

Monetary Policy in Japan

A Review of its Conduct During the Past Ten Years

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The Japanese economy has been faced with three important problems: a relatively slow growth of domestic demand by historical standards; a depressive domestic economic impact of the yen's sharp and rapid appreciation against the background of the persistent current account surplus; considerably large and continuous deficits on the government's budget. These problems have arisen, at least in part, from the structural transformation which the Japanese economy has undergone over the past ten years. The fundamental changes in the performance of the Japanese economy also had various implications for domestic monetary management and, to cope with them, the *Bank of Japan* has engineered various new techniques for monetary control. The bank should and will continue to make every effort to secure the effectiveness of monetary policy.

This article will first attempt to summarize the main changes in the Japanese economy during the past ten years. It will then identify the various operational problems the Japanese monetary authorities have been confronted with. The final part of the article is intended to review Japanese experience with monetary policy in the light of the foregoing analysis and briefly indicate various attempts made by the *Bank of Japan* to secure the effectiveness of monetary policy.

I. Economic Developments in the Past Decade: Termination of Rapid Economic Growth

It was in 1965 that the Japanese economy plunged into a deep recession for the first time in the postwar era. In retrospect, this augured a shift from "high economic growth" led by investment and export booms which had typically characterised the Japanese economy in the preceding decade. Active use of countercyclical fiscal policy was made to cope with the economic downturn and long-term government bonds to finance

increased public expenditures were introduced for the first time. As will be explained later, the floatation of government bonds had an important implication for the conduct of fiscal and monetary policies in the subsequent years.

The early 1970's saw a series of international economic and monetary events. The continued unrest in the international monetary system and foreign exchange crisis — starting with the U.S. suspension of the convertibility of the dollar into gold or other reserve assets announced in August 1971, the conclusion of the *Smithsonian* agreement in December 1971 and its breakdown in March 1973 followed by the generalized floating of major currencies — significantly influenced domestic economic management and the operation of monetary policy in various countries. Japan was no exception, and the international movement of volatile capital became a matter of serious concern to the Japanese monetary authorities. On top of this, the upswing of the Japanese economy, the simultaneous expansion of all the other major industrial economies between 1972 and 1973, was accompanied by an unprecedented explosion in the prices of industrial raw materials which culminated in the quadrupling of oil prices towards the end of 1973. The oil price increase had serious disruptive impacts on the Japanese economy. It exacerbated the inflation which had already been under way. At the same time, it had a strong depressive impact on domestic demand. Japan's balance-of-payments was hardest hit, as her dependence on imported oil was the highest among oil-importing industrial countries. Under these circumstances, the Japanese authorities put priority on the fight against inflation, and formulated fiscal and monetary policies so as to attain this goal. In the case of Japan, the problems of inflation and external disequilibrium were brought under control in a fairly short period of time. But Japan has, until recently, suffered from a protracted period of weak domestic private demand. It is not simply a legacy of the oil crisis. It is also, in part, a mirror image of the above-mentioned shift from the past pattern of high economic growth — the shift which reflects the emergence of environmental problems, the need to put more emphasis on social welfare, and the recognition of growing frictions abroad caused by Japan's export-led economic expansion. In this period of transition, considerable slack has developed in various sectors of the Japanese industry, and entrepreneurs have been forced to make quick adjustment to the new economic environment, shifting away from the growth-oriented management of their corporations. A weakening of autonomous

domestic demand such as business fixed investment in this conjuncture was for a while offset, in part, by the growth of exports. But the export-led recovery was obviously undesirable, and a series of fiscal actions have been taken to compensate for a slowdown in domestic private demand. Hence, the government has had to rely heavily on bond issues to finance increased government spending.

II. Changes in the Japanese Economy and their Implications for Monetary Policy Management

The main features of monetary policy in Japan during the past period of high economic growth can be summarized as follows.

