Identifying Quantitative and Qualitative Monetary Policy Shocks*

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This paper proposes a method for identifying quantitative and qualitative monetary policy shocks in the balance sheet operations of a central bank in VAR analysis. The method is agnostic and flexible, as it relies on no assumptions on how the size and composition of the central bank's balance sheet will respond after the bank makes a policy decision. We identify two types of policy shocks as "anticipated" shocks that best portend the current and future paths of these policy instruments in response to them. We obtain evidence that qualitative easing shocks have expansionary effects on the economy while quantitative easing shocks do not.

JEL Codes: E52, E58.

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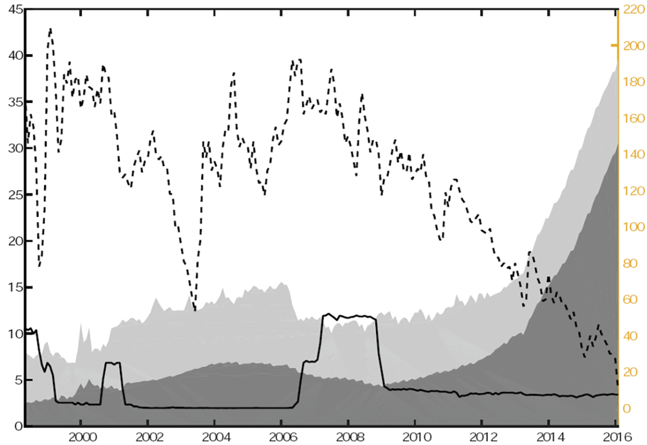
*This paper was previously circulated under the title "Identifying Unconventional Monetary Policy Shocks" but has since been substantially revised. We are grateful for the helpful comments and discussions by Kosuke Aoki, Natsuki Arai, Yoosoon Chang, Michael Dowell, Hiroshi Fujiki, James Hamilton, Naoko Hara, Philipp Hartmann, Yuzo Honda, Takeo Hoshi, Hibiki Ichiue, Keiichiro Inaba, Ryo Jinnai, Atushi Kataoka, Ryo Kato, Junko Koeda, Kenneth Kuttner, Ko Munakata, Michael Murach, Ryuzo Miyao, Yoji Morita, Yasutomo Murasawa, Tatsuyoshi Okimoto, Hugh Patrick, Mototsugu Shintani, Etsuro Shioji, Shigenori Shiratsuka, Koichiro Suzuki, Takeru Terao, Yoshiro Tsutsui; by seminar participants from the Bank of Japan, Columbia University, Hitotsubashi University, Kobe University, and Konan University; and by conference participants from the 2016 Japanese Economic Association Autumn Meeting, 2017 Western Economic Association Annual Meeting, 2018 China Meeting of the Econometric Society, 2018 Asian Meeting of the Econometric Society, 2018 International Association for Applied Econometrics Annual Conference, and 2019 CEBRA Annual Meeting. We would also like to thank Miho Kohsaka for providing excellent research assistance. This study received financial support in the form of Grants-in-Aid from the Japanese Ministry of Education and Science. The views expressed in this paper are those of the authors and do not necessarily reflect the official views of the Bank for International Settlements. Author e-mails: Nakashima: nakakiyo1027@gmail.com; Shibamoto: shibamoto@rieb.kobe-u.ac.jp; Takahashi (corresponding author) koji.takahashi@bis.org.

1. Introduction

In this paper, we introduce a novel identification approach to disentangle the causal effects of the Bank of Japan (BOJ)'s quantitative and qualitative monetary policy shocks in its balance sheet operations. More specifically, our new strategy addresses two issues entailed in identifying the unconventional monetary policy shocks in the vector autoregressive (VAR) analysis: the endogeneity of the monetary policy indicators, and quantitative and qualitative monetary policy shocks as "anticipated" shocks. By identifying quantitative and qualitative monetary policy shocks, we provide robust evidence that the quantitative easing shock, the shock that increases the size of the BOJ's balance sheet, significantly decreases the long-term nominal interest rate without conferring any favorable effects on real economic activity. Specifically, the impulse response analysis shows that a quantitative shock that increases the monetary base by 10 percentage points, in the long run, has slightly negative effects on the output gap, inflation rates, and stock prices although it significantly decreases 10-year government bond yield as well as short-term rates. On the other hand, the qualitative easing shock, the shock that increases the BOJ's unconventional asset ratio to its total assets, brings about expansionary effects. We find that a qualitative easing shock of increasing the unconventional asset ratio by 0.3 percentage point stimulates the output gap by 0.1 percentage point and the inflation rate by 0.4 percentage point while significantly increasing stock prices. Also, we show some suggestive evidence that the quantitative easing shock causes a negative effect because it has a signaling effect regarding the future path of the economy. Finally, we find that the conventional easing monetary policy shock, the increase in the short-term policy rate, has an expansionary effect even in the low interest rate period.

Central banks have several monetary policy options, even with the policy rate at an effective lower bound (Bernanke and Reinhart 2004). For example, in March 2001, the BOJ adopted a quantitative easing policy by setting the targeted overnight call rate to almost 0 percent. Under this policy framework, the monetary base, or size of the BOJ's balance sheet, expanded through the growth of excess reserves in the BOJ's current account bases (see Figure 1). The BOJ discontinued its quantitative easing policy in March 2006 but

Figure 1. Size, Unconventional Assets, Call Rate, and Long-Term Bond Yield



Note: The dark gray and light gray shadows indicate the amounts of unconventional assets and conventional assets held by the Bank of Japan, respectively. The amounts are shown in units of 10 trillion yen on the left-hand scale. Unconventional assets include exchange-traded funds (ETFs), real estate investment trusts (REITs), corporate bonds, commercial paper, long-term government bonds, and asset-backed securities. Conventional assets include other assets such as short-term government bonds. The plotted line represents the call rate, while the dashed line corresponds to the 10-year Japanese government bond yield, both in basis points on the right-hand scale.

has kept the targeted rate well below 0.5 percent since then. In its quantitative and qualitative easing (QQE) policy introduced in April 2013, the BOJ further deepened its unconventional policy framework not simply by enlarging its balance sheet, but by increasing the ratio of unconventional assets, such as long-term Japanese government bonds (JGBs) and risk assets (e.g., exchange-traded funds (ETFs) and real estate investment trusts (REITs)), on its balance sheet.[1] Central banks in advanced economies such as the United Kingdom, United States, and euro-area countries have followed with their own unconventional policy frameworks characterized by similar increases in the sizes of the central bank balance sheets and changes in the

[1]See Shiratsuka (2010) and Ueda (2012) for a detailed explanation of unconventional assets in Japan.

balance sheet compositions at extremely low policy-targeted interest rates.

While the actual implementation of the unconventional monetary policy in many countries has stimulated empirical research on unconventional policy effects using the structural VAR model, the policy effects on the real economy are still disputable.[2] One of the biggest challenges in assessing unconventional policy effects by VAR analysis is the choice of variables to use as monetary policy indicators that precisely reflect the central bank's policy decisions in the unconventional monetary policy. Starting from the premise that monetary aggregates such as the monetary base and excess reserves represent a central bank's policy stance, several previous studies have used reduced-form VAR innovations of those variables as exogenous components of the unconventional monetary policy (Iwata and Wu 2006, Inoue and Okimoto 2008, Honda, Kuroki, and Tachibana 2013, Kimura and Nakajima 2016, Miyao and Okimoto 2017, and Hayashi and Koeda 2019).[3] This empirical strategy is essentially an extension of the standard recursive VAR approach to estimate the effects of the conventional monetary policy of controlling short-term nominal interest rates (Bernanke and Blinder 1992 and Christiano, Eichenbaum, and Evans 1996).[4]

Other empirical studies on unconventional policy effects have employed a strategy that does not require one-to-one mapping between an observable monetary policy indicator and a monetary policy shock. By assuming that unconventional monetary policy shocks can be represented collectively as a single unobservable shock, they apply a VAR analysis that imposes sign restrictions on the impulse responses of the macroeconomic variables to single monetary policy shocks (Kapetanios et al. 2012, Baumeister and Benati

[2]See Ugai (2007) and Joyce et al. (2012) for a survey of the empirical research on unconventional policy effects.

