Session 2: comments

The Univ. of Tokyo and IMF Joint Seminar

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The exit conditions in the US

Changed during QE

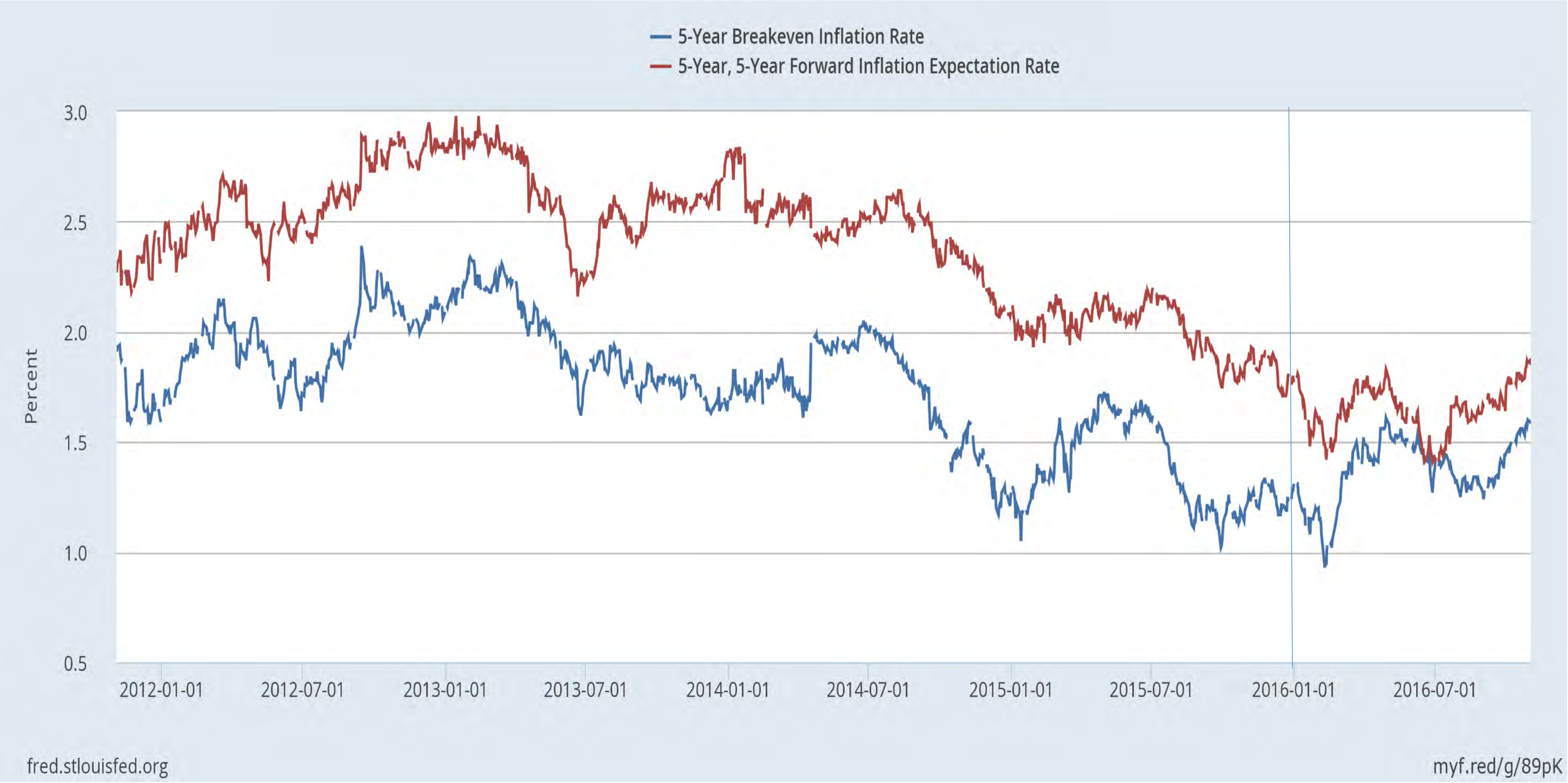
- Dec. 2012: “Exceptionally low” FF rates will be appropriate as long as
  - Unemployment rate > 6.5%
  - Projected 1-2 years ahead inflation <= 2.5% (overshooting the long-run goal of 2%)
- March 2014: Announced to keep near zero FF rates by taking into account “a wide range of information”
- Dec. 2015: Began a normalization process