The major objective of monetary policy up to around the middle of 1960's was restraint of excessive economic expansion and correction of balance-of-payments deficits. Throughout this period, the underlying strength of autonomous demand was such that once monetary policy was relaxed, the domestic economy soon resumed an upward track. This pattern of the Japanese economy essentially reflected the behaviour of business investment in plant and equipment. As this type of expenditure was mostly financed by borrowings from financial institutions, the principal concern of the monetary authorities was how quickly and effectively they could restrain financial institutions' lending to the private sector. Main policy instruments used to achieve this primary monetary objective were (1) direct ceiling controls on lendings by financial institutions (a kind of moral suasion, usually called "window-guidance" control), (2) money-market operations designed to influence the lending attitude of financial institutions. It is true that changes in the *Bank of Japan's* discount rate (the official discount rate) were also made to affect interest rates on the money market and those on commercial bank lending. But the psychological effect stemming from the announcement of a discount rate change was considered to be more important than its interest rate effect.

More recently, however, important changes in the behaviour of the Japanese economy necessitated the modification of the framework for monetary management which had been geared principally to the objective of restraining economic activity through controls on financial institutions' lending.

The first of such changes relates to a shift in the pattern of the flow of funds within the economy. In contrast to the preceding period when

the economy had been led by private non-residential fixed investment and when the corporate sector continued to incur large financial deficits, economic expansion came to be sustained mainly by the growth of government spending through bond issues. Thus, while the corporate sector's financial position has improved through reduced reliance on external borrowing together with an increase in its holding of financial assets, the amount of new issues of government bonds has increased sharply: in FY1979 (April 1979 - March 1980), it is planned to total about 40 per cent of government spending on the general account of the budget, and by the end of FY1979, the ratio of government bonds outstanding to nominal GNP is estimated to amount to about 25 per cent. This shift away from the traditional pattern of financial flows dominated by bank credit to the business sector has had an important implication for monetary management.

The second notable change is the growing importance of external influences on domestic monetary developments as a result of the increased integration of the Japanese economy with those of other countries. In a situation where changes in exchange rates and interest rate differentials tend to induce large flows of international capital, the scope is limited for the use of monetary policy aimed solely at domestic economic and financial management. A large inflow of short-term capital into Japan in 1971 and the resulting sharp increase in the money supply, coupled with a considerable growth in bank credit through an improvement in the banks' liquidity position, augured the move towards the international integration of the Japanese financial system.

The third important change relates to the performance of the real sector of the Japanese economy. In contrast to the previous period of high economic growth when underlying demand pressure had remained strong, autonomous demand has tended to lose momentum. The primary concern of the monetary authorities in the new situation is the extent to which monetary policy should be employed in stimulating demand. What can and should be expected of monetary policy, when the economy is permitted only to follow a narrow path for expansion, given persistent inflationary pressures? For the Japanese monetary authorities, this is a relatively new problem, and indeed it constitutes a great challenge to them.

In the light of these important changes, the *Bank of Japan* has made various efforts to adapt the framework for monetary management and instruments of monetary policy to the new situation. At the same time,

it took appropriate actions, when necessary, to ensure the coordination of monetary policy with fiscal policy and also with exchange rate policy. In this sense, it can be claimed that during the last ten years, the *Bank of Japan* has not only paid due attention to the need to use monetary policy for the short-run management of the economy, but it has tried to do more. Indeed, the past ten-year period also provides a record of the bank's attempts made in the longer-run perspective as well to secure the effectiveness of monetary policy in the new situation.

These points will be briefly touched upon in the final part of his article. In what follows, a review of the use of monetary policy over the past ten years will be made in some detail, dividing the decade into three phases: from 1971 to autumn 1973; from autumn 1973 to 1974; from 1975 to 1979.