[3]Previous studies applying the recursive VAR approach to unconventional monetary policy in the United Kingdom and United States have not necessarily used the monetary base or excess reserves as an unconventional monetary policy indicator. Wu and Xia (2016), for example, used shadow policy rates for an analysis of the United States, and Weale and Wieladek (2016) used asset purchase announcements for analyses of the United Kingdom and United States.

[4]Rudebusch (1998) and Nakamura and Steinsson (2018) discuss concerns underlying the use of the standard recursive VAR approach to identify monetary policy shocks.

2013, Schenkelberg and Watzka 2013, Gambacorta, Hofmann, and Peersman 2014, and Weale and Wieladek 2016)[5] and heterogeneous variance restrictions on the intensity of structural shocks, including single policy shocks (Wright 2012, Rogers, Scotti, and Wright 2014, and Shibamoto and Tachibana 2017).[6]

However, since central banks utilize different policy tools in the low interest rate environment, the two aforesaid empirical strategies are insufficient to assess the effects of unconventional policy. In the case of Japan, the BOJ has purchased a vast range of different financial assets such as exchange trade funds, commercial papers, and long-term government bonds. To address this issue, we assume that the unconventional monetary policy implemented by the BOJ in its balance sheet operations has two aspects: a *quantitative* and a *qualitative* easing.[7] In this paper, we propose a method for identifying the BOJ's quantitative and qualitative monetary policy shocks in VAR analysis.

Another identifying issue is how monetary policy indicators respond to policy changes. As discussed above, previous studies on unconventional policy effects based on VAR analysis have taken either of two approaches. Some have regarded reduced-form VAR innovations of monetary aggregates such as the monetary base as unconventional policy shocks. Others have imposed restrictions on the impulse responses of some of the variables to a single unobserved unconventional policy shock. Regardless of the difference in methodology, both of these approaches assume that all monetary policy shocks to monetary aggregates are "unanticipated," and both approaches provide evidence that unconventional policy shocks yield

[5]A naive sign restriction would fail to extract any information from data. See Baumeister and Hamilton (2015).

[6]Non-VAR approaches that assume a single unobservable unconventional monetary policy shock also include the event-study approach (Gagnon et al. 2011, Joyce et al. 2011, Krishnamurthy and Vissing-Jorgensen 2011, Swanson 2011, and Ueda 2012) and the difference-in-difference approach (Foley-Fisher, Ramcharan, and Edison 2016, and Rodnyansky and Darmouni 2017).

[7]As we discuss in Section 2.2, we use the BOJ's unconventional asset ratio to capture the qualitative easing shock and we include various financial assets from long-term government bonds to stocks as unconventional assets to calculate the ratio. However, purchasing different unconventional assets could have different effects on the economy. In this paper, we do not investigate each of the different effects because we focus on the entire effect of purchasing unconventional assets.

favorable effects on the macroeconomy. The identification of shocks, however, is unsuitable in terms of the actual dynamics of the unconventional and conventional policy indicators. More specifically, the size and composition of a central bank's balance sheet may not reflect the policy changes of the central bank immediately after an announcement, whereas the bank's policy rate does. As the BOJ clarifies in its statement, the target levels of unconventional policy instruments are basically achieved after several months or a year has passed from the BOJ's policy change announcement. Hence, agents in the economy can anticipate large changes in monetary policy indicators, including the monetary base, even in the long-run future. If, however, we impose an existing identification scheme in a VAR model such as a recursive restriction and a sign restriction and ignore the difference between those unconventional policy indicators and the short-term policy rate, we run the risk of misspecifying those anticipated changes as unanticipated shocks.

Premising that monetary policy shocks are mainly attributable to the actual movements of observable unconventional policy indicators, we identify two unconventional monetary policy shocks relating to the size and composition of the BOJ's balance sheet as anticipated shocks, or news shocks, that best presage their current and future paths.[8] We identify the unconventional shocks using the maximum forecast error variance (MFEV) approach from Francis et al. (2014), a method that builds on the work of Faust (1998) in the framework of monetary policy analysis. The MFEV approach identifies a shock such that its contribution to the forecast error variance of a time-series process is maximized over all horizons up to a finite truncation horizon, whereas Faust's approach maximizes the contribution at a predetermined finite horizon. The effective use of the MFEV approach to identify the unconventional shocks in the BOJ's balance sheet operations requires a long truncation horizon, because the monetary base and composition of assets in the BOJ's balance

[8]Milani and Treadwell (2012) tried to theoretically disentangle the anticipated and unanticipated components of policy shocks by constructing a New Keynesian model that incorporates news about future policy rates. Tsuruga and Wake (2019) find that a time lag between the decision and implementation of money-financed fiscal stimulus may cause a recession by using a New Keynesian dynamic stochastic general equilibrium (DSGE) model, indicating the importance of distinguishing between anticipated and unanticipated stimulus.

sheets change only gradually after the BOJ announced the policy change, as we discuss in Section 2.2 in more detail. Therefore, when employing the MFEV approach, we adopt the 36-month truncation horizon.[9]

Two features of the MFEV approach make it more agnostic and flexible than the existing approaches in identifying unconventional policy shock. First, the MFEV approach requires no assumptions on signs of responses of the central bank's two balance sheet instruments. Second, the approach isolates the primary driver of a time-series process as an anticipated shock and can be applied to any case in which the same dominant driving process exists (Francis et al. 2014). The MFEV approach is suitable for identifying the two unconventional monetary policy shocks, given that the BOJ implements the unconventional monetary policy by altering the expected future course of monetary policy actions, including the balance sheet operations in its statement (Okina and Shiratsuka 2004).

Finally, the endogeneity issue is one of the main difficulties for the identification of monetary policy shocks. We should note that a simple MFEV relies on the variance-covariance matrix of VAR residuals. However, using simple VAR residuals would suffer from the endogeneity problem. To overcome this problem, we follow the literature of the external instrument variable approach for a structural VAR (SVAR) model and combine it with the MFEV method. To our knowledge, this is the first paper to combine the MFEV approach with the external instrument variable method for the identification of an SVAR model. More precisely, following in the vein of the previous literature, we focus on the monetary policy meeting days as the timing when monetary policy shocks arise in the economy (Kuttner 2001; Cochrane and Piazzesi 2002; Gürkaynak, Sack,

[9]Weale and Wieladek (2016) and Zeev, Gunn, and Khan (2020) share the similar motivation with us in identifying their unconventional monetary policy shocks. In addition to the recursive restriction and the sign restriction approach, Weale and Wieladek (2016) also employed Faust's (1998) approach to analyze the U.K. and U.S. unconventional monetary policy. They identified the asset purchase announcement shock as the process that most robustly explained the forecast error variance of asset purchases, with a three-month delay. On the other hand, like us, Zeev, Gunn, and Khan (2020) employed the MFEV approach with a much longer truncation horizon. They identified the U.S. forward guidance shock regarding the future path of the short-term policy rate, with the 15-, 30-, or 45-month truncation horizon.

and Swanson 2005a, 2005b, 2007; Honda and Kuroki 2006; Campbell et al. 2012; Gertler and Karadi 2015; and Nakamura and Steinsson 2018). The BOJ decides its policy scheme at monetary policy meetings (previously, the meetings were held once or twice a month) and publicly states its policy decision just after each meeting. We exploit the idea that monetary policy shocks are reflected in the changes of asset prices just after the BOJ deploys its main communication tool, the public statement that it issues on the latest monetary policy meeting. In other words, we use the market responses to the BOJ's policy decision statements, that is, the monetary policy surprises in financial markets or the revised expectations of market participants embedded in financial asset valuations.[10] Such price revisions in the financial markets can be used to measure the extent to which monetary policy announcements surprise the markets. We thoroughly utilize this insight to identify the BOJ's monetary policy shocks. More concretely, as long as we correctly characterize the monetary policy surprises, we can use them as the instrumental variables of the reduced-form VAR innovations to identify the causal effects of the BOJ's monetary policy shocks on macroeconomic variables.[11]

The remainder of this paper is organized as follows. Section 2 constructs our monetary policy surprise measures and examines the movement of each policy indicator in response to the BOJ's monetary policy shocks. Section 3 discusses a method to identify quantitative and qualitative monetary policy shocks as anticipated shocks. Section 4 reports the estimation results for the unconventional monetary policy shocks. Section 5 explores the robustness of our empirical findings on unconventional monetary policy effects, along with several implications of the findings. Section 6 closes the paper with

[10] Through this paper, we use the term "agents' revisions of expectations" to refer to the monetary policy surprises, or the revised expectations of market participants embedded in financial asset valuations as factors correlated with monetary policy shocks, whereas some studies measured such expectation revisions either directly through survey forecasts or indirectly through models that are designed to approximate the expectation formation process (see, e.g., Coibion and Gorodnichenko 2012). We acknowledge an anonymous referee for suggesting this point.