Macroeconomic conditions at the 2015 exit

- Dec. 2015,
  - Unemployment: 5.3%
  - CPI inflation (q4/q4): 0.4%
  - Expected inflation: survey-based measures > 2%

✓The Fed did not require all expected inflation measures to overshoot the LR inflation target at the exit

✓There was no exit condition on “actual” inflation


5-Year Breakeven Inflation Rate
5-Year, 5-Year Forward Inflation Expectation Rate
3.0
2.5
2.0
1.5
1.0
0.5
Percent
2012-01-01
2012-07-01
2013-01-01
2013-07-01
2014-01-01
2014-07-01
2015-01-01
2015-07-01
2016-01-01
2016-07-01
fred.stlouisfed.org
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The exit conditions in Japan

Always conditioned on inflation, and tightened over time

- Apr., 1999, “Until the deflationary concern is dispelled”
- Mar. 2001, “Until the “core”-CPI inflation registers stably above zero or an increase year on year”
- Oct. 2010, “Until it judges that price stability is in sight on the basis of the understanding of medium- to long-term price stability”
- Feb. 2012, “Until it judges that the 1 percent goal is in sight”
- Apr., 2013, “will achieve price stability target of 2% in 2 years”
- Sept. 2016, “Until the year-on-year rate of increase in the observed CPI exceeds the price stability target of 2 percent and stays above the target in a stable manner”

For more details see Hayashi and Koeda (2014, 2016)

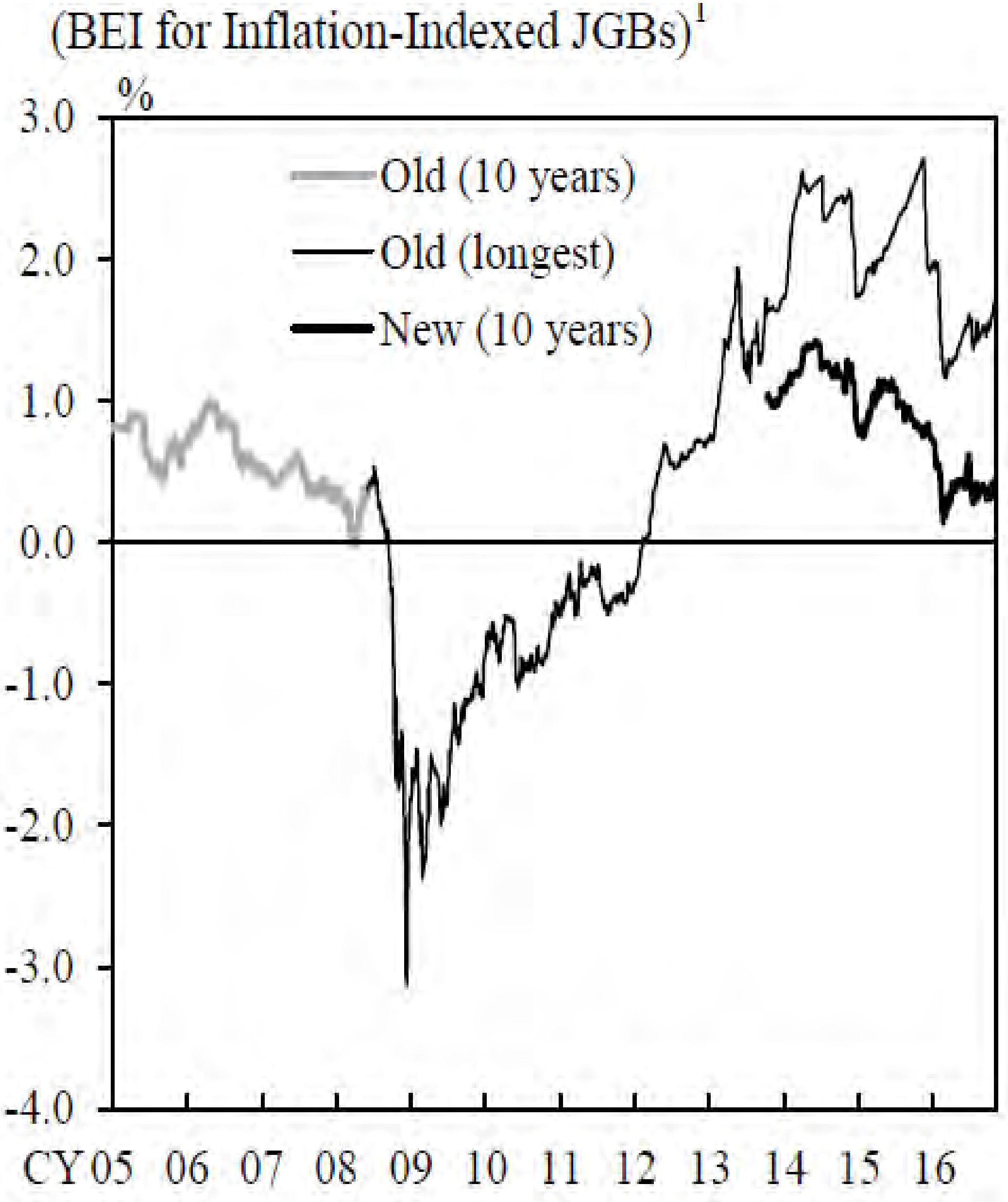
The exit conditions in Japan ctn.

