

# Has Japan Conquered the Fear of Freedom?

Remarks at PIIE Conference on Floating  
Exchange Rates at Fifty  
March 23, 2023

Masazumi Wakatabe  
School of Political Science and Economics  
Waseda University  
wakatabe@waseda.jp

I would like to thank valuable research support from Mr. Goushi Kataoka and Atsushi Ito of PwC Consulting.

# Observations

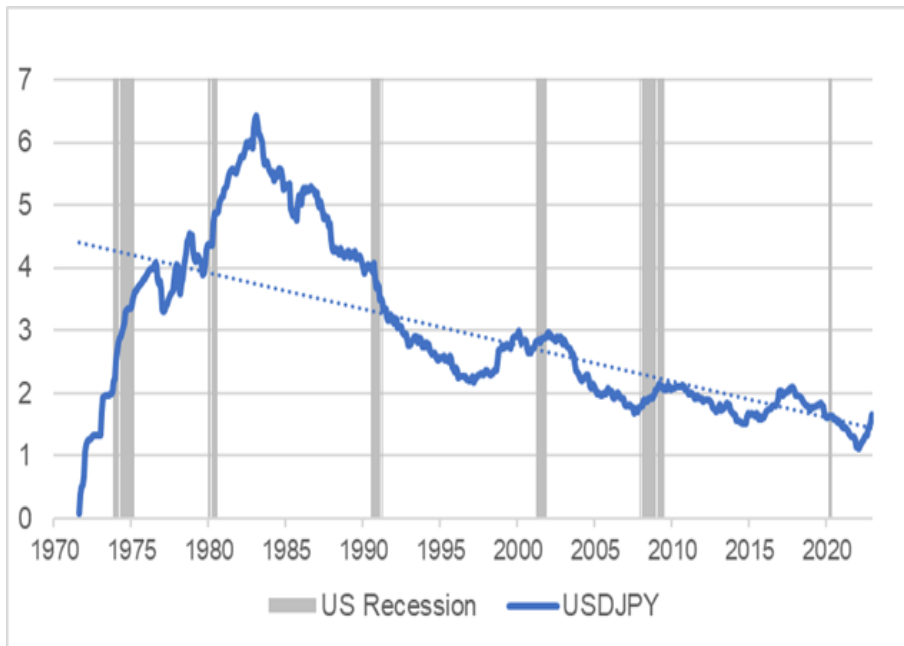
- 1. Exchange rates regime = intersection of politics and economics, both domestic and foreign; Politics and public opinion are extremely important
- 2. Floating exchange rates regime divided to two periods: Adolescent (1973-1992), and After coming-of-age (1992-)
  - Became durable and stable due to the transition to IT regime (Rose 2007)
    - Under IT regime, exchange rates volatility has decreased (Ilzetzki, Reinhart, and Rogoff 2020)
- 3. However, the Japanese experience shows that freedom tests competence of exchange rates and monetary policy
  - Japan's Lost Decades  $\approx$  Deflation and Appreciation of the Yen, "Ever-higher Yen syndrome"
  - One way to interpret Abenomics: Joining IT regime and ending the "Ever-higher Yen syndrome"

# International Monetary Systems Compared

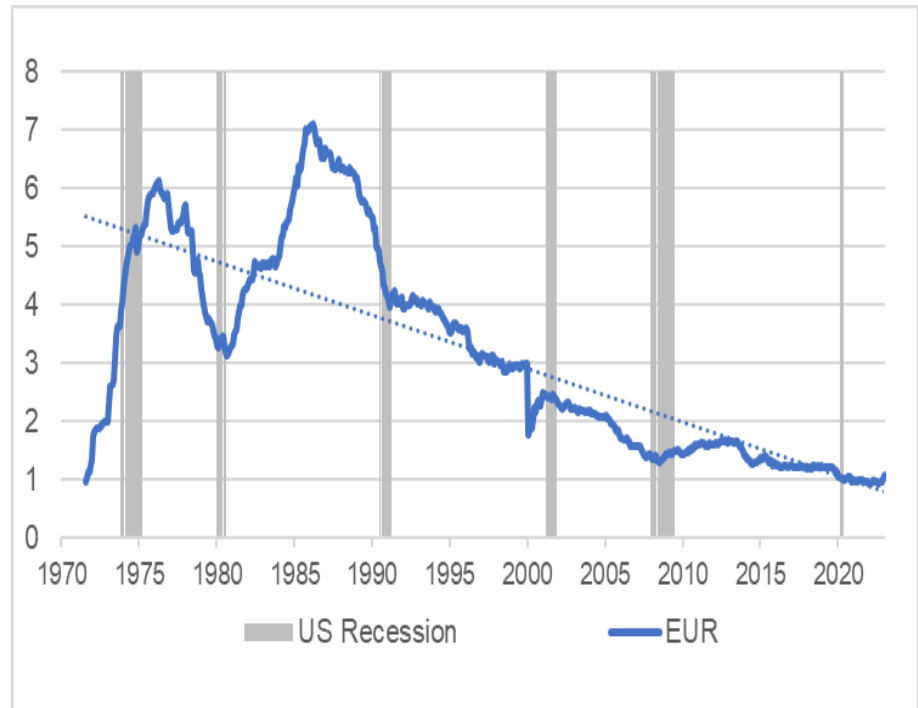
	Gold Standard	Bretton Woods	Inflation Targeting
<b>Regime durability</b>	Low	Low	High
Exchange rate regime	Fixed	Fixed	Floating
Focus of monetary policy	International	International (at least in part)	Wholly domestic
Intermediate target	Exchange rate	Exchange rate	Inflation forecast
Capital mobility	Unrestricted	Controlled	Relatively unrestricted
Capacity for current account imbalances	Limited	Limited	High
<b>System design</b>	Unplanned	Planned	Unplanned
Role of IMF	N/A	Key in principle	Small?
Role of center country	UK: Key in practice	USA: Key in practice	Small?
Central banks	Dependent, unaccountable	Dependent, unaccountable	Independent, accountable
Alignment with academics	Low	Low	High