[11] See Stock and Watson (2012, 2018) and Ramey (2016) for detailed surveys of this empirical strategy for identifying U.S. monetary policy shocks using monetary policy surprises, namely, changes in asset market prices on Federal Open Market Committee dates.

concluding comments. The appendix provides detailed definitions of the variables used in this paper and detailed discussions on the development of the monetary policy indicators and estimated monetary policy shocks.

2. Monetary Policy Surprises and the Movements of Monetary Policy Indicators in Response

As we discussed earlier in the Introduction, the fundamental issue to consider in identifying monetary policy shocks in relation to policy indicators is the timing of the central bank's policy decision announcement. After beginning this section with a discussion of the source from which monetary policy shocks originate, we examine the movements of monetary policy indicators in response to monetary policy shocks. In doing so, we demonstrate why it becomes necessary to apply our method of using the structural VAR approach to identify monetary policy shocks in relation to each of three policy indicators, one conventional and two unconventional. The conventional policy indicator is the uncollateralized overnight call rate, that is, the BOJ's targeted short-term policy rate. The unconventional policy indicators are the monetary base and the composition ratio of the BOJ's unconventional assets to its total assets. The unconventional assets include long-term JGBs, ETFs, stock, REITs, commercial papers, and corporate bonds. In this paper, we categorize all risky assets into one category as unconventional assets and use the risky asset ratio as a policy instrument variable. This is because the appropriate number of factors required for the explanation is estimated to be three. Therefore, increasing the number of instruments to more than three generates complexity but does not provide better understanding of the role of each policy tool. In addition, the BOJ categorizes its unconventional policies into two dimensions. For example, Governor Kuroda[12] mentioned that the

[12] More precisely, in the speech at the meeting held by the Yomiuri International Economic Society in Tokyo (April 12, 2013), he mentioned as follows: "That is, the central banks' purchases of government bonds and other assets from the markets have the effect of encouraging further declines in long-term interest rates and lowering risk premia of asset prices by absorbing risks. . . Thus, it is important to work on two aspects of monetary easing, both in terms of quantity and quality."

different purchasing programs have two aspects, namely quantity and quality easing.[13] Within the framework of the BOJ's unconventional monetary policy, the unconventional assets ratio is regarded as a qualitative policy indicator (Shiratsuka 2010 and Ueda 2012), while the monetary base, or the size of the BOJ's balance sheet, is regarded as a quantitative policy indicator.

Note that we use the sample period from April 1998 to January 2016 throughout this paper. We selected this sample period for two reasons: first, because the BOJ publishes detailed data on its asset composition from April 1998; second, because the transmission mechanism through control of the short-term rate may change when the policy rate turns negative after the BOJ introduces a negative interest policy in February 2016 (see, e.g., Eggertsson et al. 2019 and Abadi, Brunnermeier, and Koby 2022). Appendix A provides detailed definitions of the variables used in this paper.

2.1 Monetary Policy Surprises

The BOJ decides its policy scheme in a monetary policy meeting (MPM) held about twice per month and publicly states its policy decisions just after the meeting closes. We can assume, therefore, that the BOJ's monetary policy shocks are reflected in revisions in the expectations of agents in the asset markets. This empirical strategy helps us overcome identification problems that would arise with regard to endogenous responses of monetary policy if we simply treated innovations of monetary policy indicators as policy shocks in a monthly or quarterly VAR model. If we were to apply the innovations in such VAR models, the models would be contaminated by their endogenous responses to the underlying financial variables and other macroeconomic variables left out of the VAR system (Faust, Swanson, and Wright 2004; Romer and Romer 2004; Gertler and Karadi 2015; and Shibamoto 2016).[14] As an alternative, therefore,

[13]However, the detailed categorization and separate examination of each asset purchasing program could help us to understand the mechanism and effect more precisely. This will be our future research topic. We thank an anonymous referee for pointing out this important issue.

[14]Faust, Swanson, and Wright (2004), Romer and Romer (2004), Gertler and Karadi (2015), and Shibamoto (2016) pointed out that the reduced-form VAR

we use monetary policy surprises in asset markets, or revisions in the expectations of agents in asset markets, as external instruments to control for the endogenous responses of the three monetary policy indicators not only to the financial variables in the VAR but also to underlying correlated variables out of the VAR. This approach will be discussed in the next section.

Previous studies constructed monetary policy surprises by focusing on changes in short-term interest rate futures and using high-frequency daily trading data. Kuttner (2001), Cochrane and Piazzesi (2002), Gürkaynak, Sack, and Swanson (2005a, 2005b, 2007), Campbell et al. (2012), Gertler and Karadi (2015), and Nakamura and Steinsson (2018) constructed monetary policy surprises in federal funds or Eurodollar futures occurring on Federal Open Market Committee dates. Honda and Kuroki (2006) constructed monetary policy surprises in euro-yen futures occurring on the BOJ's MPM dates from 1989 to 2001. Although these studies examined financial market responses to exogenous monetary policy shocks under the conventional policy regime, this empirical strategy is still useful for identifying the BOJ's monetary policy shocks under the unconventional policy regime.

This strategy, however, is of limited use for our purposes, given that short-term interest rate futures have hardly changed since the BOJ introduced its unconventional monetary policy. Here, therefore, we depart from the previous studies by looking beyond changes in a particular asset market and exploiting all information on changes in the major financial markets just before and just after the BOJ's public statements. More concretely, we employ the principal component approach of Bernanke, Reinhart, and Sack (2004), Gürkaynak, Sack, and Swanson (2005a), and Swanson (2017) to prepare for monetary policy surprises as common factors of unanticipated changes in the major financial market variables following public statements. If we obtain l common factors for market participant surprises over a central bank's policy decisions, we can construct at most l types of monetary policy shocks.

innovations of policy rates would have a substantial bias in identifying the monetary policy effect.

The principal component analysis of monetary policy on meeting day t is based on the following equation:

$$\mathbf{X_t} = \mathbf{\Lambda F_t} + \eta_\mathbf{t}, \tag{1}$$

where $\mathbf{X_t} = (x_{1t}, \ldots, x_{nt})'$ denotes the vector of n financial time series, $\eta_\mathbf{t}$ indicates the vector of n idiosyncratic disturbance terms, $\mathbf{F_t}$ is the vector of l unobserved common factors, and $\mathbf{\Lambda}$ is a matrix of the coefficients identified as factor loadings. We aim to extract common factors $\mathbf{F_t}$ by using the factor model. We include 12 financial market variables x_{it} $(i = 1, \ldots, 12)$: one futures rate (three-month euro-yen TIBOR futures), five yen interest swap rates (1, 2, 5, 10, 30 years), one short-term spot rate (three-month euro-yen TIBOR), two spot exchange rates on the Tokyo market (yen-U.S. dollar and yen-AUS dollar), two stock indices (TOPIX and Nikkei JASDAQ), and bank reserve deposits.[15]

Our inclusion of asset variables in calculating principal components is similar to that in Swanson (2021); that is, he exhaustively utilized the information on various types of asset prices, such as federal fund futures, Eurodollar futures, and Treasury bond yields. In addition, we include the stock market index and exchange rates in order to capture the BOJ's policy measures appropriately. More specifically, the BOJ started to purchase exchange-traded funds that track stock indices from 2010 and then expanded the purchasing amount. In 2021, it reaches about 5 percent of the total market value of all stocks listed in the first section of the Tokyo Stock Exchange. In addition, the BOJ has paid special attention to exchange rates, as Governor Kuroda pointed out in his speech.[16] To capture the

[15]In the baseline specification, we do not control for macroeconomic news about real economic activity or inflation in the dynamic factor model. Hence, our monetary policy surprises could include information on the macroeconomic news other than the monetary policy itself. Following an anonymous referee's suggestion, to control for macro news release on policy meeting days, we use the macroeconomic news shocks defined as the difference between an actual value (for the index of industrial production and the consumer price index) and its market forecasts from the Monetary Market Services (MMS) survey. We found that our results reported below do not change much qualitatively and quantitatively. We acknowledge the referee's suggestion.

