

Comments on  
Hiroshi Fujiki and Shigenori Shiratsuka  
Zero Interest Rate Policy, Forward Rate Curve and Policy Duration Effect

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This interesting paper studies the term structure of interest rates during the period of Japan's zero interest rate policy. Let me begin by summarizing the facts documented in the paper.

Overnight rates were lowered near zero in March 1999. In the next few weeks, longer rates crept down as well. A more rapid downward shift occurred upon the April 13, 1999, announcement that zero interest rates would be maintained until deflation is not a concern. The sharper shift is consistent with the pure expectations model of the term structure, in conjunction with credibility of the policy announcement: the “policy duration effect” means that long rates fall more dramatically when short rates are expected to remain low for a longer period. During March and April, the spread between 3 month CD and TB rates also fell, to nearly zero. Thus, lower short term rates led to a lower external financing premium for financial institutions. Approximately 6 months after the April announcement, longer rates began inching upwards, though not monotonically. Such upward movement suggests expectations of a rate hike. These expectations were validated in August 2000 when the zero interest rate policy was dropped. Longer rates rose rapidly though not instantaneously. As well, the spread between CD and TB rates widened.

This paper has interesting and informative results. It's description of the behavior of interest rates during this period is splendid. I particularly like the plots of estimated instantaneous forward rate curves.

I have but two comments. First, I wonder how the authors' interpretation of the term structure squares with interpretations for other periods. The literature on the term structure typically finds the pure expectations theory inadequate. In general, this literature cannot rationalize the patterns that we see without giving an important role to factors such as expectations about policy that ultimately were not realized or to time varying risk premia. See, for example, Campbell and Hamao (1993). This leads me to ask, was there something special about this period that made

policy announcements particularly credible, or that caused risk premia to remain stable?

Second, I hope that the authors will write a sequel to this paper, drawing larger lessons for monetary policy. They state that the “easing effects failed to be transmitted to outside of the financial system” (abstract). No doubt this statement is consistent with the stubbornly poor behavior of the real economy. But of course the authors need to focus on *real* rather than nominal interest rates to decide whether policy was substantially eased, at least under traditional views of the monetary transmission mechanism. Consideration of real rates, and the consequent need to measure expected inflation, is clearly beyond the scope of this paper. I quite look forward to future work by the authors on this larger question.

### Additional Reference

Campbell, John Y. and Yasushi Hamo, 1993, "The Interest Rate Process and the Term Structure of Interest Rates in Japan," 95-120 in K. Singleton (ed.) Japanese Monetary Policy, Chicago: University of Chicago Press.