Bank of Japan's Monetary Policy in the 1980s: A View Perceived from Archived and Other Materials

May 24, 2016
Ryoji Koike (with Masanao Itoh and Masato Shizume)
Historical Studies Division,
Institute for Monetary and Economic Studies,
Bank of Japan
The main points of this paper:

What do we do?
✓ This monographic paper summarizes views held by the Bank of Japan (hereafter BOJ or the Bank) in the 1980s regarding economic conditions and monetary policy formulation, perceived from the BOJ archives and other materials from the period.

What becomes clearer?
✓ From a historical viewpoint, the authors see the 1980s as a watershed time for the Bank's policy formulation, because the Bank acquired lessons for monetary policy formulation under a large fluctuation in economic and financial conditions and innovated new approaches for monetary policy formulation and money market management as stated below.
Why do we regard the 1980s as a watershed time?

First, during the 1980s the BOJ had to largely consider the external imbalance in formulating policy, and attention began to shift towards price stability in the medium or long term by the end of the decade.

Second, the large fluctuations in asset prices, money supply, and commercial bank lending were closely monitored during this period, but the Bank's assessment about their impacts on macroeconomic consequences in the medium to long term was insufficient. A reflection of these lessons appears to evolve into a perspective on the Bank's monetary policy formulation that financial imbalances should be examined as a risk for achieving price stability in the medium to long term.

Third, in light of ongoing financial deregulation during this period, the Bank started to change monetary policy measures from those based on a regulated interest rate framework to those based on market operation with good use of money markets and flexible interest rates.
Primary sources from the archived and other materials

Governor’s Speech at the General Managers’ meeting
- Meeting held four times per year; the head of the Policy Planning Department sent the text of the speeches to heads of the departments at the head office, General Managers of the BOJ branches, and General Managers overseas.

Governor’s Speech at the meeting with top executives of the regional banks
- Meeting held nine times per year; the text of the speeches was sent to the General Manager of branches and the heads of the local offices.

Letters from the head of the Policy Planning Department
- Sent as personal letters to General Managers of branches with personal name of the department’s head; shared institutionally within the Bank.

Letters from the head of the Market Operations Department
- Sent as personal letters to General Managers of branches and heads of local offices; shared institutionally within the Bank.

Other sources in the time
- Such as BOJ's Monthly Bulletin along with other public materials.
Organization of the BOJ in the time

Policy Board

Governor
- 4 Voting Members
- 2 Non-voting members from government agencies

Governor
- Senior Deputy Governor
- Deputy Governor for International relations
- Executive Directors
- Executive Auditors
- Counsellors

Secretariat of the Policy Board

Governor’s Office

Policy Planning Dept.

Market Operations Dept.

IMES

Branches & Local Offices

Overseas Representative Offices
The Bank of Japan Archives

Chronology

1882: Bank of Japan was established.
1982: A division of IMES partly performed a function of the archives (mainly for economic historians, not open to public).
1999: The Bank of Japan Archives started.
2002: Bank of Japan is subject to “Act on Access to Information Held by Administrative Organs.”

Amount of materials

About 81,000 folders (as of March 2014).
Most of materials (99.999%) are in Japanese.
A difference between two languages

On January 11, 1776, Congress, following a preamble,

"RESOLVED, Therefore, that any person who shall hereafter be so lost to all virtue and regard for his country, as to refuse to receive said bills in payment, or obstruct or discourage the currency or circulation thereof, and shall be duly convicted by the committee of the city, county or district, or in case of appeal from their decision, by the assembly, convention, council or committee of safety of the colony where he shall reside, such person shall be deemed, published and treated as an enemy of his country and precluded from all trade or intercourse with the inhabitants of these Colonies."

In other words, persons who refused to take these notes as the equivalent of coin, were made outlaws. Nevertheless depreciation began, and even on June 4 the Virginia convention appointed a committee to inquire into the cause of the depreciation of Continental money.²

Related References

Okina, Shirakawa and Shiratsuka (2001)
Discussion of monetary policy in the late 1980s by BOJ officials.
   — It includes importance of monetary policy, recognition of risk on the whole, and policy agenda such as current account surplus.
   (www.imes.boj.or.jp/research/abstracts/english/me19-s1-14.html)

Ministry of Finance (2003a) and Komine ed. (2011)
Discussion of monetary policy in the 1980s.
Either edited by Japan’s Ministry of Finance, or written as a part of a research project organized by Japan's Cabinet Office.