[16]Governor Kuroda pointed out that one of the four major channels of monetary easing is "a channel through which the yen depreciate due mainly to an

distinct feature of the BOJ's monetary policy, we include the stock market index and exchange rates. This approach allows us to investigate what number of dimensions best describes monetary policy without selecting one particular asset price as a sufficient statistic for monetary policy, as in Gertler and Karadi (2015) and Nakamura and Steinsson (2018), who aimed at summarizing monetary policy with the one- or two-year Treasury yield.

We calculate the differences in the seven interest rate variables and the log differences of the two exchange rates, two stock indices, and bank reserves as percentages of the rate of change before and after public statements. More concretely, we use the closing values at 3:00 p.m. from the day before the public statement to the day after the statement to calculate changes of the 12 financial variables over the two-day period in order to duly consider the timing of the public statement and the time required for the news to be sufficiently recognized (see Ueda 2012).[17] That is, for stock prices, exchange rates, and bank reserves, x_{it} is defined as follows:

$$x_{it} = \log(P_{it+1}/P_{it-1}) \times 100, \tag{2}$$

and for interest rates,

$$x_{it} = r_{it+1} - r_{it-1}, \tag{3}$$

where P_{it+1} and P_{it-1} indicate the closing values of exchange rates, stock indices, and bank reserves on the day after a monetary policy meeting and the closing values of the same on the day before the monetary policy meeting, respectively, and r_{it+1} and r_{it-1} denote the closing interest rates.

We preliminarily exclude the dates of the meetings at which the BOJ coordinated policy with the Federal Reserve, the European

expansion in yield differentials between Japan and other economies" in the speech at the Meeting of Councillors of Nippon Keidanren (Japan Business Federation) on December 23, 2021.

[17]An event-study analysis by Ueda (2012) showed that asset prices, including TOPIX and Japanese government bond yields, significantly respond to monetary policy changes from two days after the BOJ's public statements onward. For a robustness check, however, we also used narrower time windows to extract the monetary policy surprises. We found that the results are qualitatively the same as those reported below.

Table 1. The Number of Common Factors Underlying the Changes in Financial Market at the MPM

Number of Factors: k	**0**	**1**	**2**	**3**	**4**
$BN(k)$	2.98	2.94	3.06	2.89	2.95
$AH(k)$	n.a.	1.05	0.89	1.09	0.52

Note: $BN(k)$ denotes the Bai and Ng (2002) information criteria, defined as follows:

$$BN(k) = \log(V(k)) + k\left(\frac{n+T}{nT}\right) log\left(\frac{nT}{n+T}\right),$$

where n is the number of variables in factor model (1): $n = 12$. T is the number of observations. $V(k)$ is the sum of squared residuals divided by nT. $AH(k)$ denotes the Ahn and Horenstein (2013) information criteria, defined as follows:

$$AH(k) = \frac{\log(V(k-1))/\log(V(k))}{\log(V(k))/\log(V(k+1))}.$$

Central Bank, or the Bank of England. We also exclude the date on which the BOJ agreed on its policy responses to the Tohoku earthquake of March 11, 2011, as policy coordination and disaster response would be likely to contaminate the BOJ's policy effects.[18]

We select the number of common factors using the information criteria proposed by Bai and Ng (2002) and Ahn and Horenstein (2013): the former and the latter respectively suggested that the preferred model is the one that minimizes and maximizes the information criteria. Table 1 reports the two information criteria applied. These criteria suggest that we should adopt three common factors as monetary policy surprises in the 12 financial markets.[19]

[18]The BOJ held meetings on September 18, 2008, September 29, 2008, and November 30, 2011 to coordinate policy. In a meeting on March 14, 2011, the BOJ agreed on its policy response to the Tohoku earthquake.

[19]To examine the importance of including the stock market indices and exchange rates, we also conduct factor analysis by excluding them. If we exclude those variables, we would summarize monetary policy by just one dimension. However, this is implausible when we consider the fact that the BOJ implemented various unconventional policy measures in this period, as discussed in Swanson (2021) for the Federal Reserve's policy. In other words, we would miss other substantial dimensions of monetary policy that involve the stock price indices and exchange rates if we exclude them. We thank the anonymous referee for pointing out this important issue.

We can therefore construct at most three types of monetary policy shocks.

When constructing monthly data on the monetary policy surprises, we extract the common factors jointly over all the surprises and then use a sum within each month, as in Romer and Romer (2004) and Barakchian and Crowe (2013).

2.2 Monetary Policy Indicators' Response

In this subsection we examine the statistical relevance among the monetary policy surprises and monetary policy indicators based on how differently each of the monetary policy indicators responds to monetary policy shocks whose information is contained in monetary policy surprises. To this end, we run the following distributed lag regression of the policy indicators on the current and lagged monetary policy surprises:[20]

$$PI_t = \sum_{j=1}^{3} \sum_{h=0}^{H} r_h^j \; PS_{t-h}^j + \text{Controls} + e_t^{PI}, \tag{4}$$

where PI_t denotes the change or the level in each of the monetary policy indicators—the short-term policy interest rate (SR), monetary base (MB), and composition ratio of the BOJ's unconventional assets to total assets (COMP)—in month t. The change in the monetary base is expressed using the monthly growth rates (annual rate) of the log-differenced values. The level in the monetary base is expressed using logarithmic values × 1200. PS_{t-h}^j denotes the h lagged values for the three monetary policy surprises generated using the factor analysis. e_t^{PI} denotes stochastic disturbances. Controls include a constant term and the one-lagged value of PI_t.

Table 2 reports chi-square statistics and P-values for testing the null hypothesis, $r_h^j = 0$ for all $j = 1, 2, 3$, in the distributed lag regression at the horizon of $h = H$. As the table shows, the monetary policy surprises are statistically correlated with the monetary policy indicators but associate with the indicators in different ways. Specifically, we find that the monetary policy surprises are significantly associated with the short-term policy rate (ΔSR_t and SR_t)

[20] This regression is essentially the same as the local projection method (see Jordà 2005 and Stock and Watson 2018).

Table 2. Results for the Distributed Lag Regression of Each Monetary Policy Indicator on Monetary Policy Surprises

	Change in Policy Indicator			Level in Policy Indicator		
	Δ MB	**Δ COMP**	**Δ SR**	**MB**	**COMP**	**SR**
$H = 0$	2.91	4.57	13.48	1.03	4.89	17.91
	[0.41]	[0.21]	[0.00]	[0.79]	[0.18]	[0.00]
$H = 1$	3.67	5.23	25.83	1.40	5.93	31.71
	[0.72]	[0.52]	[0.00]	[0.97]	[0.43]	[0.00]
$H = 2$	8.54	17.88	33.74	6.45	19.59	47.90
	[0.48]	[0.04]	[0.00]	[0.69]	[0.02]	[0.00]
$H = 6$	20.75	27.74	81.40	26.97	31.06	96.60
	[0.47]	[0.15]	[0.00]	[0.17]	[0.07]	[0.00]
$H = 12$	54.41	61.23	67.15	69.19	72.11	107.94
	[0.05]	[0.01]	[0.00]	[0.00]	[0.00]	[0.00]
$H = 24$	126.97	527.22	288.39	171.72	470.89	394.72
	[0.00]	[0.00]	[0.00]	[0.00]	[0.00]	[0.00]

Note: The distributed lag regression model is specified as Equation (4). This table shows chi-square statistics (p-values in brackets) resulting from tests of the null hypothesis: $r_h^j = 0$ for all $j = 1, 2, 3$ and $h = 0, \ldots, H$.

at the horizon of $H = 0$, or the contemporaneous time of the policy shock arrival. This association tells us that the short-term policy rate immediately responds to the BOJ's policy changes. In contrast, monetary policy surprises show no significant associations with the monetary base (ΔMB_t and MB_t) or the unconventional assets ratio ($\Delta COMP_t$ and $COMP_t$) at the horizon $H = 0$, but are significantly associated with the monetary base at $H \geq 12$ and with the unconventional assets ratio at $H \geq 2$. These estimation results imply that the monetary base and unconventional assets ratio respond to the BOJ's policy changes slowly and later in time.

