Implication of U.S. and Japanese Experience in Copig with Changes in Asset Prices

With financial liberalization and globalization since the 1980s, there have been a variety of new financial products and frequent capital flows across countries. This has brought about volatility of prices of assets, including stocks and real estates. Such volatility exerts a negative impact on investment and consumption in the household and corporate sectors, acting as inflationary pressures. It can also hamper stability of financial institutions and seamless operation of payment and settlement systems. Accordingly, a central bank whose main objectives are both price stability and financial systems stability should analyze such price fluctuations and come up with countermeasures.

In 1929 and 1987 when the U.S. experienced stock price crashes on two occasions, the Federal Reserve Bank dealt successfully with the liquidity crisis. When the stock prices soared in the mid-1990s, the Bank also did its utmost to stabilize the financial market by sending several warning signals of price bubble to the market and raising interest rates. In the late 1980s when the nation met with increase of bad loans and credit crunch following sharp price falls in real estate prices, triggered by excessive supply of real estates, the Federal Reserve Bank pushed ahead monetary easing through federal rate cuts on several occasions, with only little success though.

In Japan, meanwhile, a number of financial institutions went bankrupt since the mid-1980s as price bubbles, accumulated in real estate and stock markets, bust. The bubble in real estate prices was the result of excessive liquidity arising from the monetary easing while there was no additional supply of real estates. The monetary easing was, in fact, carried out to cope with the yen's appreciation in compliance with the Plaza Agreement. Under the circumstance, the Bank of Japan adopted monetary tightening and resolutely pushed ahead interest rate rise. However, this resulted in drastic bubble bust and recession in the real economy, leaving the Japanese economy mired in the aftermath still today.

As shown above, appropriate policy measures taken against volatility of asset prices are essential for the sound development of national economy. Thus to deal with the fluctuations of asset prices, the monetary authorities should recognize the importance of pre-emptive monetary policy and attend to management practices of financial institutions. They have to be well prepared to tackle liquidity crisis that can be triggered by drastic changes in asset prices. They also need to strive to build up confidence of financial market in order to secure effectiveness of monetary policy.