The Centennial history of the Bank of Japan
Written by the BOJ’s project team in consultation with economic historians and other experts, in commemoration of the Bank's centennial history starting from 1882.
The six volumes and an appendix volume were released from 1982 to 1986.
   — Each volume contains 500-600 pages.
   (www.boj.or.jp/about/outline/history/hyakunen/index.htm/)
Phases in the 1980s

I. Response to the Second Oil Crisis (from Late 1978 to Summer 1980)

II. Reduction of the Official Discount Rate with Consideration of Exchange Rates (from Summer 1980 to the First Half of 1981)

III. Cautious Monetary Easing with Consideration of Trade Conflicts (from the Second Half of 1981 to Fall 1983)

IV. Greater Trade Conflicts, Monetary Policy, and the Japan-U.S. Yen-Dollar Committee (from Fall 1983 to Summer 1985)

V. Development of International Policy Coordination and Monetary Policy (from the Plaza Accord to the Louvre Accord)

VI. Economic Growth Led by Domestic Demand and Monetary Policy (from Spring 1987 to Spring 1989)

VII. Monetary Tightening and a Tight Monetary Policy Retained (from Spring 1989 to Summer 1991)
I. Response to the Second Oil Crisis (from Late 1978 to Summer 1980)

The Bank's response against the second oil crises

- Against the second oil crisis, which occurred in late 1978, the Bank gave it top priority to prevent import-price inflation from spreading over inflation in domestic prices, reflecting the lessons learnt from the first oil crisis with high domestic inflation.

  Specifically, the Bank swiftly tightened monetary conditions, by preemptive and large raises of the official discount rate five times from April 1979 to March 1980, as well as by the tightened window guidance.

Impact of the second oil crises

- The impact of oil price increases on reducing domestic income during the second oil crisis was similar to that during the first oil crisis, but both the inflation in domestic prices and a deceleration in economic activity were relatively mild, as a result of a restrained inflationary mind with calm reactions by firms and households as well as the flexible conduct of monetary policy.
Phase I. (from Late 1978 to Summer 1980)

Economic growth rate and inflation facing the second oil shock
Phase I. (from Late 1978 to Summer 1980)

The Bank's policy response

[Diagram showing official discount rate and call rate trends from 1978 to 1981, with a peak in October 1987 labeled as 'Black Monday.']
Phase I. (from Late 1978 to Summer 1980)

*Excerpts from materials in the time*

… the Bank considered that a permeation of excessive inflationary expectation among the public and a resulting “vicious circle of wages and prices” should be prevented.

(Governor’s speech, January 22, 1980, No. 51422, 1980a)

… The Bank firmly decided that “both the firms’ attitudes for price increases and the employees’ spring negotiations for higher wages should strongly be halted,” and raised the official discount rate during budget deliberations for the next fiscal year at the Lower House against the parliamentary custom.

(Letter from the Director-General of Policy Planning Department, February 18, 1980, No. 39903, 1980b)
II. Reduction of the Official Discount Rate with Consideration of Exchange Rates (from Summer 1980 to the First Half of 1981)

BOJ’s response

- In response to the slowing economy as well as regained price stability, the Bank gradually eased monetary conditions by lowering the official discount rate three times from August 1980 to March 1981, as well as by relaxing window guidance gradually and then allowing commercial banks to submit their loan plans at their discretion from spring 1981 onward.

Changes in external factors and BOJ’s response

- Factors such as the amendment of the Foreign Exchange Law in 1980 encouraged international capital transactions between domestic and overseas markets, and then the differences between domestic and overseas interest rates began to have a large effect on exchange rates. Meanwhile, the highest priority for the U.S. was to contain high inflation, and monetary tightening was implemented.

