

**Comments on
“Monetary Policy When Wages Are
Downwardly Rigid:
Friedman Meets Tobin”
by Jinill Kim & Francisco J. Ruge-Murcia**

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JEDC Conference at Hitotsubashi Univ.

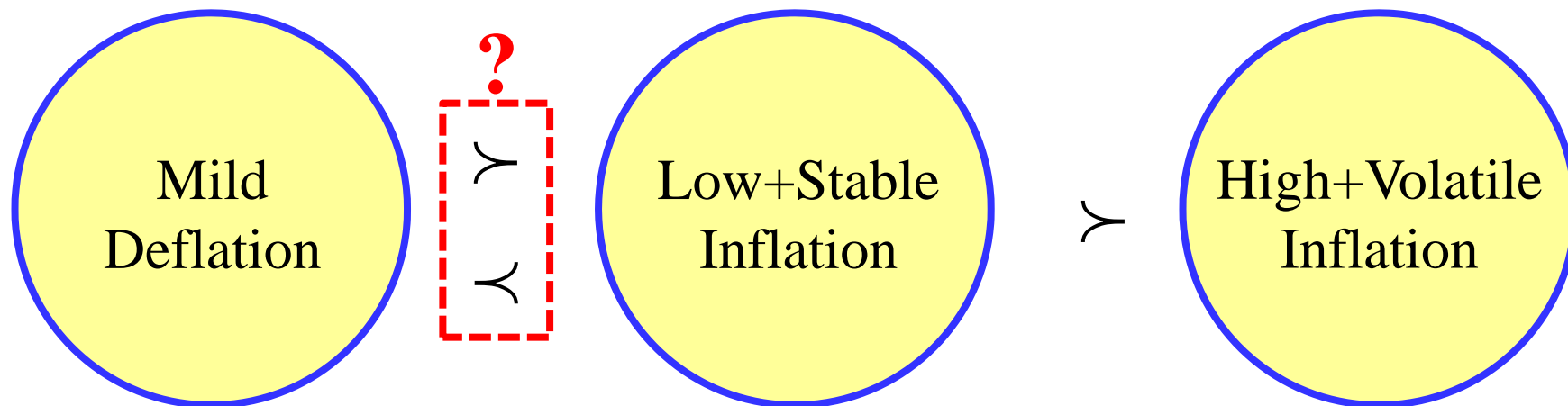
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Disclaimer: The views expressed are solely the responsibility of the presenter, and should not be interpreted as reflecting the official views of the Bank of Japan.

Challenges for Monetary Policy



Safety margin
vs
Friedman's rule

Low and stable inflation
||
Stable economic
circumstances as a basis
for sustained growth

Main Points of the Paper

- Kim=Ruge-Murcia (2009, JME):
 - A small-scale DSGE model with friction in adjusting W and P
 - Asymmetric adjustment cost in W
 - Optimal grease π : 0.35% ([0.04, 0.87])
- This Paper:
 - Adding friction of money in C expenditure as a transaction cost model
 - Competition b/w F-rule and grease π
 - Optimal grease π : 0.51%

ZLB of Nominal Interest Rates

- Under Friedman's Rule:
 - Steady-state deflation
 - Real money balances = ∞ as $t \rightarrow \infty$
 - Friction of money becomes negligible
 - Money demand is satiated
 - Nominal interest rates = 0

- Explicit Assumption of ZLB?
 - Gross nominal interest rates $i_t \geq 1$

Modeling of Money

- Transaction Cost of C expenditure:

$$c_t^h (1 + f(c_t^h, m_t^h))$$

$$c_t^h \frac{\partial f(c_t^h, m_t^h)}{\partial m_t^h} = b - a \left(\frac{c_t^h}{m_t^h} \right)^2$$

- But, estimated parameter of $a \approx 0$
 - No significant difference from cashless economy?