III. Conduct of Monetary Policy

1. *First Phase (1971 - Autumn 1973) — Economic Management in the Face of International Monetary Disorder*

During 1971, the year characterized by the breakdown of the *Bretton-Woods System* through the U.S. suspension of the convertibility of the dollar into gold, the yen came under speculative buying pressures against the background of a large surplus on Japan's current account. In the end, the yen was revalued by 16.9 per cent against the dollar as part of the agreement made at the *Smithsonian* in late December, 1971. As this sharp upvaluation of the yen was considered to have a strong depressive impact on the Japanese economy with particularly severe blows to medium- and small-sized export industries, the *Bank of Japan* in December 1971 decided to reduce the official discount rate, in addition to the successive cuts made in October 1970 and in January, May and July 1971. A further reduction was effectuated in June 1972, bringing down the discount rate to 4.25 per cent from the 6.25 per cent which had been in effect before the first cut in October 1970. The stance of fiscal policy also changed gradually. The main objective of budget policy in FY1970 had been the slowdown of economic activity, but the FY1971 budget was designed to be neutral to the economy, while leaving the scope for action to reflate the economy when needed. In FY1972, budget policy started to assume a deliberately expansionary posture.

From mid-1971, while maintaining easy monetary conditions, the *Bank of Japan* started its attempt to offset any excessively expansionary

monetary effect arising from a massive inflow of speculative capital. To achieve this objective, the *Bank of Japan* reduced its lending to the commercial banks, and sold its own bills to the banking systems as well as government bonds with repurchase agreements. In addition, in May 1972, an incremental reserve requirement against non-residents' free-yen deposits was introduced, and in June and July of the same year, the required reserve ratio was increased to further mop up excess liquidity from the money market. In the meantime, a number of exchange control measures were taken to stem speculative short-term capital inflows, such as the ban on non-residents' purchase of Japanese treasury bills (March 1971), the prohibition of non-residents' purchase of unlisted securities (May 1971), controls on Japanese exporters' advanced receipts of their export proceeds (August 1971); the introduction and tightening of controls on the net conversion of foreign currencies into Japanese yen for domestic use (August, September 1971), ceiling controls on the banks' external liabilities (August 1971), ceiling controls on non-residents' free-yen deposits (August 1971). Despite these steps, a massive inflow of capital continued, and it obliged the *Bank of Japan* to take the above-mentioned domestic monetary measures as well. While they proved effective in mopping up excess liquidity from the money market, they kept intact the net liquidity position of the banking system which had improved considerably through large current account surpluses and inflows of non-monetary capital. In retrospect, one cannot deny that the improvement in the net liquidity position of the banking system complicated domestic monetary management in the subsequent period of economic upswing. Indeed, experience with monetary policy in this and subsequent periods has given a precious lesson to the monetary authorities.

By the middle of 1972, indications were that the economy had definitely entered into the phase of economic upswing. Business non-residential investment staged a sharp recovery, and at the same time, despite the yen's upvaluation, exports started to resume growth at an unexpectedly high rate, against the background of brisk economic recovery in other countries. On the monetary front, a substantial improvement in the banks' net liquidity position through the above-mentioned inflow of short-term capital led to a sharp increase in bank credit together with a reduction in lending rates. While this undoubtedly provided a monetary incentive to business investment and thus helped economic recovery, it also tended to add impetus to the inflationary ex-

pectations which had been generated by sharp price increases in foreign countries and a firming of the domestic commodity market conditions. In fact, wholesale prices started to accelerate from around the autumn of 1972.

The price situation prompted a gradual shift in the stance of monetary policy, although fiscal policy remained expansionary throughout 1972, partly because the main concern of the authorities at the time of preparation of the FY1972 budget was to offset the deflationary effect of the yen's upvaluation and partly also because a considerable increase in public works was needed for the implementation of the so-called "Plan for Remodeling the Japanese Archipelago" (which was designed to improve social infrastructure and also to encourage the geographical relocation of industries together with greater diversification and sophistication of production). Initially, the *Bank of Japan* resorted to a tightening of its "window-guidance" controls to moderate bank credit expansion. Towards the end of the year 1972, the domestic inflation was exacerbated, with not only wholesale prices but also stock and land prices starting to hike sharply. At the beginning of 1973, the *Bank of Japan* raised normal reserve requirements to tighten the net liquidity position of the banking system. The floating of the Japanese yen, which started in February 1972, enlarged the scope for the use of monetary policy for domestic economic considerations. In fact, after this move, the *Bank of Japan* decided to increase the official discount rate from 4.25 per cent to 5.0 per cent in early April. The step was followed by the successive three increases which brought the discount rate up to 7.0 per cent by late August. Reserve requirements were also raised successively in March, June and September. On top of this, the *Bank of Japan's* "window-guidance" controls were further tightened. In line with the restrictive stance of monetary policy, the government's budget for FY1973 starting in April was designed to produce a deflationary impact on the domestic economy. Compared with the preceding periods of restraint, it took longer for the effects of these monetary and fiscal measures to show up. But, they did start to emerge clearly by the autumn of 1973, with some moderation of price increases and a weakening of inflationary expectations.

