Comments on Leeper: Japan vs. the US 1930's

February 10, 2017

The main message

- Faced with deflation and low growth, Roosevelt and the US Congress turned to expansionary fiscal policy, aimed explicitly at causing inflation and thereby turning the economy around.

The main message

- Faced with deflation and low growth, Roosevelt and the US Congress turned to expansionary fiscal policy, aimed explicitly at causing inflation and thereby turning the economy around.

- This worked. The economy started growing and, as Jalil and Rua document, expectations quickly shifted toward positive inflation.

The main message

- Faced with deflation and low growth, Roosevelt and the US Congress turned to expansionary fiscal policy, aimed explicitly at causing inflation and thereby turning the economy around.

- This worked. The economy started growing and, as Jalil and Rua document, expectations quickly shifted toward positive inflation.

- This experience probably has lessons for Japan today, even though the circumstances are different in important respects.

The main message

- Faced with deflation and low growth, Roosevelt and the US Congress turned to expansionary fiscal policy, aimed explicitly at causing inflation and thereby turning the economy around.

- This worked. The economy started growing and, as Jalil and Rua document, expectations quickly shifted toward positive inflation.

- This experience probably has lessons for Japan today, even though the circumstances are different in important respects.

- The Japanese government should tie fiscal policy explicitly to its inflation goals, rather than discussing budget consolidation as if it could be pursued independently of success in reaching inflation targets.

Important differences

- Japan has had a longer history of low inflation and with announcements of policies that were supposed to end deflation but did not succeed.
- Shifting expectations about inflation may therefore be harder in Japan today than it was in the US in the '30's.

Important differences

- Japan has had a longer history of low inflation and with announcements of policies that were supposed to end deflation but did not succeed.

- Shifting expectations about inflation may therefore be harder in Japan today than it was in the US in the '30's.

- Fiscal expansion that does not succeed at first in changing expectations runs the risk of requiring higher eventual inflation, or of failing because policy-makers lose their nerve, or an election.

Important differences

- As Leeper points out, Japan's government debt is much higher relative to GDP than was US government debt in the 1930's.

Important differences

- As Leeper points out, Japan's government debt is much higher relative to GDP than was US government debt in the 1930's.
- A given reduction in primary surplus relative to GDP therefore had a larger effect on debt valuation in the US then than it does in Japan now.

Important differences

- As Leeper points out, Japan's government debt is much higher relative to GDP than was US government debt in the 1930's.
- A given reduction in primary surplus relative to GDP therefore had a larger effect on debt valuation in the US then than it does in Japan now.
- On the other hand, a given percentage change in the public's desired real holdings of debt should have a larger effect on current flow demand in Japan today than in the US then. How these two effects net out seem to me uncertain.

Important differences

- Japan today is already running large primary deficits and is projected to continue doing so for some years under current policies.

Important differences

- Japan today is already running large primary deficits and is projected to continue doing so for some years under current policies.

- Therefore what is required in Japan is not necessarily increased deficit spending.

Important differences

- Japan today is already running large primary deficits and is projected to continue doing so for some years under current policies.
- Therefore what is required in Japan is not necessarily increased deficit spending.
- More important than increased deficits is making fiscal consolidation clearly contingent on reaching inflation targets.

Important differences

- Japan today is already running large primary deficits and is projected to continue doing so for some years under current policies.

- Therefore what is required in Japan is not necessarily increased deficit spending.

- More important than increased deficits is making fiscal consolidation clearly contingent on reaching inflation targets.

- This might be easier, or (more likely) it could be harder, than Roosevelt's simultaneous fiscal expansion and announced commitment to reflation.

Implications of substantial foreign reserves

- Leeper suggests that the fact that the Japanese government has substantial foreign reserves give the trade deficit a role comparable to that of the primary surplus in debt valuation.

- This does not seem correct. The debt valuation equation of the FTPL applies to yen-denominated net debt.

- Foreign-currency-denominated assets somewhat complicate the accounting, but do not bring the trade surplus, which backs both public and private foreign assets, into the accounting.

Implications of decline in JGB's in the hands of the public

- One of Leeper's plots shows that "debt in the hands of the public" in Japan is actually in decline, because of the large purchases of JGB's by the Bank of Japan.

Implications of decline in JGB's in the hands of the public

- One of Leeper's plots shows that "debt in the hands of the public" in Japan is actually in decline, because of the large purchases of JGB's by the Bank of Japan.

- This illustrates how important it is to recognize that at least interest-bearing reserve deposits should be recognized as government debt.

- To the extent that BOJ holdings of government bonds correspond to increases in its interest-bearing reserve deposits, the "debt in the hands of the public" is not really in decline.

- On the other hand, *currency* is non-interest-bearing and should be excluded from FTPL accounting of government debt in the hands of the public.

- Of course the BOJ could keep interest rates on reserves at or near zero for a time after other rates have risen, which would have a strong expansionary effect, perhaps even before actual rate rises, if announced in advance.

Response to Watanabe: is Japan's monetary policy still active?

- I don't think you can explain the weak response so far to Abenomics as due to monetary policy.

- At the ZLB, keeping rates at zero is the only option when inflation is below target, and this is by definition passive monetary policy..

- More likely than active money is a combination of passive money with a fiscal policy still perceived as passive, so that current deficits are perceived as implying higher future surpluses.