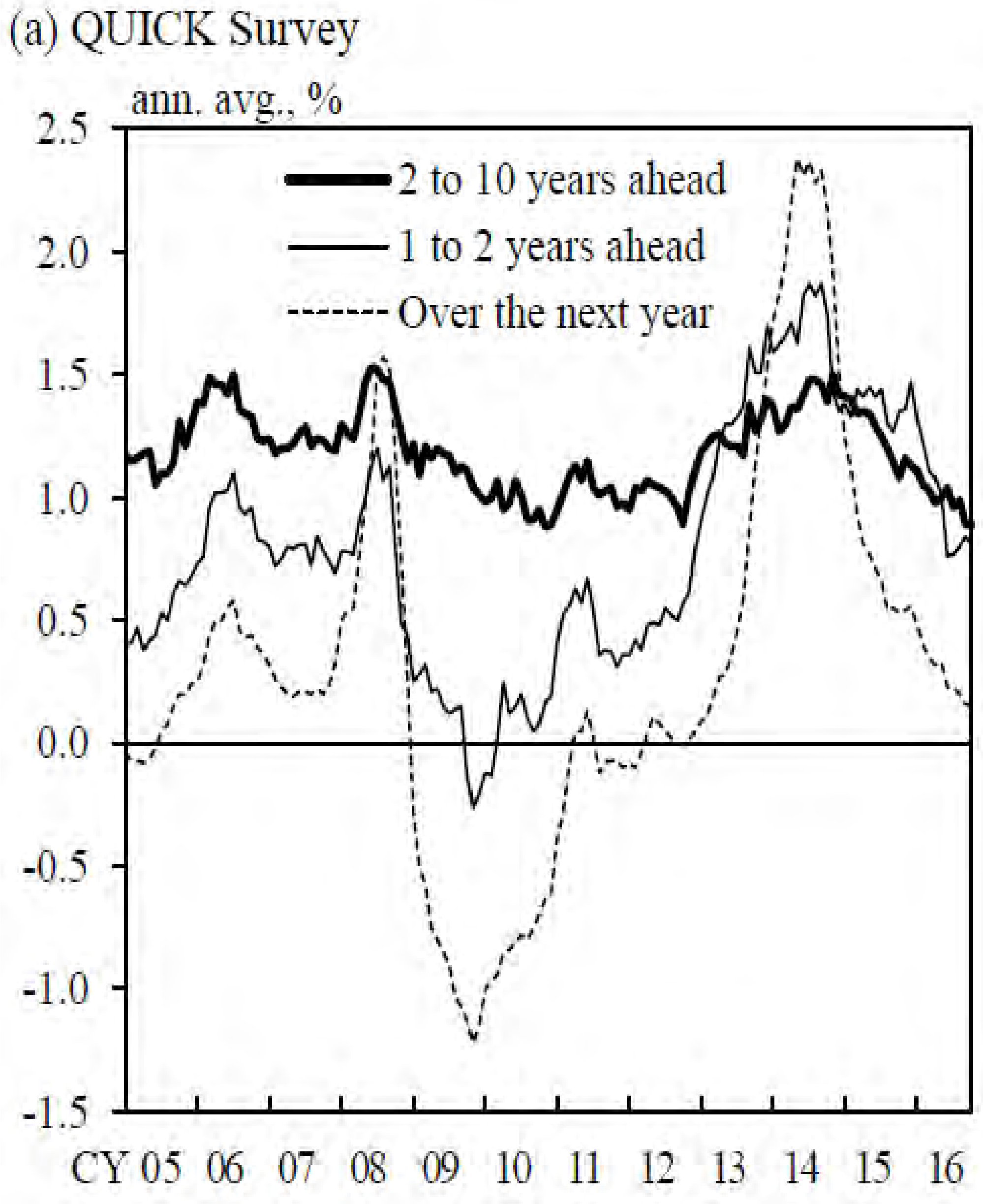
The exit condition now overshoots the LR target

