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Japan's Phillips Curve Looks Like Japan

During the past 15 years Japan has experienced unprecedented, high unemployment rates and low (often negative) inflation rates. This research shows that these outcomes were predictable as part of a stable, readily recognized Phillips curve.

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DURING THE PAST 15 years Japan has experienced unprecedented, high unemployment rates and low (often negative) inflation rates. Japan's Phillips Curve is shown in the right-hand panel of Figure 1. The data are monthly from January 1980 to August 2005. The inflation rate (on the vertical axis) is the 12-month growth rate in the consumer price index (all items), from the International Monetary Fund's *International Financial Statistics*. The monthly unemployment rate (on the horizontal axis) is from *Econstats*.

Someone once said that a country's institutions and history are reflected in its Phillips Curve. For ease of viewing, the left-hand panel of Figure 1 rotates the Phillips Curve around the vertical axis so that minus the unemployment rate now is on the horizontal axis. Clearly visible are the islands of Hokkaido and Honshu, though it is somewhat difficult to separately distinguish the southern islands of Kyushu and Shikoku. The Noto-Hanto Peninsula is evident to the north of the southern end of the main island of Honshu. Tokyo Bay is also visible. The data point to the far left in Figure 1 is the island of Fukue-Jima.

In recent years the inflation rate has remained low, despite very low, or zero, policy interest rates and high monetary growth, or quantitative easing. This is of course the Kyushu-Shikoku effect. During the 1990s, policymakers were concerned that the

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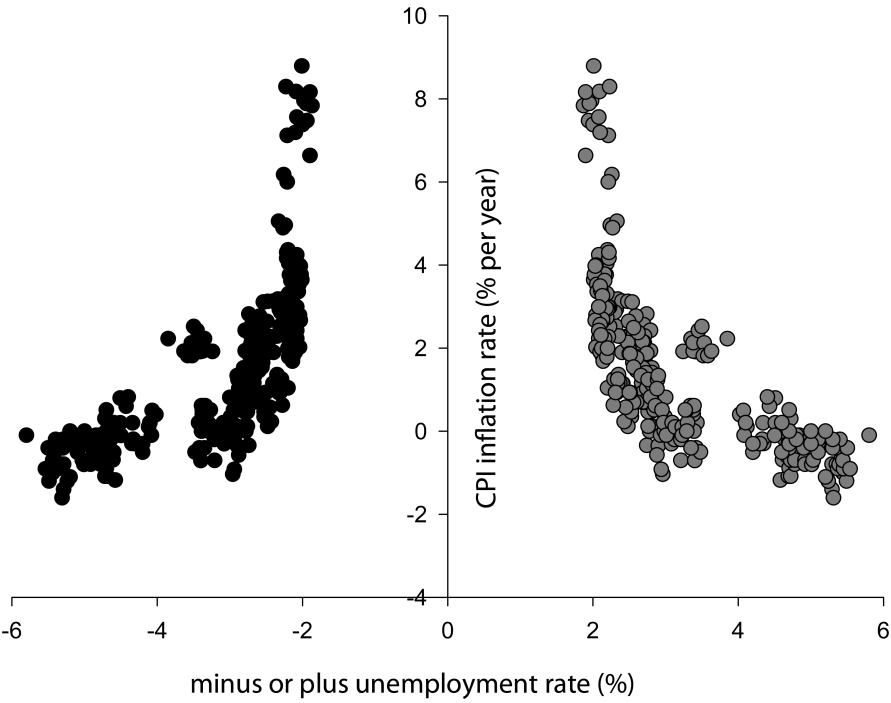


Fig. 1. Japan's Phillips Curve January 1980 to August 2005.

deepening deflation might lead to even higher unemployment rates or a movement to the southwest in the left panel: the Okinawa effect.

This research shows that the outcomes of the past 15 years were predictable as part of a stable, readily recognized Phillips curve. Further research work on Phillips curves and the new macroeconomic geography will focus on Chile. McCall (2003) provides an alternative hypothesis at the continental level of aggregation.

LITERATURE CITED

McCall, Bruce. (2003) *All Meat Looks Like South America*. New York: Crown.