Three Cheers for Japanese Monetary Policy

BY ANIL K. KASHYAP

Japan's central-bank governor, Haruhiko Kuroda, deserves tremendous praise for his bold recent action. Faced with inflation that was no longer headed towards the bank's 2% target, Mr. Kuroda surprised markets by announcing several new steps. They appear likely to work—and could serve as a much-needed guide for the rest of Japanese officials.

The strength of the Bank of Japan's current governor lies not just in his boldness, but also in his ability to communicate.

When the Bank of Japan was given independence in 1998, it was charged with the primary objective of ensuring price stability. Yet until Mr. Kuroda's appointment last year, Japanese inflation almost always remained unacceptably low, resulting in a stronger value of the yen and creating an incentive to delay consumption that depresses the economy. Zombie companies are also harder to spot when interest rates are zero, since loan repayments are easier.

Mr. Kuroda's predecessors had a laundry list of excuses for their fumbling. Originally the bank claimed that the Japanese economy was so unusual that it was impossible to give a numerical objective for inflation that would be appropriate for the economy. Then they claimed that monetary policy couldn't influence inflation in their country because its aging population and low productivity made deflation inevitable. They occasionally argued that Japanese people had come to expect very low inflation, so the central bank should ratify those expectations.

That Mr. Kuroda rejected these specious arguments and accepted responsibility for achieving 2% inflation is a welcome change. But inflation has flattened recently, as an April tax hike has helped stall the economy. The vote for the recent policy change was only 5-4 in favor, so Mr. Kuroda is bucking the defeatist mindset that remains alive in some parts of the bank.

One reason for optimism is that as governor of a democratically accountable central bank Mr. Kuroda follows a simple formula for communicating with the public and with the government.

Whenever he talks about his policy stance, he starts by explaining why those actions are needed. He then explains the mechanism by which these actions are supposed to work. And he concludes by giving the public and the market a roadmap to follow to assess if the policy is succeeding.

The policy he unveiled on Oct. 31 has two key ingredients. The first is to increase the quantity of assets that the bank will buy—for instance, tripling its purchases of real-estate investment trusts and exchange-traded funds linked to the stock market.

The bank will buy these assets with newly printed money that will work its way into the economy and—it is hoped—trigger additional spending and create an incentive to raise prices. The new money will also make yen-denominated assets generally less attractive to own, which will weaken the exchange value of the yen, leading to higher prices for imported goods.

Equally important, Mr. Kuroda has shown again that the bank will continue to experiment with new actions to make sure that it hits its inflation target. This is critical because so many economic decisions depend on what people expect about the future. Mr. Kuroda has created strong incentives for next year's wage negotiations to occur against a backdrop of likely inflation. This should lead to higher wage demands, which will raise incomes, supporting the higher spending and higher prices.

These beliefs can prove self-confirming if the public is convinced that Mr. Kuroda will succeed. All of which is good news for Japan.

But if Mr. Kuroda succeeds, people will rightly turn their attention to job creation and growth—and progress on those fronts is beyond his control. Generating a little inflation is much easier than creating growth.

There were other, nonmonetary parts of Prime Minister Shinzo Abe's economic agenda that were supposed to improve growth prospects, including good ideas such as better-utilizing women in the workforce and more ambitious ideas such as farm supports and regional-promotion policies. Unfortunately, progress on these fronts has been slow.

One must therefore hope that Mr. Kuroda's example will raise pressure on the rest of the government to do its share. A good starting point would be to adopt his three-part formula for communicating plans. That would at least force the government to discard its worst ideas and focus on ones that could make the most difference.

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