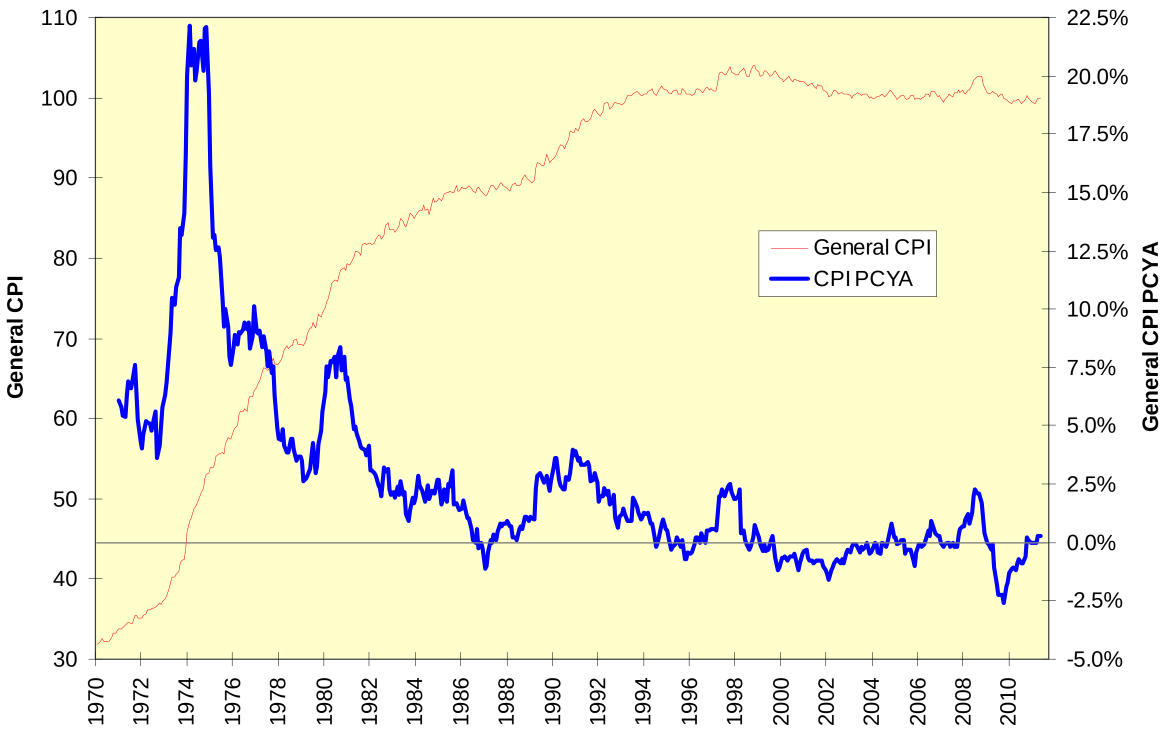
Price Stability In Japan Pleases No One

"But it's all right now / I learned my lesson well
You see ya can't please everyone / So you got to please yourself" – Ricky Nelson

Back in what now seem the good old days of the mid-1990s, references were made to the "Goldilocks economy," not too hot and not too cold. Cute. I have an opposite description for anything measured with a price index: Regardless of whether prices are rising in inflation, falling in deflation or simply treading water and threatening to do either of the first two alternatives, no one is happy.

Well, being a can-do sort and remembering the late Senator George Aiken's Vietnam-era advice to "declare victory and get out," I think our good friends at the Bank of Japan should do much the same thing. Let's consider the magnitude of their achievement: Despite going to 0% short-term interest rates in February 1999, quantitative easing in March 2001, a failed attempt to reverse these policies in May 2006 followed by contemplation of another reversal just as the global financial crisis was starting in August 2007 and last March's massive injection of liquidity following the earthquake and tsunami, the general (as opposed to Tokyo region, which gives essentially the same answer) CPI has gone sideways for more than fifteen years. You could not do this on a dare.

Consumer Deflation In Japan Moving Sideways



What is even more impressive is how impervious these changes are to changes in the yen, to changes in the global economy and to Japan's loss of export markets to China and lower-cost competitors in Asia. No matter what anyone throws at Japan's price indices, it just bounces off harmlessly.

Implications For The U.S.

I have been citing parallels between Japan and the U.S. since late 2002; I began these analogs with the respective post-bubble interest rate paths and later extended them to stocks. I am happy to report the stock analog, which looked so scary in mid-2010, has broken, but the short-term interest rate one remains in full throttle. What is amazing about all of these analogs is the amount of denial out there; I frequently get a list of objections from readers about differences between Japan and the U.S. I have identified twelve or so of them myself and wonder why if the two countries are so different the two market and economic destinies are so similar.

Hmm.

Regardless, what should our Federal Reserve do with Japan's CPI experience? After all, they have declared war on deflation twice, once in May 2003 and again in March 2009, and have steadfastly refused to accept any blame for any price moves higher other than those for U.S. stocks. They finally are admitting what should have been obvious to anyone not caught up in their group-think chambers, that monetary policy alone cannot create employment or stimulate output. For every borrower getting something for less there is a lender getting scalded.

I think the Federal Reserve should adopt my advice – I will provide it for free even though it is worth at least twice as much – of proclaiming whatever has happened was their intention all the way. As long as the commercial banking system remains impaired and is not converting the monetary base into credit, they will not create domestic price (as opposed to asset) inflation, and as long as they can print money, the risks of slipping into deflation are small.