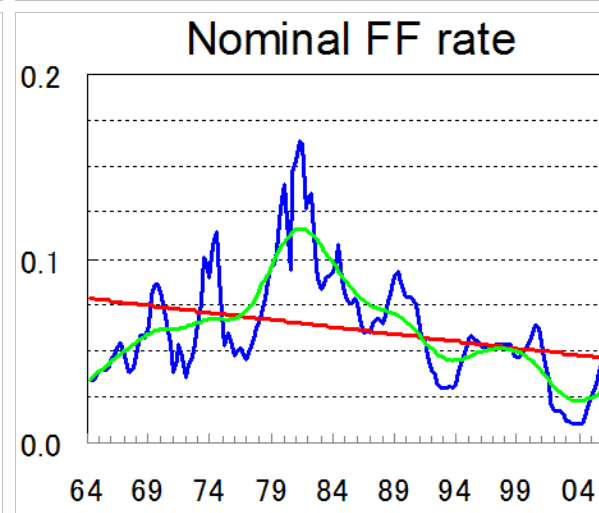
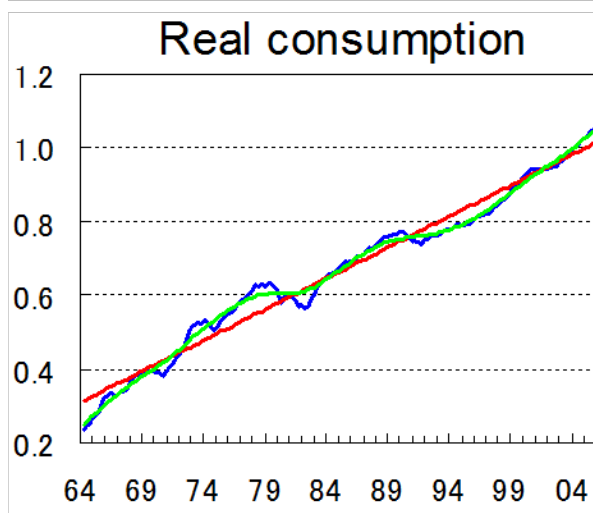
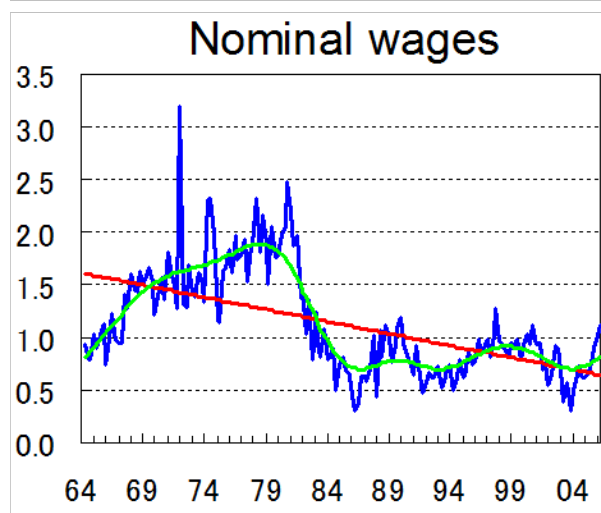
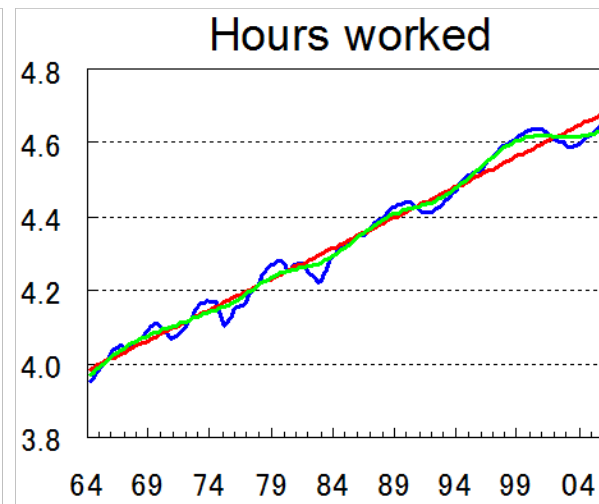
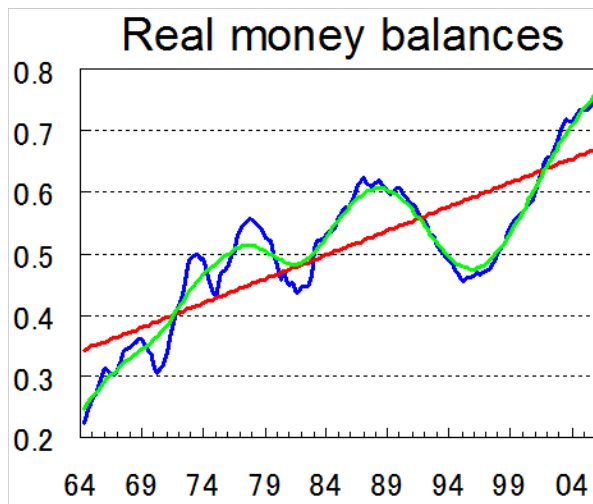
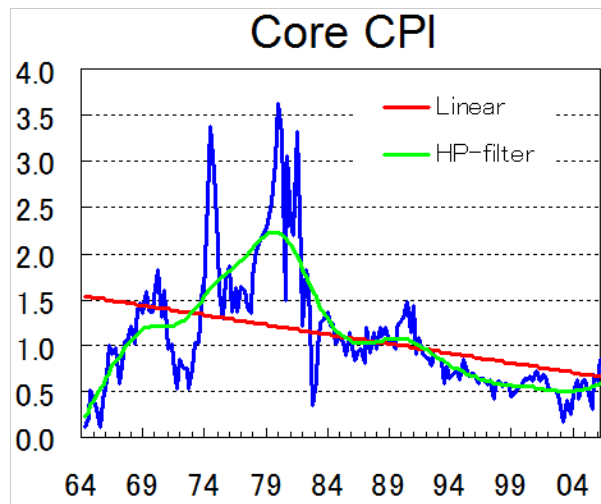
Nominal Wage Adjustment

