What happens when exiting from QQE: Analysis in Terms of Fiscal Theory of Price Level

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Abstract

In this paper, I examine a possible scenario in an exit from Japan's Quantitative Qualitative Easing. As the exit, I focus on raising the interest on excess reserves and ceasing to purchase JGBs. With huge excess reserves, paying the interest on excess reserves will lead to the inevitable loss for the Bank of Japan. Following Fujiki and Tomura (2015) and improving the methodology of their calculation of the amortization of JGBs by estimating the market value of each JGB held by the Bank of Japan, I reveal that the Bank of Japan will report 5 trillion yen losses at worst yearly and the remittance from the Bank of Japan to Ministry of Finance will stop for 19 years. Next, I investigate the QQE effect on prices through fiscal channel. I use the fiscal theory of price level with long-term debt to analyze the effects of the fiscal cost caused by the interest on excess reserves and the change of the maturity structure of the debt issued by the consolidated government. I find that the interest on excess reserves with huge excess reserves leads to inflation. I also reveal that the change of the maturity structure by ceasing to purchase JGBs decreases the price level instantaneously and then subsequently inflation occurs in short run.

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