Our finding on the responses of the quantitative and qualitative monetary policy indicators clearly indicates that monetary policy surprises have substantial information on their future movements, but not on their contemporaneous ones. In other words, the public statements issued just after the MPM on the bank's decision to change the two unconventional policy indicators behave like anticipated shocks that portend future changes in the indicators. Therefore, if we were to impose an existing identification scheme in a VAR model such as a recursive restriction and a sign restriction and ignore the difference between those unconventional policy indicators and the short-term policy rate, we would misspecify those anticipated changes as unanticipated shocks. In the next section we incorporate these medium- and long-term findings among the monetary policy surprises and two unconventional policy indicators into an identifying restriction on the intertemporal relations among the unconventional monetary policy shocks and indicators.

Note, also, that each of the monetary policy indicators associates differently with the monetary policy surprises. The differences between the associations compel us to separately identify the three monetary policy shocks relating to the three policy indicators: one conventional monetary policy shock that aims to exogenously change short-term nominal interest rates and two unconventional monetary policy shocks that aim to exogenously change the size and composition of the central bank's balance sheet.

3. Identifying Quantitative and Qualitative Monetary Policy Shocks

This section describes the empirical strategy we use to identify the effects of the two unconventional monetary policy shocks (quantitative and qualitative monetary policy shocks) and the one short-term policy rate shock with the three principal components of the monetary policy surprises in the structural VAR analysis. First, we assume that monetary policy shocks originate from the public statements released just after the MPM. Second, we account for the identifying restrictions that incorporate the features of the monetary policy indicators discussed in Section 2. Specifically, we impose restrictions on unconventional monetary policy shocks as shocks that capture current and future changes in the size and composition of the BOJ's balance sheet, and we define the short-term policy rate shock as a shock that is extracted after the unconventional monetary policy shocks. In Section 5 we show that estimated impulse responses to the quantitative and qualitative policy shocks based on this assumption are robust even under the alternative assumption that the policy rate shock is followed by the two unconventional policy shocks involving the central bank's balance sheet operations.

Also note that in setting the VAR model, we change our assumptions about the entry of a new policy scheme in an unconventional monetary policy regime. When, for example, the central bank introduces or halts a zero interest rate policy, quantitative easing policy, or quantitative and qualitative easing policy, we assume that the new scheme reflects not a change in the central bank's deep parameter in its policy decision announcement, but a policy shock that either portends future changes in the monetary base and unconventional assets ratio or leads to an immediate change in the short-term policy rate. Below, therefore, we make no use of regime-switching and time-varying parameter VAR models such as those of Fujiwara (2006), Kapetanios et al. (2012), Baumeister and Benati (2013), Kimura and Nakajima (2016), Miyao and Okimoto (2017), Hayashi and Koeda (2019), and Koeda (2019).

Our procedure for VAR identification is based on the following two-step approach. In the first step, we use the monetary policy surprises as the instrumental variables of the reduced-form VAR innovations of the three policy indicators and other macroeconomic variables. Specifically, we construct an impact matrix for the instantaneous responses of the VAR variables by disentangling the causal relationships among the monetary policy shocks and VAR variables. The impact matrix in this stage disregards the movement in the unconventional policy indicators following policy changes. We therefore impose restrictions, in the second step, to identify the quantitative and qualitative shocks, which we define as shocks that best explain the changes in the conditional expectation about the current and future paths of the size and composition of the central bank's balance sheet. To this end, as discussed in the Introduction, we employ the maximum forecast error variance (MFEV) approach from Francis et al. (2014).

3.1 Structural VAR Model

Letting y_t denote a $K \times 1$ vector of time-varying observables in month t, this stochastic structure can be expressed in terms of the vector moving average representation:

$$y_t = \Phi(L)u_t, \tag{5}$$

where $\Phi(L) = I + \Phi_1 L + \Phi_2 L^2 + \cdots$ is a matrix polynomial in the lag operator, L, and u_t denotes the $K \times 1$ vector of the reduced-form VAR innovations. The monetary base (MB), unconventional assets ratio (COMP), and short-term policy rate (SR) are given by the first, second, and third elements of y_t, respectively. The structural vector moving average representation can thus be written as follows:

$$y_t = \Psi(L)\epsilon_t, \tag{6}$$

where $\Psi(L) = \Psi_0 + \Psi_1 L + \Psi_2 L^2 + \cdots$, and ϵ_t denotes the $K \times 1$ vector of the structural shocks. Let ϵ_t^{MP} be the 3×1 policy shock vector $\epsilon_t^{MP} = [\epsilon_t^{QN}, \epsilon_t^{QL}, \epsilon_t^{SR}]'$, where ϵ_t^{QN}, ϵ_t^{QL}, and ϵ_t^{SR} denote unconventional quantitative, qualitative policy shocks, and conventional short-term interest rate shocks, respectively. The space spanned by the policy shock vector ϵ_t^{MP} is disentangled from the space spanned by other possible shocks of the $(K-3) \times 1$ vector ϵ_t^X in the following linear relation between the reduced-form VAR innovations u_t and structural shocks ϵ_t:

$$\begin{gathered} u_t = R\epsilon_t = R^{MP}\epsilon_t^{MP} + R^X \epsilon_t^X, \\ \underset{(K\times K)}{R} = [\underset{(K\times 3)}{R^{MP}}, \underset{(K\times(K-3))}{R^X}], \underset{(K+1)}{\epsilon_t} = [\underset{(3\times 1)}{\epsilon_t^{MP}}, \underset{((K-3)\times 1)}{\epsilon_t^X}]', \end{gathered} \tag{7}$$

where R^{MP} represents the impact matrix for the responses of the VAR variables y_t to the monetary policy shocks.

The variance-covariance matrix of the space spanned by the monetary policy shocks can be expressed as

$$\Sigma^{MP} = R^{MP} E(\epsilon_t^{MP} \epsilon_t^{MP'}) R^{MP'} = R^{MP} R^{MP'}, \tag{8}$$

where the variance of monetary policy shocks is normalized to one. The impact matrix R^{MP} satisfies the variance-covariance matrix but it is not unique. For some arbitrary orthogonalization of this impact matrix, $\tilde{R}^{MP}$, the entire space of possible impact matrices can be written as

$$R^{MP} = \tilde{R}^{MP} D, \tag{9}$$

where D denotes the 3×3 orthonormal matrix ($DD' = I$). Note that $\tilde{R}^{MP} d_j$ ($j = 1, 2, 3$) (where d_j is the 3×1 orthonormal vector indicating the jth column of the orthonormal matrix D) is the $K \times 1$ vector, and thus interprets the contemporaneous impact of the jth monetary policy shock on the VAR variables. In the following subsections we construct this impact matrix (9) to identify the three types of monetary policy shocks.

3.2 Controlling the Endogeneity of the Monetary Policy Indicators

We use three principal components of the monetary policy surprises (PS_t) extracted from the changes in the 12 major financial markets on MPM days as instrumental variables for the reduced-form VAR innovations, u_t. Thus, we aim to control for the endogeneity of the monetary policy indicators and disentangle the causal effects of the policy shocks on the VAR variables at the shock arrival time. More concretely, we conduct the following system regression:

$$u_t = \underset{(K \times 3)(3 \times 1)}{R^{PS} PS_t} + e_t, \tag{10}$$

where PS_t denotes the 3×1 vector of the three monetary policy surprises at a monthly frequency. The system regression yields the instantaneous responses of the VAR variables to the BOJ's public statements in the form of fitted values $u_t^{ps} = \hat{R}^{PS} PS_t$. We then obtain the following variance-covariance matrix incorporating the instantaneous impacts of the public statements on the VAR variables:

$$\Sigma^{PS} = E(u_t^{ps} u_t^{ps'}). \tag{11}$$

A diagonal element of this variance-covariance matrix, $\Sigma_{i,i}^{PS}$ ($i = 1, \cdots, k$), includes the instantaneous forecast error variances of the VAR variables attributable to the BOJ's public statements on MPM days.[21]

[21] We find that the VAR innovations of the monetary policy indicators differently load on a linear combination of the three principal components through system regression (10) as shown in Table 3. For more details, see Section 4.1.