In short, during the two-year period up to the outbreak of the oil crisis, the *Bank of Japan* was faced with a number of new difficult problems. How to overcome disruptive effects of the yen's upvaluation experienced by Japan for the first time? How to stem speculative short-

term capital inflows? How to neutralize their undesirable domestic monetary effects? How to prevent domestic inflation when the acceleration of inflation became a world-wide phenomenon? The confrontation with these problems was, in a way, an inevitable outcome of the growing internationalization of the Japanese economy, at a time when the international monetary system was crumbling. The *Bank of Japan* made every effort to conduct proper management of monetary policy, but before it could see the final success of its efforts, it came to be confronted with another new problem: a massive wave of inflation generated by the outbreak of the oil crisis.

2. *Second Phase (Autumn 1973 - 1974) — Fight Against Hyper-Inflation*

The quadrupling of oil prices in late 1973 gave a new momentum to the inflationary situation in Japan which had started to show some signs of improvement towards the end of the first phase. Another important aspect of the oil crisis was its depressive economic impact stemming from the prospects for a reduction in the availability of imported oil as well as from a loss of the real purchasing power of domestic economic agents as a result of the oil price increases. It was also expected that a sharp increase in Japan's payment for oil imports would turn the current account into a large deficit. The price situation deteriorated particularly markedly, with speculative buying not limited to those materials whose prices are most susceptible to the effect of the oil price increases, but spreading also to a wider range of goods. In fact, the year-to-year increase in the overall index of wholesale prices rose to 37 per cent by February 1974.

In formulating monetary policy, the *Bank of Japan* took into account not only the acceleration of inflation but also the possible weakening in demand pressure arising from a loss of the real purchasing power of domestic economic agents. However, as the development of deflationary impulses was considered, at that stage, as just one of the possibilities and not as the inevitable outcome of the oil crisis, the bank in the end attached priority to the more immediate task of moderating the price hike and eradicating inflationary expectations. Thus, in December 1973, the bank announced a set of measures to further tighten monetary conditions: an increase in the official discount rate by 2 percentage points to an unprecedentedly high level of 9 per cent; a further increase in reserve requirements against the banks' liabilities; tighter controls on commercial bank lending. Among them, the announcement of the offi-

cial discount rate increase seemed to have a particularly important psychological effect. In line with the actions taken by the bank, the government also decided to defer its expenditures and introduced emergency measures to put the prices of some food and other basic goods under direct control.

The package of monetary measures was designed to weaken speculative activity based on inflationary expectations, both by raising the general level of interest rates — hence, the cost of financing such activity — and also by reducing the availability of funds. Under the bank's "window-guidance", the permissible net increase in lendings by major commercial banks was set at a level some 30 - 40 per cent lower than the actual net growth of lending in the corresponding period of the previous year, and as a result, the growth of the money supply decelerated sharply. As business enterprises and individuals came to perceive the definitive resolve of the authorities in the fight against inflation, inflationary expectations started to dwindle. At the same time, as the financial situation of corporations tightened, industrial output and business investment slowed down. By January 1975, about a year after the introduction of the severely restrictive monetary and fiscal measures, wholesale prices began to show signs of weakening.

