Comparing Japanese Monetary Policy Effects between the Low Interest Rate and the Normal Periods

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This paper compares macroeconomic effects of Japanese monetary policy between the low interest rate (post-1998) and the normal (pre-1998) periods. To this end, we estimate the sign-identified VAR model combined with the stock-returns equation, the latter incorporated to measure the relative size of monetary policy shocks. The results show that monetary policy effects in the two periods are qualitatively similar in that an expansionary policy shock increases both prices and output with the highest probabilities and decreases both variables with the lowest probabilities. However, the effects are quantitatively different: when the size of monetary policy shocks is equalized, monetary policy effects in the low interest rate period are from about one-sixth to one-fifth of those in the normal period. This suggests that much more aggressive easing would have been needed to escape from persistent deflation in Japan.