3.3 Identifying Quantitative and Qualitative Monetary Policy Shocks

Here we describe the second-step procedure to identify the conventional and unconventional monetary policy shocks. We identify the unconventional monetary policy shocks with help from the monetary base and unconventional assets ratio, assuming that agents believe that the policy indicators will meet their target levels after the BOJ's public statements on MPM days. To incorporate this feature into our identification of the unconventional monetary policy shocks, we define them as anticipated shocks that best portend the current and future paths of the monetary base and unconventional assets ratio.

This identification strategy requires that we model changes in the expectations regarding the current and future paths of the unconventional policy indicators. We do so by employing the MFEV approach proposed by Francis et al. (2014).[22] In this approach, we specify the changes in the conditional expectation based on a VAR model as maximization problems for the contributions of the unconventional policy shocks to the h-step-ahead forecast error variances of the unconventional policy indicators.

To explain the MFEV approach, we begin by expressing the h-step-ahead forecast error conditioning on the structural shocks ϵ_t:

$$y_{t+h} - E_{t-1}y_{t+h} = \sum_{\tau=0}^{h} \Phi_\tau R \epsilon_{t+h-\tau} = \sum_{\tau=0}^{h} \Phi_\tau R^{MP} \epsilon_{t+h-\tau}^{MP} + \sum_{\tau=0}^{h} \Phi_\tau R^{X} \epsilon_{t+h-\tau}^{X}, \tag{12}$$

where the first and second equalities use Equations (5) and (7). The h-step-ahead forecast error due to monetary policy shocks $\epsilon_{t+\tau}^{MP}$ can therefore be expressed as

[22] Barsky and Sims (2011) employed the MFEV approach to identify anticipated shocks related to future technology. Zeev, Gunn, and Khan (2019) used this approach to identify anticipated monetary policy shocks in the U.S. conventional monetary policy regime.

$$\sum_{\tau=0}^{h} \Phi_\tau R^{MP} \epsilon_{t+h-\tau}^{MP} = \sum_{\tau=0}^{h} \Phi_\tau \tilde{R}^{MP} D \epsilon_{t+h-\tau}^{MP}, \tag{13}$$

where the equality uses Equation (9). If we have orthogonalization matrix $\tilde{R}^{MP}$ and orthonormal vector d_j $(j = 1, 2, 3)$, we can therefore generate the impulse responses of the VAR variables to the jth monetary policy shock from the impact vector $\tilde{R}^{MP} d_j$.

We first prepare for an orthogonalization matrix $\tilde{R}^{MP}$ such that it satisfies the following condition:

$$\Sigma^{PS} = \tilde{R}^{MP} D D' \tilde{R}^{MP'}. \tag{14}$$

This equality ensures that the impact matrix $\tilde{R}^{MP} D$ is determined based on the estimated instantaneous responses $\hat{R}^{PS}$ of the reduced-form VAR innovations to the central bank's public statements in Equations (10) and (11). Next, we employ the MFEV approach, thereby obtaining the orthonormal vector d_j $(j = 1, 2, 3)$ with a given orthogonalization matrix $\tilde{R}^{MP}$ satisfying Equation (14), as discussed below.

From the h-step-ahead forecast error (13), the share of the h-step-ahead forecast error variance (FEV) of the unconventional policy indicator i $(i = 1, 2)$ attributable to the associated unconventional monetary shock $\epsilon_{j,t}^{MP}$ $(j = i)$ is expressed as a variance decomposition of the following form:

$$\Omega_j^i(h) = \frac{\iota_{1i}' \left(\sum_{\tau=0}^{h} \Phi_\tau \tilde{R}^{MP} D \iota_{2j} \iota_{2j}' D' \tilde{R}^{MP'} \Phi_\tau' \right) \iota_{1i}}{\iota_{1i}' \left(\sum_{\tau=0}^{h} \Phi_\tau \Sigma^{PS} \Phi_\tau' \right) \iota_{1i}}$$

$$= \frac{\overbrace{\sum_{\tau=0}^{h} \Phi_{i,\tau} \tilde{R}^{MP} d_j d_j' \tilde{R}^{MP'} \Phi_{i,\tau}'}^{\text{FEV of policy indicator } i \text{ due to } \epsilon_{j,t}^{MP}}}{\underbrace{\sum_{\tau=0}^{h} \Phi_{i,\tau} \Sigma^{PS} \Phi_{i,\tau}'}_{\text{FEV of indicator } i \text{ due to public statements}}}, \tag{15}$$

where i $(i = 1, 2)$ indicates the place of the unconventional monetary policy indicators (MB and COMP) in vector variable y_t, and j

$(j = i)$ indicates the place of the associated unconventional policy shocks ϵ_t^{QN}, ϵ_t^{QL}, and ϵ_t^{SR} in policy shock vector ϵ_t^{MP}. ι_{1i} and ι_{2j} are the $K \times 1$ and 3×1 selection vectors, with ones in the ith place and jth place and zeros elsewhere, and d_j is the 3×1 orthonormal vector indicating the jth column of the orthonormal matrix D. The selection vectors outside of the parentheses in both the numerator and denominator ι_{1i} pick out the ith row of the matrix of the moving average coefficients, which is denoted by $\Phi_{i,\tau}$.

Variance decomposition (15) models the extent to which the changes in expectations about the h-step-ahead path of unconventional policy indicator i at the time of the BOJ's public statement (represented by the denominator) are attributed to the associated unconventional policy shock j, denoted by $\epsilon_{j,t}^{MP}$ (where the contributed component of j is represented by the numerator). The MFEV approach to identify unconventional monetary policy shocks (i.e., quantitative and qualitative policy shocks) maximizes the variance decomposition by mapping unconventional policy indicator i to the associated unconventional policy shock j. This identification is based on the legitimate assumption that when the central bank announces its plans of action on two unconventional policy instruments—the change in the size of its balance sheet (MB) and the purchase of more or less unconventional assets (COMP)—agents will hear the announcement and update their expectations about the paths of the policy instruments accordingly. In other words, as long as the central bank keeps the its promises (at least for operations on the size of its balance sheet and the composition of its assets) and secures the agents' trust in the central bank's announcement, the identification of the associated two unconventional policy shocks based on the MFEV approach allows us to reveal the actual movements in the two balance sheet instruments after the unconventional policy shocks arrive.

Also note that unlike an existing identification scheme such as a recursive restriction or a sign restriction, the MFEV approach makes no assumption on how the size and composition of the central bank's balance sheet will respond after the bank makes a policy decision. This approach only assumes that agents revise their expectations of the path of a policy indicator according to the scheduling actions that the central bank announces with regard to the indicator. In this sense, the MFEV approach is more agnostic and flexible than the existing identification approach in identifying a particular type of policy shock relating to monetary policy indicators. Given the specific movements of the quantitative and qualitative policy measures following policy changes (see Subsection 2.2), this approach allows us to prevent misspecification of the quantitative and qualitative monetary policy shocks.

To identify the quantitative, qualitative, and short-term policy rate shocks with the MFEV approach, we begin by identifying the quantitative monetary policy shock, ϵ_t^{QN}, satisfying the following conditions:

$$\hat{d}_1 = \arg\max_{d_1} \ \Omega_1^1(h), \tag{16}$$

s.t.

$$d_1^{'} d_1 = 1. \tag{17}$$

Constraint (17) (d_1 have unit length) ensures that d_1 is the first column vector belonging to orthonormal matrix D. After obtaining $\hat{d}_1$ by solving the above maximization problem, we calculate the impulse responses of the VAR variables to the quantitative monetary policy shocks using the estimated impact vector $\tilde{R}^{MP}\hat{d}_1$.

Next, we identify the qualitative and conventional monetary policy shocks. Specifically, we identify the qualitative monetary shocks ϵ_t^{QL} by solving the following maximization problem:

$$\hat{d}_2 = \arg\max_{d_2} \Omega_2^2(h), \tag{18}$$

s.t.

$$d_2^{'} d_2 = 1, \tag{19}$$

$$d_2^{'} d_1 = 0, \tag{20}$$

$$d_1 = \hat{d}_1. \tag{21}$$

Constraints (19) and (20) ensure that d_2 is the second column vector belonging to orthonormal matrix D. Constraint (21) ensures that the qualitative shock is extracted after the quantitative shock. This implies that, in a qualitative shock with a target level for the monetary base given, the central bank aims to change the composition of its assets through, for example, an operation twist.[23] We can compute the impulse responses to the qualitative monetary policy shocks using the estimated impact vector $\tilde{R}^{MP}\hat{d}_2$.

