The effectiveness of the Japanese forward guidance to deal with the crisis caused by the Covid-19 pandemic: an analysis and an alternative proposal

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In this article, the authors discuss the effectiveness of the monetary policies adopted by the **Bank of Japan** (BoJ) in order to contrast the economic crisis caused by the pandemic of the **Covid-19** virus and, in particular, they focus on the forward guidance. This issue is particularly relevant and of immediate and wide importance at a time in which the political decision-makers are taking adequate measures to face what is likely to be the most serious recession of the history. The aim of this paper is to identify a valid fiscal policy alternative to the forward guidance adopted by the Japanese central bank. The authors carry out their own analysis in consideration of the measures already adopted by the central bank and by the government and of the theoretical and of the empirical results, both own and of other scholars and, after have highlighted that this particular policy tool could be inadequate to prevent the country from finding itself in recession and deflation, they suggest that a fiscal stimulus could be more useful for this purpose. In other words, the conclusion that the authors reach is that forward guidance is, in general, not very incisive and that in the current context it may be more appropriate to reduce the overall tax burden on the national consumers and on the national firms.

Keywords: Forward guidance, Bank of Japan, Covid-19 shock, Monetary policy, Fiscal policy
JEL Classification: E02, E30, E50, E58

1.Introduction

The explosion of the Covid-19 pandemic has triggered a very deep recession whose magnitude and whose effects, on a global level, are expected to be even more serious than those of the crisis following the failure of Lehman Brothers in 2007 and, probably, also of those of the Great Depression of 1929. The central banks and governments are facing this emergency situation by adopting accommodative fiscal and monetary policies. The latter consist mainly of reductions in interest rates, of the starting of new open market operations (OMO) or of the enhancement of those already adopted previously and, in some cases, also in the monetization (explicitly or implicitly) of the deficit in order to expand the public sector budget constraint. For an assessment of the effectiveness of such policies, at a global and individual levels, it is particularly interesting to focus on the case of Japan, because this country will have to calibrate the new measures on those already adopted, starting from 2013, to contrast the present macroeconomic shock and to revive the national economy following the "crisis of the lost decade" (the so-called "Abenomics"). A summary of the policies established by Japanese policy makers is offered by report “Policy Responses to Covid-19 “ of the International Monetary Fund (IMF), updated to on 30 April 2020. Regarding the fiscal policy, on April 07 2020, the Tokyo government announced the Emergency Economic Package Against Covid-19 (EEPAC) which incorporates the previous fiscal stimulus plan launched in December 2019 and which consists of an increase in public spending of 117.1 trillion yen (21.1% of GDP). The EEPAC resources are distributed in such a way as to achieve five objectives: the 0.5% of the expenditure in relation to GDP is destined to contain the epidemic and to the health treatment of the infected (first objective), the 16% is used to support the employment and the productive sector (second objective), the 1.5% is aimed to restore the production activities for the damage suffered by the quarantine (objective III), the 2.8% will serve to make the economy more resilient national by future macroeconomic shocks (target IV) and the 0.3% will be used to ensure that institutions can respond more quickly to the same shocks in the future (target V). Regarding the monetary policy, on 27 April 2020, the Bank of Japan (BoJ) has decided that it will purchase the amount of the Japanese government bond that it will deems necessary without setting any limits, has increased the maximum limit of the commercial paper and of the corporate bond to 20 trillion yen, has fixed an interest rate of 0.1% on deposits held by financial intermediaries within itself. In addition, the Japanese central bank is considering the possibility of offering new funding at an interest rate of 0% against all pooled collateral to eligible financial institutions with the aim of offering support to small and medium-sized enterprises. Also, the forward guidance has