- Against this background, the BOJ gradually lowered interest rates while assessing developments in exchange rates so that the rate reduction would cause neither depreciation of the yen in relation to the high interest rates in the U.S. nor imported inflation.
Phase II. (from Summer 1980 to mid-1981)

Yen-dollar exchange rate and the U.S. interest rates

[Graph showing yen/dollar exchange rate and U.S. interest rates from 1978 to 1991, with key events such as 'Black Monday' and changes in official discount rate and Federal funds rate marked.]
Phase II. (from Summer 1980 to mid-1981)

Economic growth, inflation and unemployment rates in the U.S.
Phase II. (from Summer 1980 to mid-1981)

Excerpts from materials in the time

… the Bank cautiously assessed the developments in foreign exchange markets, so that the rate reduction would not cause depreciation of the yen or higher import prices, due to larger differences between the domestic and overseas interest rates and international capital flow.
(Letter from the Director-General of Policy Planning Department, August 19, 1980, No. 39903, 1980d)

… The Bank allowed commercial banks to submit their loan plans at their discretion, from the 1st quarter of 1981 for regional banks and from 2nd quarter of 1981 for major banks.
(Letter from the Director-General of Market Operations Department, March 17, 1981, No. 10585, 1981b)

… Window guidance “was a supplementary policy tool” … “not a legally binding guidance” but “a demand for cooperation in nature” … banks also expected to lower the risk of a liquidity shortage ...
(Reference memo: overview and transition of window guidance, June 1991, No. 40318, 1991d)
III. Cautious Monetary Easing with Consideration of Trade Conflicts (from the Second Half of 1981 to Fall 1983)

Economic conditions in the U.S. and Europe and criticism against Japan

• In the U.S. and European countries, the higher inflation remained mainly due to a continuation of significant wage increases, and the tight monetary policy for taming inflation brought the slower economic growth and the higher unemployment rates.

  Under such circumstances, Japan's expanding current account surplus, accompanied with the smaller imports through energy saving and with the enhanced competitiveness through improvement of the productivity, brought about increasingly intense trade conflicts.
Phase III. (from mid-1981 to Fall 1983)

Economic growth, inflation and unemployment rates in West Germany
Phase III. (from mid-1981 to Fall 1983)

Interest rates in Germany and German mark exchange rate

[Graph showing official discount rate and call rate with marked dates and percentage changes from 1978 to 1991.

Mark/dollar rate with arrows indicating depreciation and appreciation of German mark.

Graphs depict trends in official discount rate, call rate, and mark/dollar rate over the specified period.]
Phase III. (from mid-1981 to Fall 1983)

*Excerpts from materials in the time*

... the Bank recognized that “difficulties have developed in maintaining the regime of free trade,” which was the foundation for the world economy in the postwar era and which was particularly “the most beneficial for Japan to achieve growth.”

Therefore, the Bank considered that monetary policy should be implemented with “due attention to economic and political circumstances in the U.S. and European countries” so that the “free trade principle” would be esteemed and Japan “would not be isolated in the global community.”

(Governor’s speech, April 13, 1982, No. 51422, 1982a)
Japan's economic conditions

- Japan's economy overcame the impact of the second oil crisis. Solid corporate profits through firms' managerial efforts for improving energy efficiency and labor productivity as well as the tamed wage growth by both labor and management helped to avoid an escalation of inflation and a sharp economic downturn.

  However, the economic growth remained relatively low compared to the previous periods, partly due to weak overseas demand under the U.S. monetary tightening for containing high inflation.

The Bank's policy response

- A further interest rate cut may have been appropriate for domestic economic conditions such as low inflation and moderate economic growth.

  However, in the context of worsening trade conflicts, the lower interest rates could have weakened the yen under the pressure of the U.S. high interest rates.

  In this regard, the Bank gradually and carefully reduced the interest rates and eased monetary conditions, while confirming that the exchange rates were stable and that the risk of an overly weaker yen was small enough.
Phase III. (from mid-1981 to Fall 1983)

Excerpts from materials in the time

The Bank considered that an interest rate reduction with a view to “ensuring an economic recovery balanced for both domestic and external demand” could be accountable overseas.…

… The Bank maintained a stance that “the stability of the yen rate at a higher level” was the necessary condition for an interest rate reduction and the careful examination of timing for the reduction was mandatory.

(Governor’s speech, October 25, 1983, No. 9264, 1983b)
Phase III. (from mid-1981 to Fall 1983)

External balances of the U.S. and Japan
IV. Greater Trade Conflicts, Monetary Policy, and the Japan-U.S. Yen-Dollar Committee (from Fall 1983 to Summer 1985)

Economic conditions in the U.S.