# Reduced Volatility after around the 1990s: exchange rates volatility (Apr., 1971 – Dec., 2022)

## USDJPY



## USDEUR ( -1999 German Deutschemark, 2000- Euro)



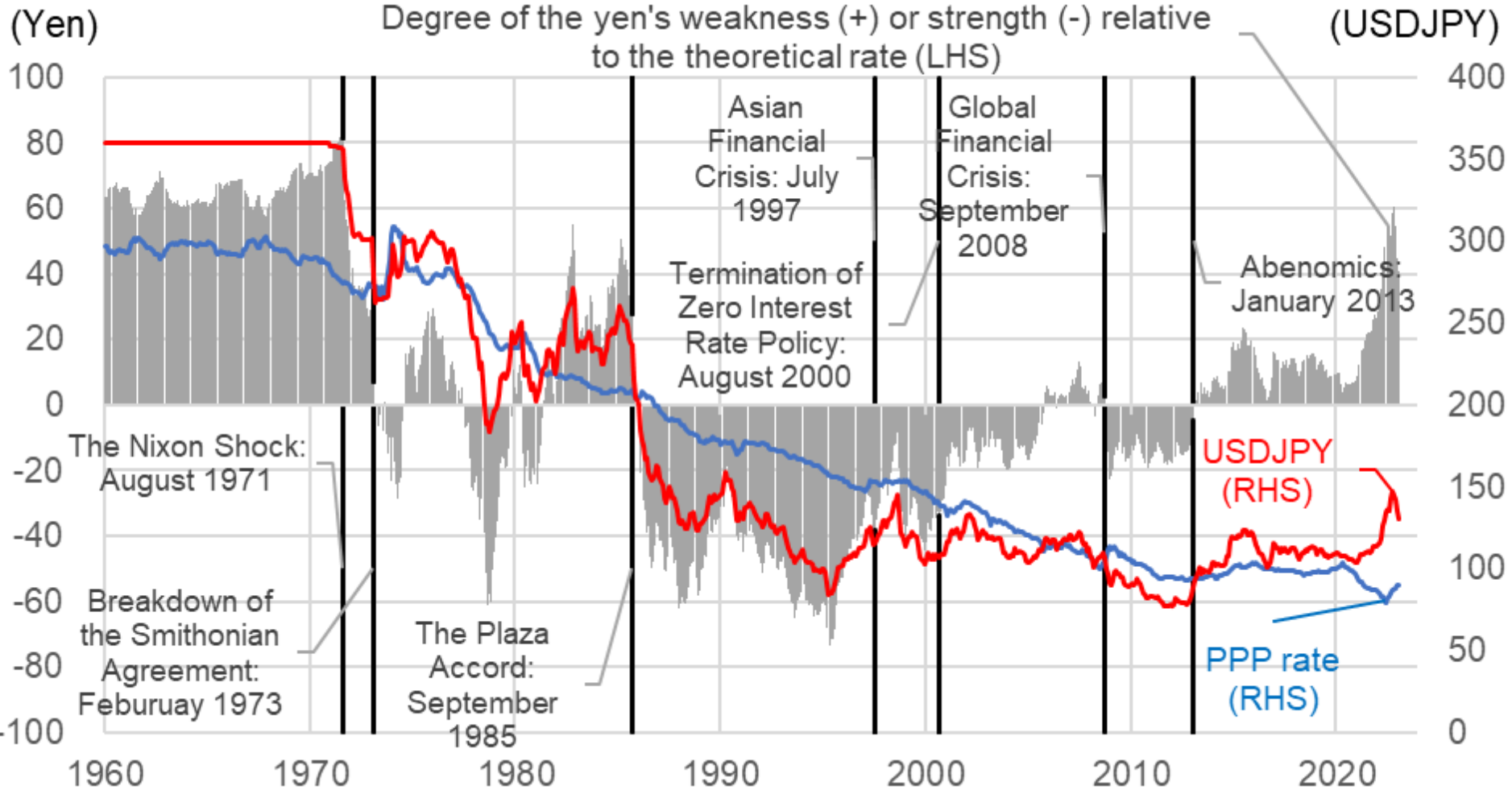
The figure shows the four-year moving average of the absolute value of month on month exchange rate change

