while the consumer price index (CPI) inflation rate reached 1.4% by the spring of 2014. However, the increase in the consumption tax rate from 5 to 8% in April 2014, along with still sluggish wage increases, made personal consumption deteriorate, leading to a declining CPI inflation rate. So, in October 2014, the Bank of Japan expanded the QQE by substantially increasing its JGB purchases with longer-term maturities and committing to a higher increase in base money.

However, oil prices, which had been around \$100 per barrel, declined toward \$50 in 2015 and reached less than \$30 in early 2016, reducing the CPI inflation rate to zero. The situation required the bank to further strengthen monetary easing (see table 9.2).

TABLE 9.1. Inflation, Growth, and Unemployment in 1998–2012.

	Inflation Rate	Growth Rate	Unemployment Rate
1998–2012 average	-0.3%	+0.6%	4.6%

Source: Statistics Bureau, Ministry of Internal Affairs and Communications, Japan.

TABLE 9.2. Inflation, Growth, and Unemployment in 2013–15.

	Inflation Rate	Growth Rate	Unemployment Rate
2013	+0.4%	+2.0%	4.0%
2014	+1.1%	+0.3%	3.6%
2015	0.0%	+1.6%	3.4%

Source: Statistics Bureau, Ministry of Internal Affairs and Communications, Japan.

## QQE with Negative Interest Rates

To further lower the entire yield curve, in January 2016 the Bank of Japan decided to introduce the negative interest rate policy (NIRP) by imposing a  $-0.1\%$  policy rate on one of the three tiers of demand deposits at the bank while it further lengthened remaining maturities of JGB holdings. The bank certainly learned from the experience of NIRPs utilized by the European Central Bank and other European central banks so as not to undermine financial intermediation by the banking sector.

## QQE with Yield Curve Control

Thereafter, considering unstable international financial markets and weakening emerging-market economies, in July 2016 the Bank of Japan decided to expand the QQE by increasing its purchase of ETFs and declared it would make a comprehensive examination of the QQE regarding the negative interest rate. Then, in September 2016, after the comprehensive examination, the bank introduced the yield curve control (YCC)—accompanied by new forward guidance to continue the monetary base increase until the 2% inflation target was achieved—and widened operational tools. The CPI inflation rate recovered toward 1%, although because of the consumption tax rate increase from 8 to 10% in October 2019, inflation (excluding its direct impact on prices) slowed down slightly (see table 9.3).

TABLE 9.3. Inflation, Growth, and Unemployment in 2016–19.

	Inflation Rate	Growth Rate	Unemployment Rate
2016	-0.3%	+0.8%	3.1%
2017	+0.5%	+1.7%	2.8%
2018	+0.9%	+0.6%	2.4%
2019	+0.6%	-0.4%	2.4%

Source: Statistics Bureau, Ministry of Internal Affairs and Communications, Japan.

TABLE 9.4. Inflation, Growth, and Unemployment in 2020–23.

	Inflation Rate	Growth Rate	Unemployment Rate
2020	-0.4%	-4.3%	2.8%
2021	-0.2%	+2.1%	2.8%
2022	+2.3%	+1.0%	2.6%
2023	+3.1%*	—	2.6%*

\* March 2023

Source: Statistics Bureau, Ministry of Internal Affairs and Communications, Japan.

Then in early 2020, the world economy was seriously affected by the COVID-19 pandemic, which reduced supply as well as demand, becoming mired in negative growth and deflation. Japan was no exception. By 2022, the pandemic became less severe and the world economy started to recover. But then the war in Ukraine erupted in February 2022, which raised energy and food prices enormously, resulting in extremely high inflation, the highest in the last forty years. Again, Japan was no exception (see table 9.4).

### Inflation Targeting in Japan, 2013–23

As I said at the outset, although the current CPI inflation rate is 3–4%, it will slow down to less than 2% by the middle of FY2023. However, the important fact is that the fifteen-year deflation has been overcome with substantial employment and wage increases. Based on the significant improvement in the economy, we can now

TABLE 9.5. Hourly Wage Increase and Total Wage Increase, 1998–2012 vs. 2013–22.

	Hourly Wage Increase	Wage Increase
1998–2012 Average	–0.4%	–0.9%
2013–22 Average	+1.1%	+0.5%

Source: Statistics Bureau, Ministry of Internal Affairs and Communications, Japan.

TABLE 9.6. Employment, Employment Income, and Corporate Income.

	Employment*	Employment Income**	Corporate Income**
2012	62.6	251.7	47.2
2022 (Oct–Dec, annualized)	67.3	296.8	82.2

\* million employees; \*\* trillion yen

Source: Statistics Bureau, Ministry of Internal Affairs and Communications, Japan.

envisage the 2% inflation target being achieved in the near future (see tables 9.5 and 9.6).

I am sure that without the clear 2% inflation target and strong commitment by the Bank of Japan, we could not have overcome Japan's persistent deflation. At the same time, with various shocks coming from inside as well as outside of Japan, and above all, with the aftermath of fifteen years of deflation—i.e., the resulting entrenched deflationary mindset (the new “norm”)—achieving the 2% inflation target within a reasonable time span has been difficult. Having said that, I must emphasize that there appears to be no other policy framework, other than inflation targeting, for achieving price stability, which is the main mandate and objective of any central bank.