- The U.S. economy strongly expanded, led by domestic demand, mainly supported by the subdued inflation with the effect of previous monetary tightening and by the effect of tax reduction. At the same time, the progress in reduction of fiscal deficits was not enough. The U.S. interest rates remained at a high level and the dollar continued strengthening.

Economic conditions in Japan

- Japan's economy recovered gradually and then the expansion became increasingly solid, supported by the remaining price stability due to the improved productivity and the mild rise in wages, and by the spillover effect of export growth to the U.S., in particular on the domestic demand such as fixed investment and consumption.
IV. Greater Trade Conflicts, Monetary Policy, and the Japan-U.S. Yen-Dollar Committee (from Fall 1983 to Summer 1985) cont.

BOJ's policy response

• The Bank kept the official discount rate unchanged throughout the period from 1984 to 1985.
  
  In the first half of 1984, when domestic demand was recovering slowly and prices were stable, the Bank's policy stance was slightly inclined for loosening. From mid-1984 to early 1985 when the recovery of domestic demand became obvious and the yen depreciated further, the Bank's policy stance was slightly inclined for tightening reflecting concerns about intensification of trade frictions or imported inflation under a further depreciation of the yen.

Japan-U.S. Yen-Dollar Committee and its effect

• The widening external imbalance among industrial countries worsened and the trade friction further intensified.
  
  However, the requests against Japan in this period were mainly for greater market access in individual sectors.
  
  In response to the requests, the Japan-U.S. Yen-Dollar Committee was established, and it published a report in 1984.
  
  Then the financial deregulations were persistently promoted in the second half of the 1980s, thereby affecting monetary policy operations from medium- and long-term perspectives.
Phase IV. (from Fall 1983 to Summer 1985)

Excerpts from materials in the time

…the Bank considered that “further efforts would be desirable for stabilizing the trend of the stronger yen” from the perspective of monetary policy implementation, in addition to a consideration of rectifying the current account imbalance. (Governor’s speech, July 22, 1985, No. 9270, 1985d)

…the Bank considered that monetary policy measures should be reformed for “better use of money market and free interest rates” to ensure the effectiveness and flexibility of monetary policy. The Bank also recognized that “further elaboration by ourselves should be necessary” for operational frameworks “such as the role of financial markets and monetary operations with conveying policy intentions smoothly.” (Governor’s speech, July 24, 1984, No. 9268, 1984d)
V. Development of International Policy Coordination and Monetary Policy (from the Plaza Accord to the Louvre Accord)

The Plaza Accord

• In September 1985, the Plaza Accord was achieved primarily for exchange rate realignment through concerted intervention in the foreign exchange markets and thereby rectifying the external imbalance, and the U.S. dollar depreciated sharply.

  However, the external imbalance continued to expand partly due to the J-curve effect. Therefore, from fall 1986 onward, major countries strengthened their pursuit for international policy coordination with fiscal and monetary policies in addition to exchange rate realignment.

The Louvre Accord

• In February 1987 the Louvre Accord was achieved, aiming for the stabilization of exchange rates, the expansion of domestic demand and subsequent reduction of current account surplus in surplus countries, and the reduction of both domestic imbalance and current account deficit in deficit countries.
Phase V. (from Sep. 1985 to Feb. 1987)

Exchange rate realignment of Japanese yen and German mark

![Graph showing exchange rates and currency devaluation/appreciation](image-url)
Effects of the exchange rate realignment on Japan's economic conditions

- Against a backdrop of the yen's sharp appreciation from fall 1985 onward, prices became calmer and calmer, affected by lower import prices with a stabilization effect on domestic prices.

Regarding economic activity, domestic demand continued to grow, but the decline in exports and subsequent deterioration of corporate profits in export-oriented industries steadily worsened conditions of corporate fixed investment and employment.
V. Development of International Policy Coordination and Monetary Policy (from the Plaza Accord to the Louvre Accord) cont.

The Bank's policy response

• In the first half of 1986, the Bank reduced the official discount rate three times and thereby eased monetary conditions, considering that expansion of domestic demand should be necessary in terms of both solid economic growth and rectification of external imbalance.