In short, during the one-year period after the outbreak of the oil crisis, the *Bank of Japan*, pursued monetary restraint, mobilizing all policy instruments in its arsenal, and it succeeded in moderating price increases in a fairly short period of time. It must be added that in its fight against inflation, the bank was helped by the government which made a flexible use of fiscal policy. The fight against inflation proved more successful also because of relative flexibility in wage determination in Japan than in some other countries where an exogenous rise in import prices tends to trigger the spiral of domestic wage and price increases.

All in all, the price situation became calmer by the autumn of 1975: the year-to-year increase in wholesale prices declined to 0.8 per cent in the third quarter of 1975 from a record rate of 35.5 per cent in the first quarter of 1974, while the year-to-year increase in consumer prices declined to 10.2 per cent in that quarter from a record high of 24.8 per cent in the third quarter of 1974. On the balance-of-payments front, the basic account turned into a surplus in the January-March quarter of 1975. With an improvement of the domestic price and balance-of-payments situations having been achieved, the realization of faster economic

growth without rekindling inflation was placed on the forefront of economic policy objectives.

3. *Third phase (From 1975 to 1979) — Warding off Both Depression and Inflation*

In the course of the fight against hyper-inflation after the outbreak of the oil crisis domestic demand pressure weakened substantially. This was not simply a cyclical or policy-induced phenomenon; it was also at least partly a reflection of the earlier-mentioned change in the growth pattern of the Japanese economy — the transition to a lower longer-term growth path — which coincided with the cyclical and policy-induced downturn of economic activity. With the termination of gestation periods for new investments in the preceding phase of economic upswing, output capacity increased substantially. Against this background, low domestic demand pressure considerably increased the amount of excess capacity in the economy. The underutilization of capacity put a heavy burden on industries, which were suffering also from increased labour costs and costs of borrowing to finance the past plant and equipment investment.

Faced with this situation, the *Bank of Japan* started to relax monetary policy in April 1975: it reduced the discount rate from the “crisis” level of 9 per cent, and relaxed its window-guidance. The permissible quarterly growth of major banks’ new lending was set at a level larger than the actual growth in the corresponding quarter of the previous year, while other banks were permitted in principle to expand lending following their own programs. But the price situation was still precarious. In fact, industries were desperately trying to pass increased wage and material costs on to selling prices, as soon as the situation permitted them to do so. Under these circumstances, the bank considered it also important to prevent the resurgence of inflationary expectations. Thus the discount rate was reduced only step by step (April, June and August 1975), and by a small amount of 0.5 per cent on each of the three occasions. Subsequently, watching the course of the domestic economy and the price situation, the *Bank of Japan* further relaxed its window-guidance. Moreover, a 1 percentage point cut in the discount rate to a level of 6.5 per cent (lower than the rate of 7 per cent prevailing immediately before the outbreak of the oil crisis) as well as a reduction in the banks’ reserve requirements was announced in the autumn of 1975.

In the meantime, to offset a weakening in private demand, the government had started to adopt expansionary fiscal policy. The increase in public-works expenditures starting from autumn 1975 had to be financed mainly by government bond issues, as tax receipts decelerated against the background of economic stagnation. Fiscal policy maintained its expansionary stance in FY1976, 1977 and 1978, with considerable increases in public-works expenditure provided for in the initial budgets having been augmented by supplementary budgets in the course of each of those fiscal years. The share of proceeds of bond issues in total government revenues rose from 11.3 per cent in FY1974 to 31.3 per cent in FY1978¹, while the amount of government bonds outstanding amounted to about 20 per cent of GNP by the end of FY1978.

On the external front, exports increased at a rapid rate as domestic aggregate demand remained relatively weak. From around the second half of 1976, the year-to-year increase in exports in dollar terms rose above the 20 per cent mark. Consequently, the current account, which had turned into surplus in the course of 1975, registered a surplus of \$ 3.7 billion in 1976. The surplus increased further to \$ 10.9 billion in 1977.

