Unconventional Monetary Policy and its External Effects: Evidence from Japan's Exports

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Abstract

In this paper, we explore whether unconventional monetary policy in Japan had a negative spillover effect on the rest of the world. After Prime Minister Abe advocated the new policy regime, the Japanese yen depreciated substantially which raised a concern that it would have a beggar-thy-neighbor effect in the region. However, despite the yen's depreciation, Japan's exports did not show significant improvement. To explain why the exports did not increase, this paper focuses on weak external demand and increased overseas production. Our theoretical model shows that a small change of the exchange rate has no effect on exports because of fixed costs when shifting the plant location across the countries. However, it also implies that a change of the exchange rate has a significant effect on the exports either when the exchange rate depreciation coincides with strong external demand or when the appreciation coincides with weak external demand. In the latter part of the paper, we examine the validity of these theoretical implications through estimating a simple export function in Japan and through calibrating our export function. In both of the experiments, we confirm that the model can track Japan's exports reasonably well especially after the new policy regime started.

Key words: export function, fixed costs, unconventional monetary policy
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