- Sept. 2016: "Until the year-on-year rate of increase in the observed CPI exceeds the price stability target of 2 percent and stays above the target in a stable manner"

✓The exit condition is on "actual" inflation

✓The exit condition requires an overshooting of the LR inflation target


(BEI for Inflation-Indexed JGBs)1
%
3.0
2.0
1.0
0.0
-1.0
-2.0
-3.0
-4.0
Old (10 years)
Old (longest)
New (10 years)
CY 05 06 07 08 09 10 11 12 13 14 15 16


(a) QUICK Survey
ann. avg., %
2.5
2.0
1.5
1.0
0.5
0.0
-0.5
-1.0
-1.5
2 to 10 years ahead
1 to 2 years ahead
Over the next year
CY 05 06 07 08 09 10 11 12 13 14 15 16

Source: BoJ

Should we overshoot the long-run inflation target at the exit?

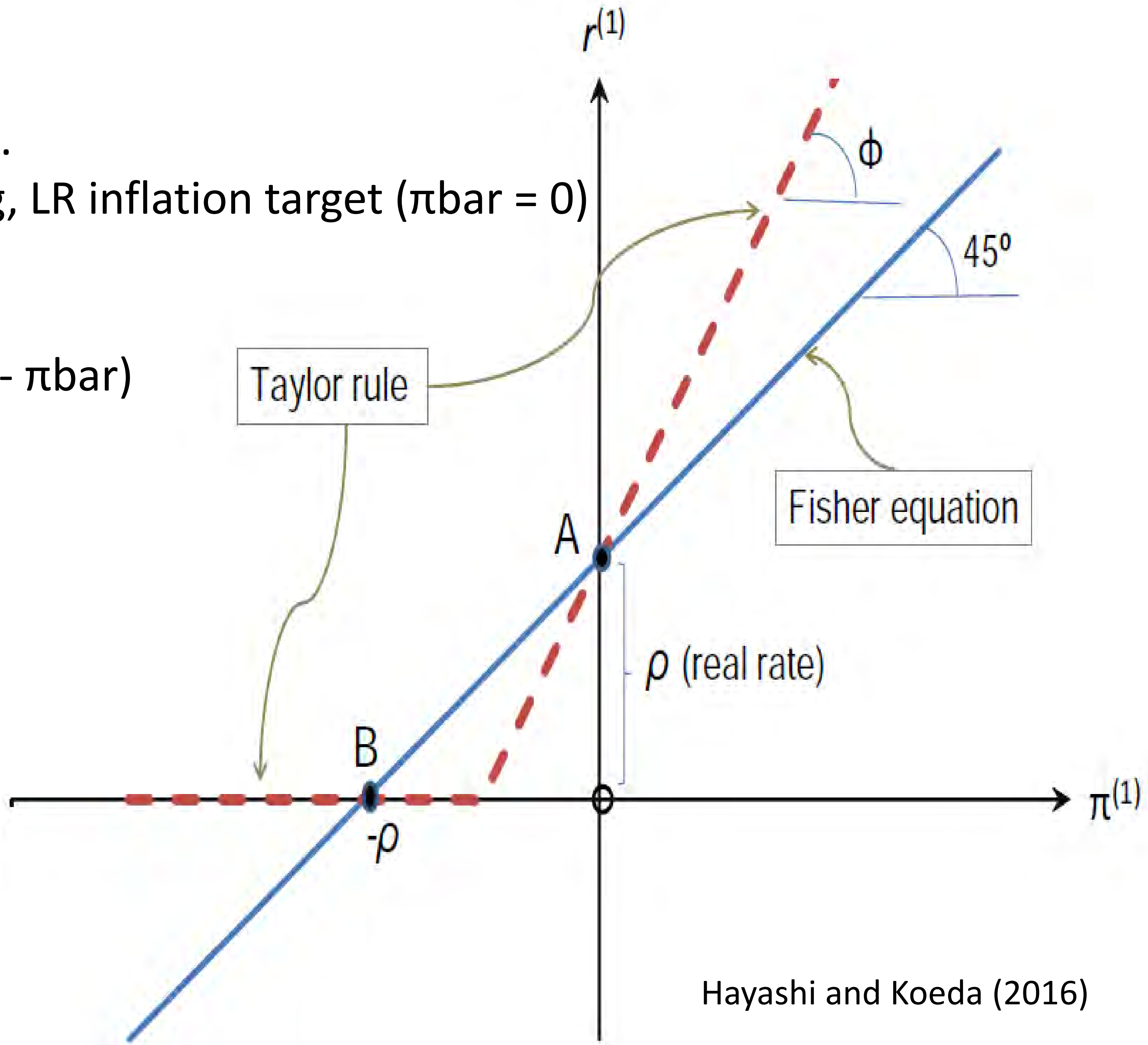
Pros and cons?