Once two column vectors in the 3×3 orthonormal matrix D are given as its first and second column vectors $\hat{d}_1$ and $\hat{d}_2$, the third column vector d_3 is automatically determined. In the identification of the conventional short-term policy rate shock ϵ_t^{SR}, the third column in the impact matrix R^{MP} representing the impulse responses to the conventional policy rate shock is obtained as $\tilde{R}^{MP}\hat{d}_3$. The column vector is orthogonal to the first and second columns obtained through the above maximization problems, hence the surprise component of the monetary policy explains the small variation in the monetary base and unconventional assets ratio in the middle- and long-term period. In this sense, our identification strategy assumes that the central bank controls the short-term policy rate after it determined a plan of balance sheet extension and unconventional asset purchases. Section 5 demonstrated that even when we employ the alternative identification strategy in which a policy rate setting is assumed to precede a balance sheet setting, the estimated quantitative and qualitative policy effects do not depend on those identification strategies.

4. Results for Quantitative and Qualitative Monetary Policy Shocks

In this section we discuss the empirical results obtained using the monetary policy shocks identified by the method presented in the previous section. We focus on two unconventional monetary policy shocks, that is, quantitative and qualitative monetary policy shocks, in particular. In the VAR model, we include the monetary base (MB), unconventional assets ratio (COMP) as a percentage of total

[23]In the quantitative and qualitative monetary easing from March 2013, the BOJ targets a yearly expansion of the monetary base by 60 to 70 trillion yen (80 trillion yen from October 2014). To meet this monetary base target, the BOJ purchases exchange trade funds, commercial papers, and long-term government bonds. Given the fact that the BOJ sets the target level for the monetary base first, the recursive restriction for the quantitative and qualitative shocks is plausible.

assets, and short-term policy rate (SR) in basis points. For illustrative purposes, we multiply the logarithm of the monetary base by 1,200. Additionally, we include five macroeconomic variables in constructing the VAR: two asset market prices, two real economic variables, and one price indicator. The two asset market prices are the logarithm of the stock price index (SP) multiplied by 100 and the 10-year government bond yield (10YJGB) in basis points. The two real economic variables are the GDP gap (GGAP) in percentage points and the difference between the risky assets and safe assets held by commercial banks (BRISK) in trillion yen.[24] The risky asset holdings of commercial banks consist of equity holdings and bank lending, while the safe assets consist of JGBs. The consumer price index (CPI) is included as the price indicator. We also take the logarithm of CPI and multiply it by 1,200. See Appendix A for more detailed information on those variables in the VAR. As discussed in Section 2, our sample period is from April 1998 to January 2016. The number of lags in the VAR is determined to be two based on the Schwarz-Bayesian information criterion.

4.1 VAR Innovations and Monetary Policy Surprises

In what follows, we report the statistical relevance between the reduced-form VAR innovations and monetary policy surprises. Table 3 shows the estimation results for the system regression of the reduced-form VAR innovations on the three monetary policy surprises as expressed in (10).

The monetary policy surprises significantly explain only the reduced-form VAR innovations of the short-term policy rate (SR) and the asset prices (SP and 10YJGB), which tells us that the three asset price variables quickly respond to exogenous policy changes. On the contrary, the monetary policy surprises explain little of the unconventional policy indicators (MB and COMP), real economic variables (GGAP and BRISK), or price indicator (CPI) when the shock arrives. We know, therefore, that these latter variables show no immediate responses to the monetary policy shocks. In particular, the significant explanatory power of the short-term policy rate and

[24] We also use the unemployment rate, shipment of investment goods, and industrial production index in place of the GDP gap, but the results provided by these alternatives do not differ from the results reported below.

Table 3. Results for the Regression of Each VAR Innovation on Monetary Policy Surprises

	VAR Innovation: u_t							
	MB	**COMP**	**SR**	**SP**	**10YJGB**	**BRISK**	**GGAP**	**CPI**
PS^1	–2.68†	–0.19	–0.95**	0.03	–4.79**	–0.05	–0.01	0.04
	(1.62)	(0.22)	(0.35)	(0.49)	(1.71)	(0.27)	(0.01)	(0.19)
PS^2	–1.34	–0.27	0.96*	–3.85**	–0.93	–0.47	0.01	0.16
	(2.20)	(0.29)	(0.38)	(0.82)	(1.40)	(0.43)	(0.02)	(0.21)
PS^3	–1.02	–0.37	1.50*	2.16**	0.47	0.40	0.02	0.18
	(3.88)	(0.48)	(0.75)	(0.83)	(2.56)	(0.64)	(0.02)	(0.30)
χ^2	3.38	1.69	11.54	29.87	10.98	1.96	3.09	1.03
	[0.34]	[0.64]	[0.01]	[0.00]	[0.01]	[0.58]	[0.38]	[0.79]

Note: The regression model is specified as Equation (10). Values in parentheses are robust standard errors. **, *, and † indicate significance at the 1, 5, and 10 percent levels, respectively. χ^2 indicates chi-square statistics (p-values in brackets) resulting from tests of the null hypothesis that estimated coefficients on the three monetary policy surprises, PS^1, PS^2, and PS^3, are jointly zero for each VAR innovation u_t.

the weaker explanatory power of the quantitative and qualitative policy indicators are consistent with the results of the distributed lag regression (4) (see Subsection 2.2).

From these estimation results, we can interpret the three principal components in line with previous studies that extracted a principal component (Gürkaynak, Sack, and Swanson 2005a and Swanson 2017) or emphasized the informational effect of monetary policy (Campbell et al. 2012, Jarociński and Karadi 2020, and Andrade and Ferroni 2021). For example, PS^1 summarizes the policy surprises that involve the effect of monetary policy on the yield curve, like the longer-term policy factor of Gürkaynak, Sack, and Swanson (2005) and Swanson (2017) and the Odyssean forward guidance of Campbell et al. (2012) and Andrade and Ferroni (2021), which publicly commit the central bank to a long-term future action. On the other hand, PS^2 summarizes the policy surprises embodying the conventional effect that causes a negative association between the short-term policy rate and the stock price index, as discussed in Jarociński and Karadi (2020). By contrast, PS^3 indicates the policy surprises that involve the positive correlation between the short-term policy rate and the stock price index, like the informational shock of Jarociński and Karadi (2020) and the Delphic

Table 4. Forecast Error Variance Decomposition of Monetary Policy Indicators

Policy Indicator →	Monetary Base			Composition			Short-Term Rate		
Policy Shock →	***QN***	***QL***	***SR***	***QN***	***QL***	***SR***	***QN***	***QL***	***SR***
$h = 0$	0.83	0.17	99.00	9.60	16.34	74.06	36.22	53.29	10.49
$h = 12$	88.03	1.87	10.10	11.01	81.54	7.45	63.54	16.08	20.38
$h = 24$	94.68	2.97	2.36	28.87	65.36	5.77	54.64	27.88	17.47
$h = 36$	97.20	1.67	1.13	40.16	54.83	5.01	53.00	30.00	17.00
$h = 48$	97.70	1.66	0.64	48.06	47.67	4.27	51.97	31.36	16.67

Note: This table shows the estimated percentage share of the forecast error variance of each monetary policy indicator attributable to each monetary policy shock for h months ahead.

forward guidance of Campbell et al. (2012) and Andrade and Ferroni (2021), which presage near-future economic performance and likely subsequent policy actions.

4.2 Variance Decomposition Analysis

Table 4 presents the variance decomposition of the three monetary policy indicators attributable to each of the monetary policy shocks for $h = 0$, 12, 24, 36, and 48 months ahead, which is computed using Equation (15) for the MFEV approach.

While most of the variance of the monetary base (MB) and unconventional assets ratio (COMP) at $h = 0$ is attributable to the conventional policy rate shock, the table clearly shows that most of the variance of the two unconventional policy indicators at $h \geq 12$ is explained by their corresponding monetary policy shocks. More concretely, at $h \geq 12$ the quantitative shock explains almost all of the variance of the monetary base and the qualitative explains almost all of the variance of the unconventional assets ratio, while at $h \geq 36$ the two types of shock explain the variance of the unconventional assets ratio equally. This implies that the extension of the BOJ's balance sheet is realized slowly and gradually and that its medium- and long-term purchasing of unconventional assets is determined in accordance with the balance sheet extension.