## GENERAL DISCUSSION

JOHN TAYLOR (INTRODUCTION): Before we have our lunch, we're going to have a wonderful speech by the former governor of the Bank of Japan, my good friend Haruhiko Kuroda. And I have to say, there's been no more fun for me in working with central banks than to spend some time at the Bank of Japan. It's a real treat. If you ever have a chance, go and do that. You learn so much about different ways to do policy. But we're interested in what's happening in Asia and Japan, and we can't wait to hear your talk. So welcome, and thanks so much for being here.

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SEBASTIAN EDWARDS: One of the controversial tools used in this process of bringing this inflation to an end was the YCC [yield curve control]. And when I teach monetary policy and the Taylor rule, and I go and teach Japan, my students say, how can you attempt to be successful without creating great distortion fixing and targeting both the short-term and longer-term interest rates? So could you comment a little bit on that?

HARUHIKO KURODA: Yeah. I think we call it yield curve control with QQE [quantitative and qualitative monetary easing]. So the basic structure and nature of the QQE continue, and then with a negative policy rate, coupled with a ten-year JGB [Japanese government bond] rate target at around 0%, we introduced YCC. Why did we change from simple QQE to QQE with the yield curve control? The main concern was, of course . . . maybe two things. One, targeting the amount of the JGB purchase, and the asset purchase program, of course, had some strong impact



on market expectations and so forth. But at the same time, you can imagine that depending on overseas financial market conditions, and so on and so forth, even if you continue to make an 80-trillion-yen JGB purchase every year, the long-term interest rate may fluctuate somewhat. So, we thought that by targeting the ten-year JGB rate at around 0%, we could fix the strings of monetary easing more than the simple QQE.

The second point is because [the] 80-trillion-yen JGB purchase, and so on and so forth, may be understood by financial market people, but ordinary households and ordinary company managers do not understand what 80 trillion yen is. Better to say that we will target the ten-year JGB rate at around 0%. That could be more transparent, understandable, and make the QQE more effective.

So, we introduced YCC, and of course, it is somewhat unusual. Many central banks adopted some kinds of QE [quantitative easing] after the Lehman crisis, but none of them adopted yield curve control, except for the Australian Reserve Bank. The Bank, of course, introduced a minus or quite low short-term policy rate but never intended to target long-term interest rates. That is true, that it is somewhat unusual, but we thought it was more effective and more transparent and could be good. And, of course, that could make JGB market people less happy or unhappy. That is true. But we still think that this YCC was appropriate and will continue to be appropriate until the 2% inflation target is achieved in a stable manner.

BEAT SIEGENTHALER: Thank you very much. Beat Siegenthaler, Rokos Capital. The market is debating a lot about what could happen once the system is unwound. And we're seeing in the US, and this morning we discussed about, what can happen when you have years and years of a lot of liquidity in the system, and then how once you withdraw it, rates go up. You see an impact there. Now, in Japan, I'm wondering how dangerous is it

going to be when eventually monetary policy will be normalized. And how disruptive could it turn out to be? Thank you.

KURODA: I think once the 2% inflation target is achieved in a sustainable and stable manner, the Bank of Japan would start normalization, meaning raising the policy rate and, of course, gradually reducing asset purchases, and so on and so forth. Now, then, there would be various impacts on the financial sector, households, companies, and also the government.

Now, as far as the household sector is concerned, you may know that Japanese households have about 60% of GDP equivalent debt, mainly housing purchase debt. But at the same time, Japanese households hold something like 2,000 trillion yen in financial assets, which is roughly four times GDP. So, even if interest rates are raised, that could affect some households that have significant amounts of housing loans, and so on. But households, generally speaking, would benefit from rising interest rates, because they hold a huge amount of bank deposits.

Ordinary companies after the Lehman crisis reduced total debt, but now they increased their debt beyond the level that prevailed before the Lehman crisis, now about 120% of GDP. But Japanese companies and firms hold something like 60% of GDP equivalent cash. And the former finance minister [Tarō] Asō always criticized Japanese companies—why do they have such huge amounts of cash instead of raising wages or increasing investment? So, firms have enough liquidity, and even if monetary situations tighten and the interest rate rises, no major impact is likely.

Now, Japanese financial institutions, they have substantial capital bases, and also liquidity is quite abundant. And by the way, in Japan, the deposit insurance scheme is quite interesting. On the one hand, there is some upper limit for ordinary deposits, but demand deposits without interest payments would be insured without limits. So, the entire amount of the demand

deposits without interest payments will be insured by the deposit corporation. And also, FSA [the Financial Services Agency] has been making various stress tests on megabanks as well as local banks, and they found that they have enough capital. There's enough liquidity. And so even if the interest rate goes up and monetary conditions become tighter, I don't think the banking or financial sector would be affected seriously.

The only entity that will be significantly affected by the monetary normalization is the government. Government has more than 200% of GDP equivalent debt. By the way, when I was vice minister of finance around 2000, at that time the Japanese government's national debt burden in terms of interest payment was about 10 trillion yen. And the current budget shows the interest payment by the government is only 8 trillion yen, while the stock of government debt increased more than triple. And yet the interest payment declined. That means that if the monetary situation is normalized, the interest rate would rise. Eventually, the Japanese government's interest payment burden would experience more than a threefold increase. So, from 8 trillion yen to 30 trillion yen. Quite huge, of course. Not instantly, but it will take five, six years, because the average maturity of JGBs outstanding is, I think, seven or eight years, including ten-year, twenty-year, and thirty-year JGBs. So roughly in five years, more than half or nearly two-thirds of JGBs would mature. So in the next five years or so after monetary normalization, the government debt burden will increase substantially. I have been telling the government this is the case. They know, but I don't know whether politicians understand the situation.

TAYLOR: Thank you.