  In fall 1986 and afterwards, although both a turnaround in economic activity and a sign of financial imbalance were emerging, the Bank gave higher priority to a better circumstance for achieving the international agreement on stabilization of exchange rates.

  The official discount rate was lowered twice in November 1986 and February 1987 for further monetary easing.
Phase V. (from Sep. 1985 to Feb. 1987)

Excerpts from materials in the time

… “an unidentified high official of the Bank” expressed “concern about an increase of money supply” as “a lot of dry tinder under the chair.”
(a Nikkei Newspaper article on May 20, 1986)

… Until early fall 1986, the Bank considered that the economy was slowing down but “the pace of deceleration would not be increasing,” and also recognized “a rising stock market and wider areas with increasing land prices.”

The Bank assessed that “this timing would not be appropriate for lowering interest rates.”
(Letter from the head of Policy Planning Department, Nov. 1, 1986)

… Governor Sumita recognized that “given the size of the external surplus and Japan’s proportion relative to the global economy, we should prepare well for larger expectations by other countries.”
(Governor’s Speech, October 28, 1986)
Phase V. (from Sep. 1985 to Feb. 1987)

Sign of financial imbalances in bank lending and money under monetary easing

<table>
<thead>
<tr>
<th>y/y % chg.</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
<th>V</th>
<th>VI</th>
<th>VII</th>
</tr>
</thead>
<tbody>
<tr>
<td>78</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>79</td>
<td>8</td>
<td>9</td>
<td>10</td>
<td>11</td>
<td>12</td>
<td>13</td>
<td>14</td>
</tr>
<tr>
<td>80</td>
<td>15</td>
<td>16</td>
<td>17</td>
<td>18</td>
<td>19</td>
<td>20</td>
<td>21</td>
</tr>
<tr>
<td>81</td>
<td>22</td>
<td>23</td>
<td>24</td>
<td>25</td>
<td>26</td>
<td>27</td>
<td>28</td>
</tr>
<tr>
<td>82</td>
<td>29</td>
<td>30</td>
<td>31</td>
<td>32</td>
<td>33</td>
<td>34</td>
<td>35</td>
</tr>
</tbody>
</table>

Bank lending (Sum of 5 categories plus euroyen impact loans)
Bank lending (Sum of 5 categories)

Projection range
M2+CD (year-on-year change)

<table>
<thead>
<tr>
<th>78</th>
<th>79</th>
<th>80</th>
<th>81</th>
<th>82</th>
<th>83</th>
<th>84</th>
<th>85</th>
<th>86</th>
<th>87</th>
<th>88</th>
<th>89</th>
<th>90</th>
<th>91</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>8</td>
<td>9</td>
<td>10</td>
<td>11</td>
<td>12</td>
<td>13</td>
<td>14</td>
</tr>
</tbody>
</table>

Official discount rate
Call rate

Oct. 1987: Black monday
Phase V. (from Sep. 1985 to Feb. 1987)

Sign of financial imbalances in stock and land prices

- Nikkei stock average
- Commercial districts, 3 major wards in Tokyo
- Commercial districts, Tokyo and adjacent area
- Residential districts, Tokyo and adjacent areas
- Commercial districts, Osaka and adjacent area
- Commercial districts, Nagoya and adjacent area
- Commercial districts, others
VI. Economic Growth Led by Domestic Demand and Monetary Policy (from Spring 1987 to Spring 1989)

Japan's economic conditions

- After the second half of 1987, reflecting price stability as a result of the past appreciation of the yen and the effect of monetary easing and fiscal expansion under the Louvre Accord, Japan's economy entered a phase of strong expansion, led by increases in personal consumption and corporate fixed investment.
  
  The expansion continued with a faster pace than the Bank's preliminary anticipation.

BOJ's consideration before October 1987

- During the summer and fall of 1987, the Bank increasingly became cautious about excessive monetary easing, while confronting the greater upward pressure on prices with the tighter domestic conditions of supply and demand, as well as the indication of larger financial imbalances such as faster growth in money supply, more aggressive lending attitude by commercial banks, and steep rises in stock prices and land prices.
  
  Against this background, the Bank called for a “prudent lending attitude” toward commercial banks in window guidance while respecting the autonomous formulation of commercial banks' loan plans as a basic principle.
VI. Economic Growth Led by Domestic Demand and Monetary Policy (from Spring 1987 to Spring 1989) cont.