Are there any unintended consequences?

- An “overshooting” exit condition may keep a country liquidity trapped (Hayashi and Koeda, 2014, 2016)

Two equilibriums exist.
For simplicity but wlog, LR inflation target (πbar = 0)

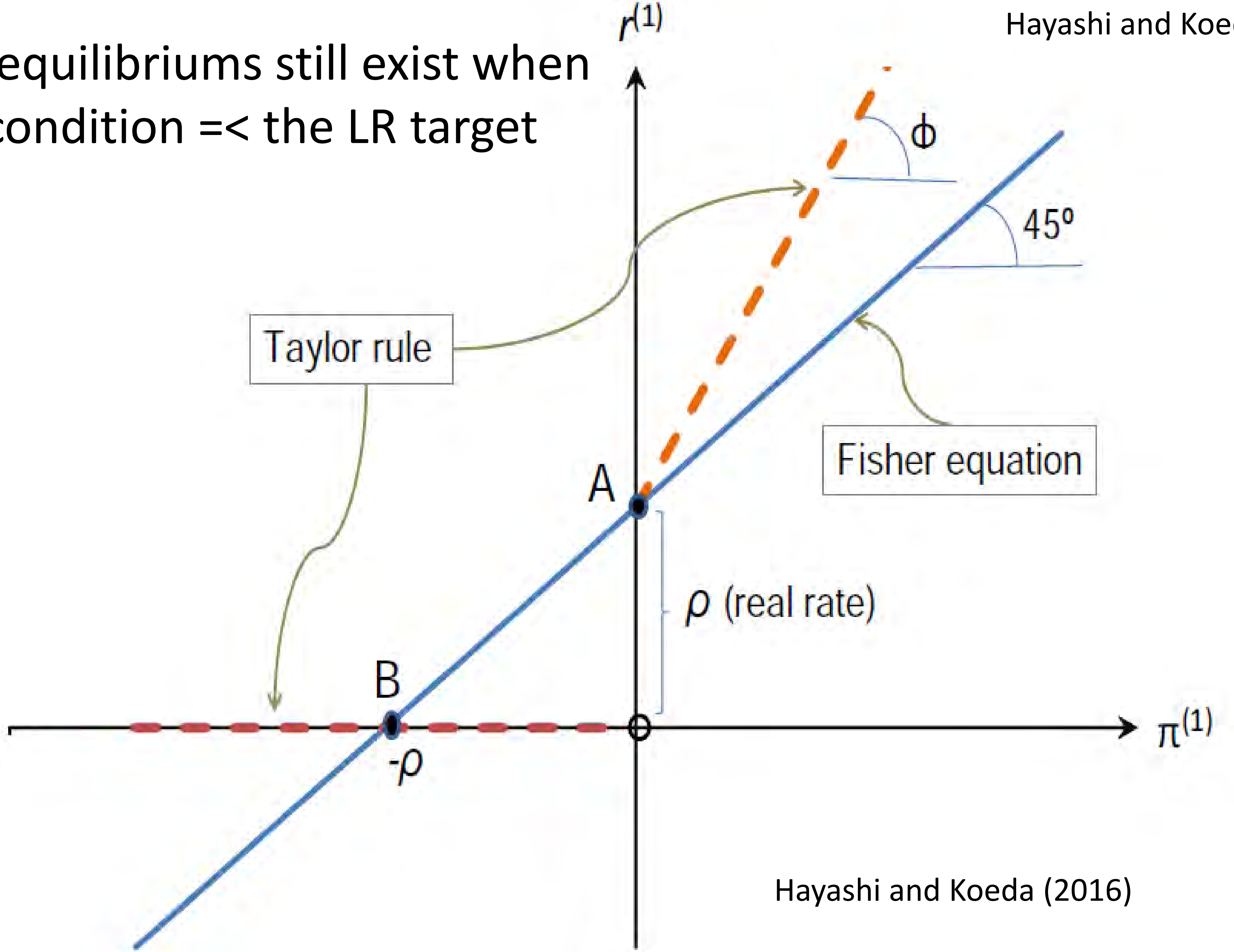
Taylor rule: r =ρ + ϕ (π- πbar)