Source : International Financial Statistics (IFS), NBER

(Reference) Ilzetzki, E., C. M. Reinhart, and K. S. Rogoff, 2020, "Will the Secular Decline in Exchange Rate and Inflation Volatility Survive COVID-19?" NBER Working

# Freedom tests competence:

Theoretical rich/cheap trends in the USDJPY market (Jan., 1960 – Jan., 2023)

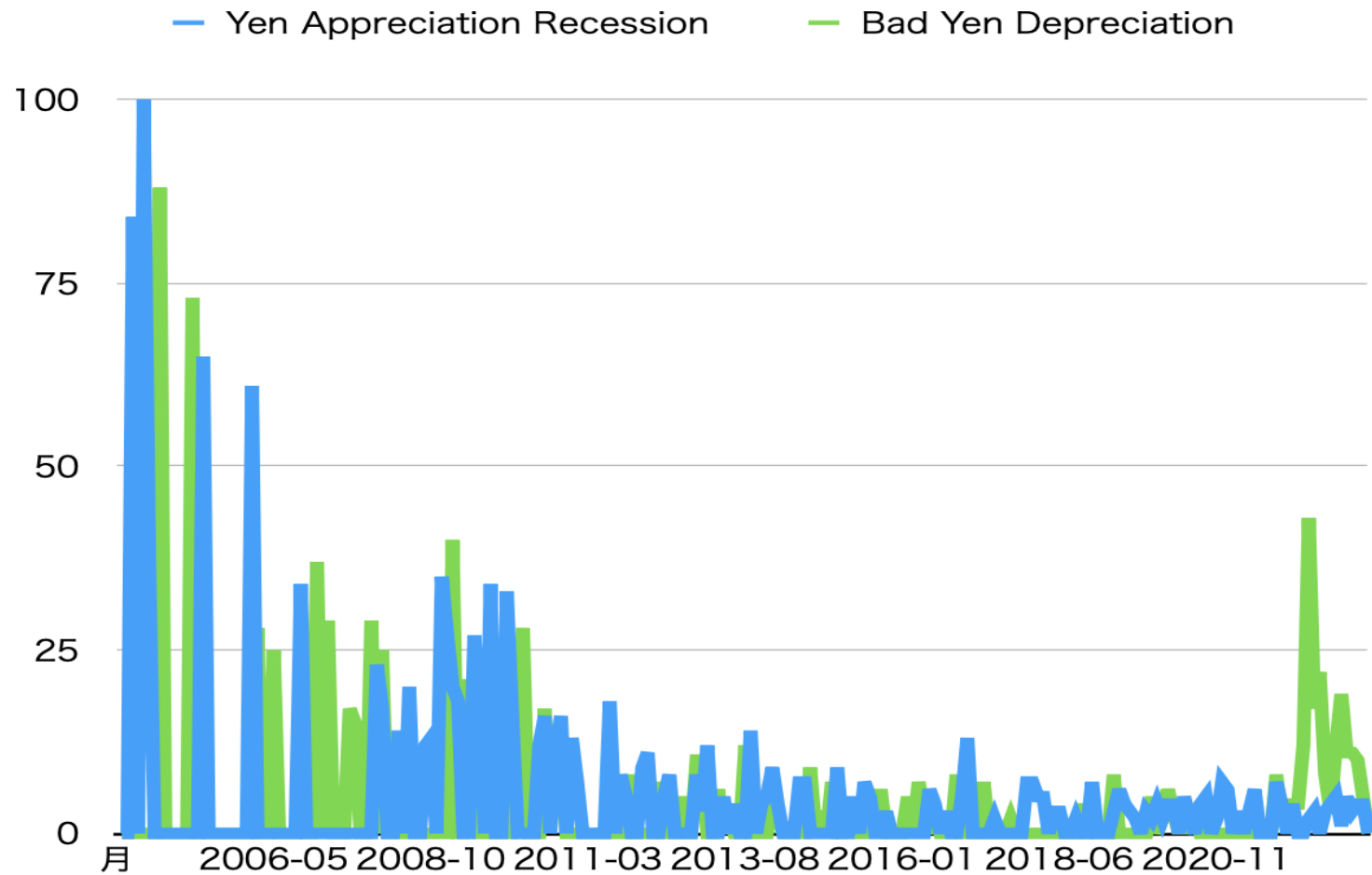


PPP rate is the theoretical USDJPY rate based on producer price index in Japan and the US.  
 Note: The base year for producer price index is 2020.

The base year for the US is 1982, converted to 2020 by the author's calculations.

Source: Fred, Bank of Japan, Author's calculation

# Freedom still generates fear: “Yen Appreciation Recession” vs. “Bad Yen Depreciation”



Source: Google trends