During 1976, the *Bank of Japan* carefully watched economic trends and price movements. As time advanced, it became clear that despite fiscal and monetary stimuli, the recovery of domestic demand was too slow and insufficient, while further progress was made on the price front. Thus, a series of additional monetary measures were taken in the course of 1977. The official discount rate was reduced three times (March, April and September), and credit availability was further increased by the relaxation of the *Bank of Japan's* "window-guidance" ceilings on the increase of bank lending. In fact, such ceilings came to be mainly a formality, with all banks just asked to provide the bank with their own lending programs in advance, and permitted in principle to extend credit following those programs. In March 1978, the official discount rate was cut again to 3.5 per cent, the lowest level in the past three decades (Its cumulative decline from 1975 amounted to 5.5 percentage points).

The effects of the further relaxation of monetary policy became manifest in various sectors of the economy. The average lending rate of commercial banks followed a declining trend, renewing its record low each

¹ The ratio would have been approximately 37 per cent, without the reform of the tax system which enabled the fiscal authorities to include the corporate tax revenue received in May 1979 in the revenue for FY 1978.

month, while the financial conditions of corporations eased considerably. The lowering of financial expenses has undoubtedly contributed to the recent improvement of corporate profits, and facilitated the recovery of business investment in the course of 1979.

Until 1979, a major concern of the monetary authorities was the monetary impacts of a balance-of-payments surplus and official intervention in the exchange market. From around the autumn of 1977, the persistent large surplus on Japan's current account and the loss of confidence in the U. S. dollar generated waves of speculative yen purchases. The authorities followed the principle of allowing underlying balance-of-payments trends to be reflected in the yen rate and of intervening in the exchange market to counter erratic movements in the exchange market. It was in this context that the introduction of an incremental reserve requirement against the banks' free-yen liabilities and the suspension of public offering of Treasury bills were decided upon in November 1977. In March 1978, the incremental reserve requirement was raised to 100 per cent and non-residents' purchase of bonds with maturities of five years and one month or less was banned. Despite these measures, massive inflows of speculative capital occurred, and the authorities had to intervene in the exchange market. The resulting surplus funds in the money market were mopped up by the bank's offsetting actions such as a reduction in its lending to the banking system and the diminution of its bill purchases from the market. Thus, both the direct expansionary effect on the monetary stock (arising from the surplus on non-monetary transactions) and the secondary monetary effect (stemming from credit expansion induced by an improvement in bank liquidity through intervention) remained moderate.

Subsequently, the monetary impact of the balance of payments became negative. In fact, during the second half of 1978, the current account surplus started to narrow, while a large net outflow of capital materialized. In the spring of 1979, the current account turned into deficit. The change was brought about through the lagged effects of the yen appreciation between 1977 and late 1978 and the sustained growth of domestic demand since the autumn of 1978 as well as successive increases in oil import bills in 1979. Moreover, higher interest rates abroad tended to encourage outflows of capital from Japan. This, together with the turmoil of the oil situation, led to a weakening of the yen rate in the first three quarters of 1979. But, a substantial decline in the yen rate is thought undesirable both from the viewpoint of international cooperation and from that of

moderating the rise in domestic prices of imported goods. With these considerations in mind, the Bank at times intervened in the market to sell dollars, while measures to discourage capital inflows were lifted.

By early 1979 when Japan had achieved two important policy goals (acceleration of its economic growth through expansion of domestic demand and elimination of an excessively large surplus on the current balance of payments), the re-emergence of inflationary pressure began to loom as the greatest problem. The deterioration of the price situation is observed most clearly in the behaviour of wholesale prices. The overall index started to rise in November 1978, and the year-to-year rise reached a double-digit figure in August 1979 after an interval of about four years and a half. The increase in wholesale prices took place, against the background of external factors such as the general tightening in international commodity markets as well as a weakening in the yen rate and firmer domestic demand-supply conditions. On top of this, the successive increases in oil prices accelerated the wholesale price hike. Fortunately, the effect of wholesale price increases is not yet felt markedly on consumer prices. In fact, the year-to-year rise in consumer prices has remained around a level of 3 per cent. But, the rise in consumer prices is also bound to accelerate, as the impact of the wholesale price hike spreads over. In view of this, the *Bank of Japan* raised the discount rate by 2.75 percentage points in total to 6.25 per cent in three steps, i. e., in April, July and November 1979, while the window guidance was gradually tightened to moderate the growth of bank lending.

