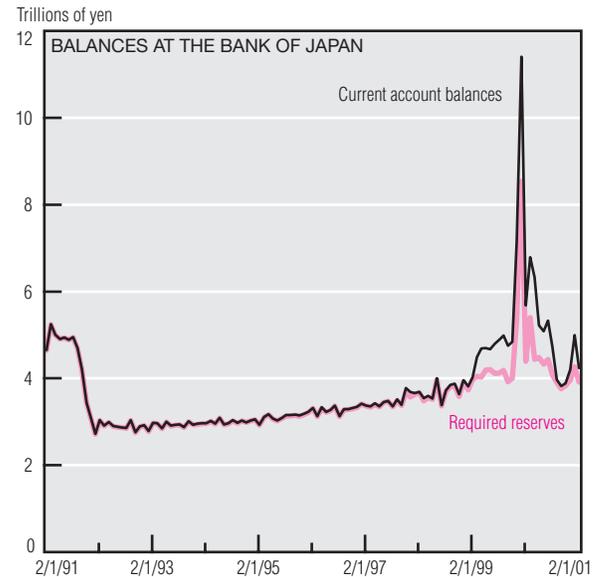
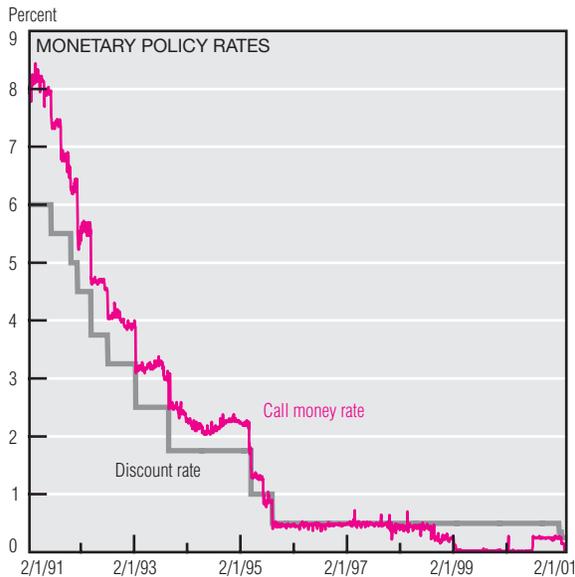
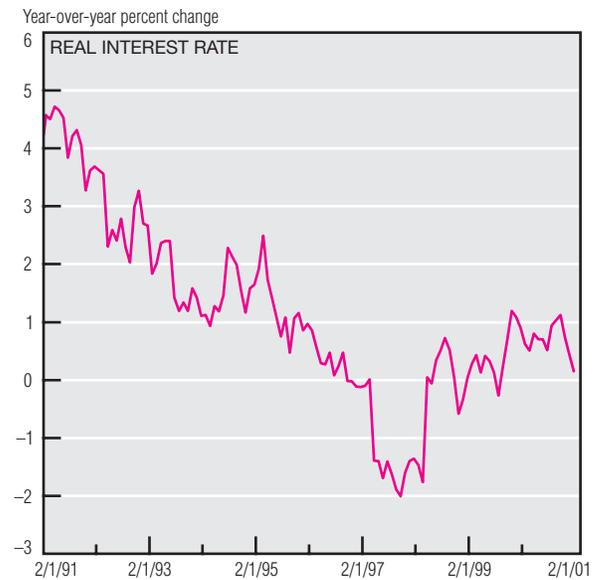
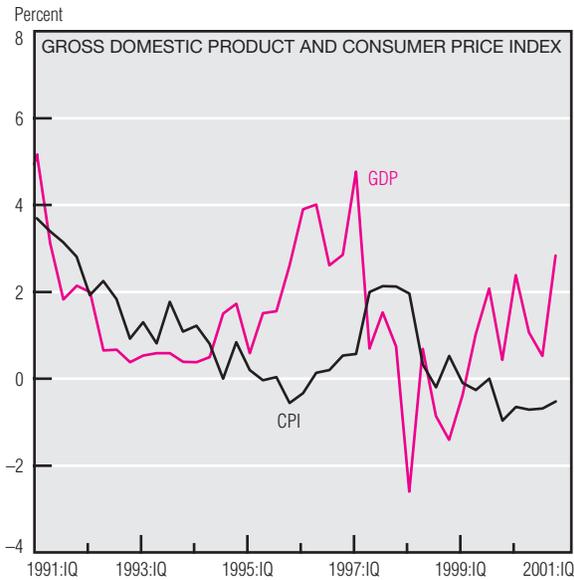


Japan's Monetary Policy



SOURCES: Board of Governors of the Federal Reserve System; Bank of Japan; and International Monetary Fund, *International Financial Statistics*.

Deflation and relatively weak economic growth have bedeviled the Japanese economy for more than two years. Sharp declines in real growth and inflation during the early 1990s were followed by several years of advancing growth rates and very low measured inflation. This recovery was cut short during the Asian crisis, which brought plummeting growth rates and a year of rising prices, followed by the current deflation.

Over the past decade, the Bank of Japan has reduced both the overnight call loan rate and its own lending rate

through a steady succession of cuts. The real call loan rate (the actual rate minus the annual rate of inflation) reached a low of -2% during the 1997 period of rising prices, but then averaged about zero in 1998 and 1999 before moving up slightly further to average closer to 1% in 2000. This occurred despite a monetary policy that brought the nominal call loan rate close to zero. The Bank, perhaps encouraged by the halting pickup in real growth, modified the zero-rate policy slightly in August 2000 to maintain a target of 0.25% , which it reduced to 0.15% in early March of this year.

On March 19, the Bank of Japan adopted a new policy strategy, abandoning interest rate targets to achieve a drastic easing “unlikely to be taken under ordinary circumstances.” The new policy target is the quantity of current account deposit balances at the Bank. Initially, by ensuring a surplus of balances over required levels, this approach is expected to keep the call loan rate close to zero. In addition, the Bank of Japan pledged to continue this way of implementing policy until inflation stabilizes at zero or above.