BOJ's consideration after October 1987

- In the aftermath of Black Monday in October 1987, the Bank strenuously tried to stabilize financial markets mainly by providing plentiful liquidity. After the markets calmed down, the Bank assessed by contrast that a sharp drop of stock prices reduced speculative bank loans and that the financial imbalances somewhat shrank.

  It appears that the Bank in those days considered ongoing structural changes for the economy driven by domestic demand to be elevating the potential economic growth rate, and that the Bank's recognition of an expansion of the bubble in those days was not sufficient.

  Regardless of a concurrent prospect in the near term, the Bank considered that the further appreciation of the yen after the Black Monday would support both a calmer inflationary mind and more active fixed investment, and that both price stability and higher economic growth would thereby continue.

  Accordingly, the Bank continued monetary accommodation by maintaining low interest rates.
VI. Economic Growth Led by Domestic Demand and Monetary Policy (from Spring 1987 to Spring 1989) cont.

BOJ's consideration in the time

• Throughout the period from spring 1987 to early 1989, the Bank recognized that the prolonged monetary accommodation served as a contributing factor to increases in asset prices.

  At the same time, it appears that the Bank did not strongly recognize the necessity of monetary tightening so far as prices were stable.

• Meanwhile, in light of the progress of financial liberalization, the Bank played a leading role in the market reforms in November 1988 for smoother market operations, including a shift to an offer-bid system at interbank money markets.
Phase VI. (from Spring 1987 to Spring 1989)

Excerpts from materials in the time

… “Japan's economy achieved a favorable balance of the vigorous increase in domestic demand under price stability and the resulting rectification of external imbalances and also showed favorable economic performance relative to other economies.”
(Governor's speech, April 5, 1988, No. 9274, 1988c)

… The Bank also considered that ... “the reallocation of resources is also under way with capital and labor shifting towards production aimed at domestic sales, which, in turn, increases supply potential as well as corporate and household income, and hence domestic demand,” and eventually “a dynamic process involving demand, supply and income” was emerging.
(BOJ special paper No.162, March 1988)
Phase VI. (from Spring 1987 to Spring 1989)

High economic growth with moderate inflation under low interest rates in Japan

(The dotted line is data adjusted for VAT.)
VII. Monetary Tightening and a Tight Monetary Policy Retained (from Spring 1989 to Summer 1991)

Economic conditions from Spring 1989 to mid-1990 and BOJ’s response

- Under eased monetary conditions maintained during the second half of the 1980s, Japan’s economy continued to expand mainly led by private domestic demand, and adjustment in current account imbalance steadily progressed.
  
  Among a gradual rectification of macroeconomic external imbalance, issues of economic friction between Japan and the U.S. shifted toward structural factors such as structural impediments in certain sectors and accessibility to markets.

  At the same time, mainly due to the progress in current account adjustment and the monetary tightening in the U.S. ahead of that in Japan, the yen ceased to appreciate and started to depreciate from late 1989 to mid-1990.

- Although inflation in the near term did not rapidly accelerate, the Bank considered that inflationary pressure started to be elevated, reflecting an increase in labor cost due to a tightened labor market on the domestic front and yen depreciation on the international front.

  The Bank also considered that an increase in asset prices might raise inflationary sentiment.

  The Bank turned its policy stance and raised the official discount rate five times between May 1989 and August 1990 in order to prevent inflationary sentiments from arising.
Phase VII. (from Spring 1989 to Summer 1991)

Inflationary conditions under a tightened labor market and yen depreciation
Japan's economic conditions after mid-1990

- Japan's economic conditions remained strong amid the sequence of tightening, and land prices continued to rise. Therefore, the Bank assessed that a cautious consideration for rising asset prices remained necessary.

BOJ's recognitions and policy response

- In November 1990 and afterwards, the growth of money supply slowed down rapidly due to the effect of interest rate increases to date and a more cautious attitude in extending credit by financial institutions, and then in summer 1991 the deceleration in economic expansion was gradually becoming clear.
  
  Meanwhile, the Bank maintained its tightening of monetary policy until June 1991, emphasizing the risk of recurrent inflation and assessing that that upward pressure on prices remained strong against a background of tightness in product and labor markets.
  