- Nominal Wage Adjustment:
 - Intertemporal direction:
 - How much hours worked over time?
 - Cross-sectional direction:
 - Downward rigidity of W
 - Smaller relative W variation
 - Inefficient cross-sectional allocation of L
- Japan's Lost Decade:
 - Cross-sectional resource misallocation behind the downward shift in trend growth

Safety Margin

- Downward Wage Rigidity:
 - Important but one of the factors in formulating the necessary size of safety margin against deflationary spiral
- Also Need to Focus on:
 - Debt deflation and financial system
 - Effectiveness of MP under ZLB
 - Room for fiscal expansion

Data: Level



Linear De-trending?

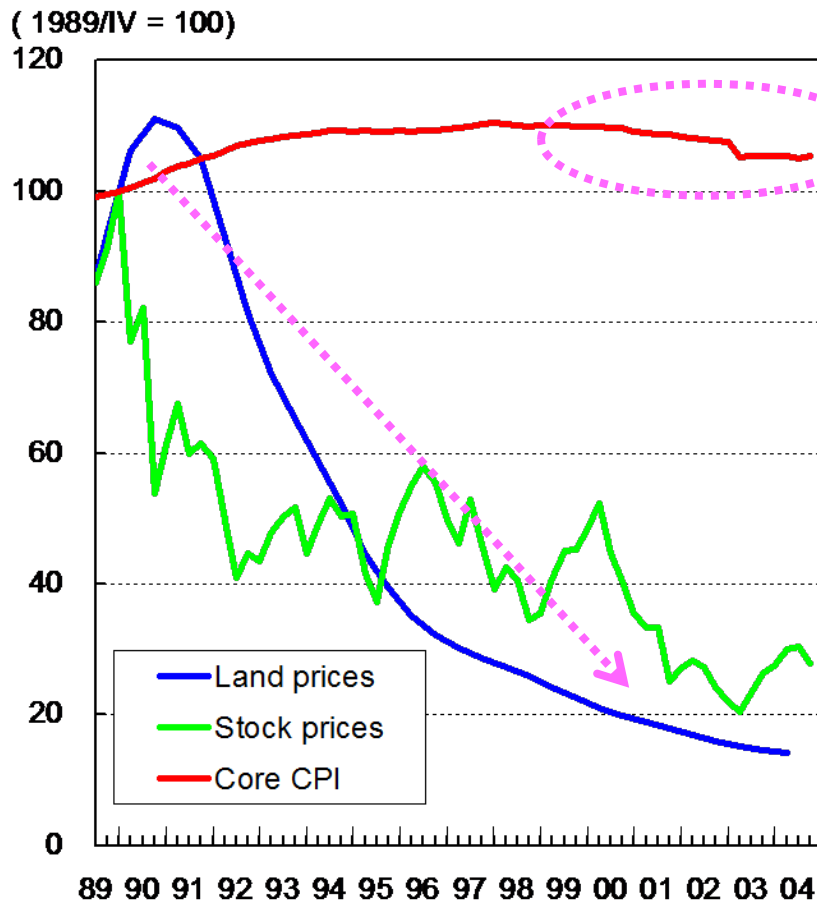
- Stable Trend in 1964-2006?
- Real variables → ?
 - Hours worked: maybe OK
 - Trend-break in real consumption, real money balances around the late 1970s or early 1980s?
- Nominal variables → ???
 - Level shift in steady-state inflation
 - Influence on nominal wages, nominal FF rate

Future Work?

- Application to Japan?
 - Better data for this empirical exercise:
 - Virtually zero nominal interest rates from 1995
 - Downward adjustment in W
 - But, some cautions are in order:
 - Asset price deflation was more serious than mild deflation
 - Resultant NPL problem in banking sector
 - Importance of other factors than downward rigidity of W for examining the required size of safety margin

Japan's Lost Decade

Asset Prices and Prices



Output