Hayashi and Koeda (2016)

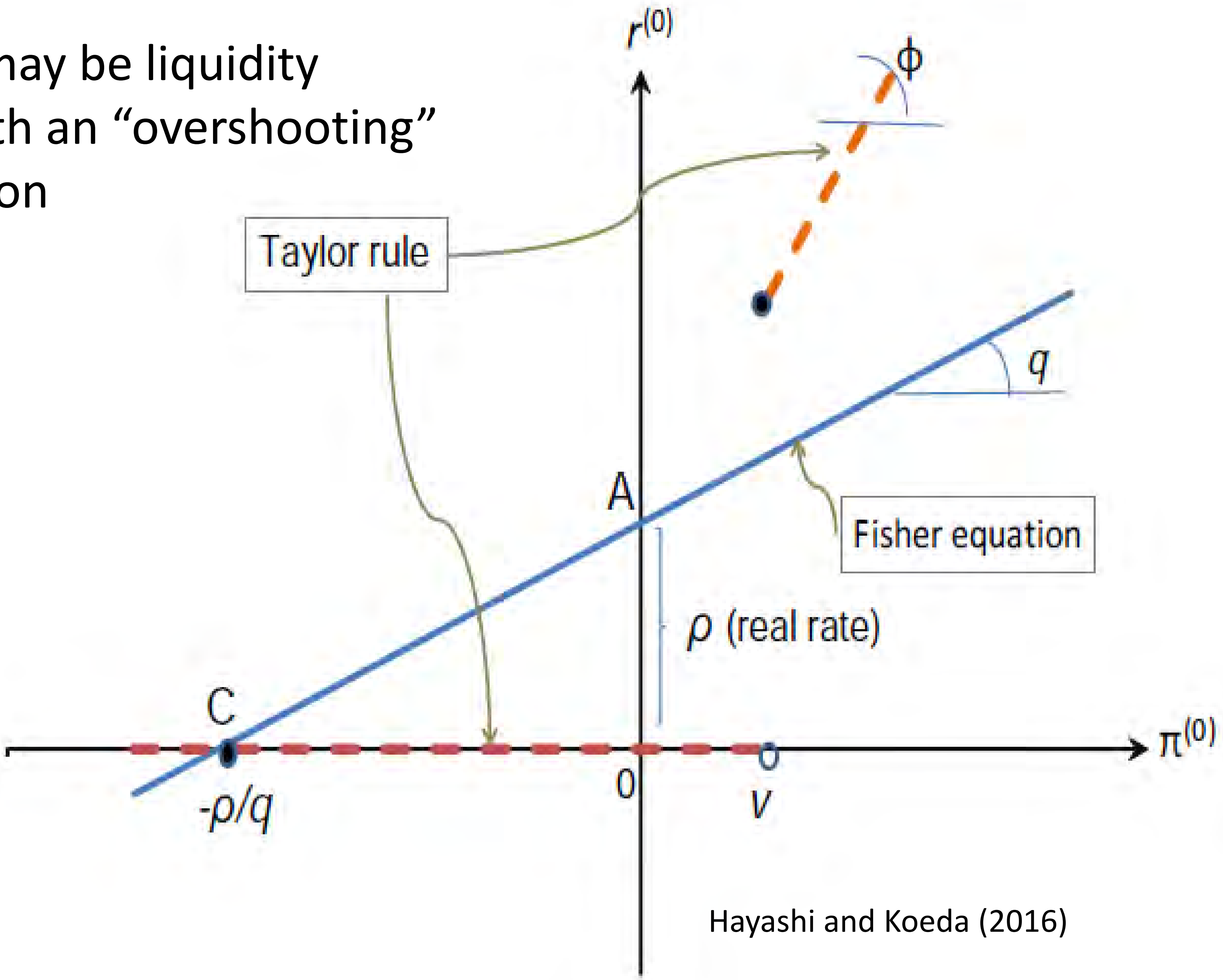
The two equilibriums still exist when the exit condition =< the LR target

Hayashi and Koeda (2016)



Hayashi and Koeda (2016)

A country may be liquidity trapped with an "overshooting" exit condition



Hayashi and Koeda (2016)