  Then, in July 1991 the Bank turned its policy stance and lowered the official discount rate, on the assessment that the upsurge of inflationary pressure weakened.
Phase VII. (from Spring 1989 to Summer 1991)

Excerpts from materials in the time

… “the Bank came to recognize that the economic activity led by corporate fixed investment and personal consumption was “stronger than expected in spite of the so-called triple decline in early 1990,” and that “potential upward pressure for prices might be piling up again.”
(Governor’s speech, July 16, 1990, No. 41807, 1990g)

… The Bank also considered that “in the current circumstance land prices should rather tend to be moderated than be cautious for large falls.”
(Governor’s speech, October 23, 1990, No. 41807, 1990k)

… The Bank assessed that “the pace of economic expansion moderated but overall economic activity was still at a fairly high level,” and that “market conditions in demand and supply as the most important aspect for future development in prices remained tight.”
(Governor’s speech, April 2, 1991, No. 41807, 1991b)

—— A reflection of this lesson evolved into a perspective on the monetary policy formulation. (our paper, p.163)
VII. Monetary Tightening and a Tight Monetary Policy Retained (from Spring 1989 to Summer 1991) cont.

Abolition of window guidance

- The Bank gradually strengthened recognition that the framework for window guidance, where the Bank ex-ante adjusted loan plans submitted from each commercial bank in consideration of the rivalry and equality among the banks, was getting out of date as financial deregulation progressed.

  However, from 1989 to mid-1991, the Bank tightened the guidance for commercial banks. Specifically, the Bank induced commercial banks to provide smaller loans than those in the same period in the previous year.

  Then from July 1991 onward the Bank abolished the framework, considering that the growth of bank lending was expected to be moderate even if the loan plan of each bank was fully left to its discretion.
Phase VII. (from Spring 1989 to Summer 1991)

Excerpts from materials in the time

… After the money market reform on November 1988, … market interest rates “became more influential on lending behavior by financial institutions.” …

… However, in the tightening phase from May 1989 “a level of overall liquidity … remained fairly high…” …

… the Bank adjusted portions of loan increments for respective commercial banks with a policy “requesting a further discipline in formulating loan plans …” and thereby tightened window guidance.

(Letter from the head of Market Operations Department, June 29, 1989, No. 10610, 1989h)

… It was also recognized … that “each share of banks in the past loan plans tended to remain as ossification in a following quarter” …

The Bank acknowledged that the adverse effect of window guidance was increasingly problematic.

(Interview with the Head of Market Operations Department, Kinzai Magazine, July 15, 1991)
Summary (a restatement)

- The authors see the 1980s as a watershed time for the Bank's policy formulation, because the Bank acquired lessons under a large fluctuation in economic and financial conditions and innovated new approaches for monetary policy formulation and money market management.

  ✓ First, during the 1980s the BOJ had to largely consider the external imbalance in formulating policy, and attention began to shift towards price stability in the medium or long term by the end of the decade.

  ✓ Second, the large fluctuations in asset prices, money supply, and commercial bank lending were closely monitored during this period, but the Bank's assessment about their impacts on macroeconomic consequences in the medium to long term was insufficient. A reflection of these lessons appears to evolve into a perspective on the Bank's monetary policy formulation that financial imbalances should be examined as a risk for achieving price stability in the medium to long term.

  ✓ Third, in light of ongoing financial deregulation during this period, the Bank started to change monetary policy measures from those based on a regulated interest rate framework to those based on market operation with good use of money markets and flexible interest rates.
Excerpts of Comments at BOJ workshop in April 2014

Discussant

What are new findings? (Importance of primary sources; recognition in 1988.)
Do the authors accept materials with questioning?
   (We assessed them carefully.)
What kinds of frameworks did the BOJ have?
   (BOJ may not seem to have maintained any specific framework.)
Did the BOJ have either Fed view or BIS view? (Not clear.)

Other participants

Interpretation of the archived materials. (Limitations and merits.)
Other recognitions inside the BOJ. (Hard to find; Governor comes first.)
Decision-making process under various views and related parties.
   (Important; focus on the Bank’s view)

Chairman of the session

Primary sources: important, even if we know most findings.
Financial imbalances: challenges in the past and in future.
More topics: Recognition about low inflation; implication of moral suasion.
Thank you