Another matter of major concern to the monetary authorities has been to continuous large issues of government bonds. In Japan, while most of the government bills for short-term financing are subscribed to by the *Bank of Japan* and various governmental agencies, the longer-term financing of government deficits has been made in the form of bond issues, which until recently had a single maturity of ten years. Recently, efforts have been strengthened to increase the capacity for the market to absorb new government bonds. One of them was the introduction of medium-term (5 years) and shorter-term (3 years) government bonds. It is also considered important to prevent the "crowding out" of funds for business investment required by the private sector, and interest rates should play a more important role in the allocation funds to both the public and private sectors. Bearing this in mind, the authorities have recently introduced certain schemes under which interest rates on government bonds and Treasury bills should more

properly reflect market interest rates. The introduction in May 1979 of yen-denominated negotiable certificates of deposit with terms and conditions reflecting market conditions also represents a new step toward the so-called liberalization of interest rates to increase the role of the price mechanism in the channelling of funds.

The impact on the money supply arising from government bond issues deserves special mention. In Japan, a predominant part of them is absorbed by the banking system, with only a small part purchased by non-banks. Because of this, the issuance of government bonds is a factor directly contributing to the growth of the money supply, and its relative importance has been increasing. Under these circumstances, starting in July 1978, the *Bank of Japan* made it a practice to publish, in the first month of each quarter, the projected growth of M2 during the current quarter. It is hoped that the public announcement of such projections will help deepen the general public's understanding on the important problem of the money supply, and thereby will permit the authorities to resort more flexibly to monetary restraint, when needed. The bank has not yet started to set a specific numerical target for monetary growth, partly because empirical studies so far carried out have not found a demand for money function stable enough to justify normative monetary targetry, and partly also because experience with the control over the money supply has not yet demonstrated the sufficiently high degree of precision required for the adoption of such a strategy. However, the bank expects that the new practice per se will enhance its capacity to operate monetary policy efficiently and effectively.

This article has reviewed the conduct of monetary policy in Japan over the past 10 years. It indicates that a number of problems still remain unresolved. Needless to say, the most important task for the authorities will continue to remain the achievement of price stability, while attaining a reasonably high rate of economic growth and promoting balance-of-payments adjustment. In this context, it is imperative for the *Bank of Japan* to control the money supply properly, warding off external monetary disturbances, and protecting the Japanese economy from the danger of inflation.

Zusammenfassung

Die Geldpolitik in Japan Ein Rückblick auf das letzte Jahrzehnt

Dieser Beitrag beschreibt die Geldpolitik in Japan während des letzten Jahrzehnts. Im Gegensatz zu der vorangegangenen Dekade, als das Hauptziel der Geldpolitik in der Drosselung eines übermäßigen Wirtschaftswachstums und der Korrektur der Handelsbilanzdefizite lag und die Kreditkontingentierung das Hauptinstrument der Geldverknappung war, machten nun einige wichtige Veränderungen in der japanischen Wirtschaft eine Modifikation des geldpolitischen Instrumentariums notwendig. Als erste dieser Änderungen trat der öffentliche Sektor als ein großer Nettoschuldner auf den Finanzmärkten auf. Die zweite bestand in der ständig wachsenden Bedeutung der außenwirtschaftlichen Einflüsse auf die inländische Geldentwicklung, ausgelöst durch die wachsende Integration der japanischen Wirtschaft in die Weltwirtschaft. Die dritte war eine abgeschwächte autonome Nachfrage nach Beendigung eines starken Wirtschaftswachstums bei gleichbleibendem Nachfragedruck.

Angesichts dieser Veränderungen unternahm die *Bank of Japan* verschiedene Versuche, die monetäre Politik und ihre Instrumente der neuen Situation anzupassen. In jüngster Zeit bemühte man sich verstärkt um die Zinsliberalisierung, so daß die Zinsen einen größeren Einfluß auf die Geldverteilung sowohl auf den öffentlichen als auch auf den privaten Sektor nehmen konnte. 1978 ging die Bank of Japan dazu über, die projizierte Wachstumsrate von M_2 für das laufende Quartal zu veröffentlichen, um damit in der Öffentlichkeit ein größeres Verständnis für die Bedeutung der Geldversorgung zu wecken. Die strikte Geldmengensteuerung wird für die *Bank of Japan* eine wichtige Aufgabe bei den Bemühungen zur Erreichung von Preisstabilität, bei gleichzeitig angemessener hoher Wachstumsrate und Förderung des Zahlungsbilanzgleichgewichtes bleiben.

Summary

Monetary Policy in Japan A Review of its Conduct During the Past Ten Years

This article reviews the conduct of monetary policy in Japan over the past ten years. During this period, in contrast to the preceding decade when the major objective of monetary policy was restraint of excessive economic expansion and correction of balance-of-payments deficits and when credit rationing was the main mechanism of monetary restraint, a number of important changes in the behaviour of the Japanese economy called for the modification of the framework for monetary management. The first of such changes was the emergence of the public sector as a large net borrower in the financial market. The second was the growing importance of external influences on domestic monetary developments as a result of the increased integration of the Japanese economy with those of other countries. The third

was a weakening of autonomous demand after the termination of the period of high economic growth when underlying demand pressure remained strong.

In the light of these changes, the *Bank of Japan* made various attempts to adapt the technique of monetary management and policy instruments to the new situation. More recently, efforts have been strengthened to liberalise interest rates, so that they should play a larger role in the allocation of funds to both the public and private sectors. In 1978, the *Bank of Japan* introduced a new practice of publishing the projected growth rate of M2 during the current quarter in the hope that it will help deepen the general public's understanding about the importance of the money supply. For the *Bank of Japan*, the proper control of the money supply will continue to remain an important task in its efforts to achieve price stability, while attaining a reasonably high rate of economic growth and promoting balance-of-payments adjustment.

Résumé

La politique monétaire du Japon Une rétrospective de la dernière décennie

L'étude décrit la politique monétaire du Japon de la dernière décennie. Contrairement à la décennie précédente, lorsque l'objectif principal de la politique monétaire consistait à freiner une croissance économique excessive et à corriger les déficits de la balance des paiements et lorsque le contingentement du crédit était l'instrument premier de la raréfaction monétaire, d'importantes mutations dans l'économie japonaise exigèrent ensuite de changer d'instruments de politique monétaire. La première de ces mutations fut l'apparition sur les marchés financiers du secteur public comme important débiteur net. La deuxième est représentée par l'impact croissant des influences économiques extérieures sur le développement monétaire interne que ne pouvait manquer d'occasionner l'intégration croissante de l'économie japonaise à l'économie mondiale. Et la troisième fut une demande autonome affaiblie après la fin d'une forte expansion économique alors que la pression de la demande globale subsistait.

Confrontée à ces mutations, la Banque du Japon entreprit plusieurs démarches à l'effet d'ajuster à la nouvelle situation la politique monétaire et ses instruments. Plus récemment, elle s'est tout particulièrement préoccupée de la libéralisation des taux d'intérêts afin que ceux-ci puissent exercer une plus forte influence sur la répartition monétaire tant dans le secteur public que dans le secteur privé. En 1978, la *Banque du Japon* se décida à publier le taux projeté d'expansion de M₂ pour le trimestre en cours en vue d'amener l'opinion publique à mieux saisir l'importance de l'approvisionnement monétaire. La stricte gestion de la masse monétaire demeurera pour la *Banque du Japon* une tâche essentielle dans la recherche de la stabilité des prix tout en préservant un taux d'expansion aussi élevé qu'approprié et en promouvant l'équilibre de la balance des paiements.