The quantitative and qualitative monetary policy shocks appear to explain most of the variance of the short-term policy rate (SR).

The variance of the policy rate at $h = 0$ is almost fully attributable to the qualitative policy shock, but most of the variance at $h \geq 12$ is accounted for by the quantitative policy shock. Our finding that the short-term policy rate shock accounts for much rather than little of the variance is consistent with the identifying assumption that the central bank's planning balance sheet operations dictates its control of the short-term policy rate. In Subsection 5.1, we will discuss a case in which the central bank's policy rate control comes before the balance sheet size and composition are controlled.

4.3 Impulse Response Analysis

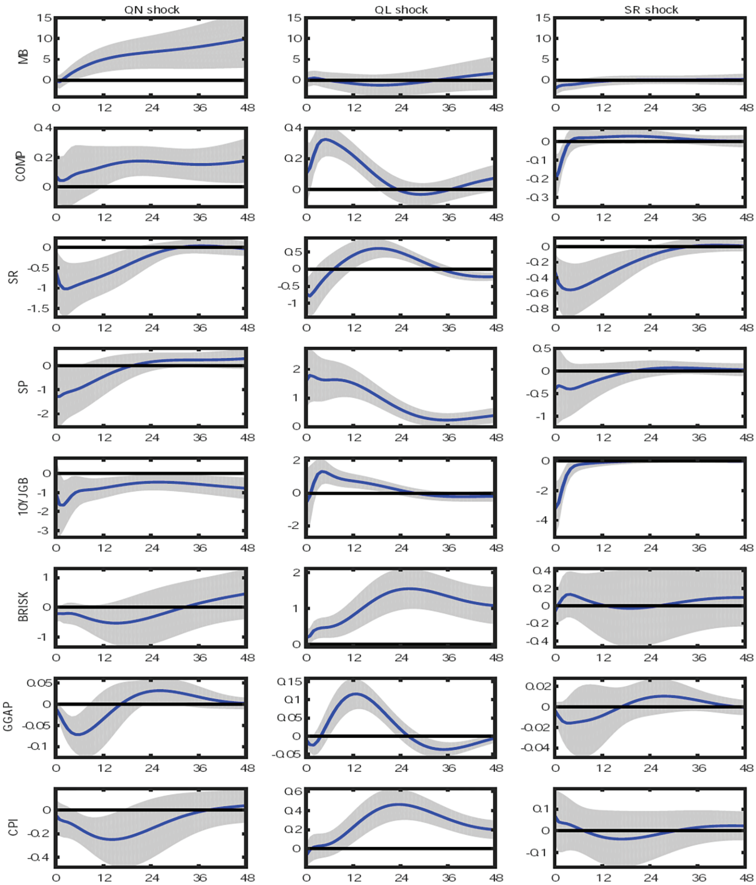
In this subsection we describe the estimated impulse responses to the exogenous monetary policy shocks. Figure 2 outlines the estimated impulse responses to the quantitative policy shock, the qualitative policy shock, and the short-term policy rate shock.[25]

4.3.1 Effects of Quantitative Shocks

As the left column of Figure 2 shows, the quantitative easing shock leads to a gradual and continuous increase in the monetary base (MB) without affecting it immediately. The monetary base reaches a peak at around one year following the quantitative easing shock. We can thus identify the quantitative shock as an anticipated shock linked to the expansion of the balance sheet (i.e., agents expect the monetary base to reach its target level soon after the BOJ announces its new target). The quantitative easing shock also leads to a slow increase in the unconventional assets ratio (COMP), which

[25] We employ a parametric bootstrap to compute the confidence intervals in the following; we randomly replace the pair of the three common factors and the VAR residuals, and then generate a bootstrap sample of each macroeconomic variable by substituting the resampled VAR residuals into the estimated VAR model. After obtaining VAR residuals by reestimating the VAR model with the bootstrap sample of macroeconomic variables, we use the reestimated VAR residuals and the resampled common factors to calculate impulse responses to the monetary policy shocks through Equations (10)–(21). We repeat this procedure 1,000 times to compute one standard error confidence band. Following Jentsch and Lunsford (2016), we also use the moving-block resampling to compute confidence intervals for robustness check. Confidence intervals based on the moving-block resampling with the block length of 12 is not so different from those based on our simple bootstrap resampling with the block length of 1.

Figure 2. Impulse Responses to the Quantitative Easing, Qualitative Easing, and Short Rate Shocks



Note: See Section 3 for details on the identification of each of the monetary policy shocks. The solid lines represent the point estimates of the impulse responses to a monetary policy shock in the eight-variable VAR model. The shaded areas represent the ± one-standard-error confidence band calculated by the bootstrap method with 1,000 replications. The bootstrap with external instruments involves resampling from the instruments. The impulse response functions (IRFs) of the short-term policy rate (SR) and the 10-year yield (10YJGB) are reported in basis points, while the IRFs of commercial bank holdings of risky assets (BRISK) are reported in trillion yen. The IRFs of the other variables are reported in percentage points.

clearly shows that the BOJ tends to increase its unconventional assets more than its conventional assets when expanding its balance sheet.

In estimating the responses of the nominal interest rates, we find that the short-term policy rate (SR) and long-term nominal interest rate (10YJGB) both fall immediately, but that the latter falls more. The immediate response of the long-term interest rate implies that a quantitative easing shock has a policy duration effect that decreases long-term interest rates immediately by working as a signal about the future path of policy rates.

The quantitative easing shock confers no favorable effects on the stock price (SP) or the commercial bank holdings of risky assets (BRISK), so both of the variables decline. We can infer, from the estimation results, that the quantitative easing shock was in no way effective in bringing about a portfolio rebalance where financial institutions with safer assets could be expected to lend more and increase the purchase of relatively risky assets, including stocks. Rather, the quantitative easing shock appeared to merely result in a tight supply/demand balance in the long-term Japanese government bond market or to change the market's expectations on the duration of the zero interest rate policy (Okina and Shiratsuka 2004 and Ugai 2007).

Consistent with this inference, the quantitative easing shock brought about less than favorable effects on the GDP gap (GGAP) and price indicator (CPI), as well.[26] Given that this shock significantly decreases the long-term nominal interest rate and generates a flattening yield curve, we can infer that the interest rate channel through the decrease in the long-term nominal interest rate in response to quantitative easing fails to bring about the intended effects under Japan's unconventional monetary policy regime.

4.3.2 Effects of Qualitative Shocks

As we see in the middle column of Figure 2, the qualitative easing shock has a significant effect on the unconventional assets ratio (COMP) without imparting a contemporaneous impact. More concretely, the unconventional assets ratio peaks almost six months later. On the contrary, the monetary base (MB) shows no significant response to the qualitative easing shock.

[26] Hayashi and Koeda (2019) found that exiting from the quantitative easing policy is expansionary if the actual-to-required reserve ratio is not unduly large.

In contrast to the quantitative easing shock, the qualitative easing shock leads to a substantive increase in the stock price (SP), an increase in the long-term nominal interest rate (10YJGB), and a persistent increase in the commercial bank holdings of risky assets (BRISK). Unlike the effects we find when the BOJ expands its balance sheet, the larger purchases of unconventional assets under the qualitative easing policy increase the stock price and generated a steepening yield curve. Qualitative easing also prompts financial institutions to increase the purchase of unconventional assets and lend more in portfolio rebalancing.

For the estimated responses of the other real economic variables, the GDP gap (GGAP) and price indicator (CPI) both increase significantly.

4.3.3 Policy Rate Shock Effects under Planning the Balance Sheet Structure

As the right column of Figure 2 shows, a short-term policy rate shock that significantly decreases the policy rate leads not to a change in the monetary base (MB), but to an immediate decrease in the unconventional assets ratio (COMP). This effect tells us, as discussed in Section 3, that our identification scheme assumes that the BOJ determines its evolution of balance sheet structure before an actual change in the short-term policy rate. Once the BOJ decides to decrease (increase) the policy rate, however, the central bank implements the policy rate control temporarily by purchasing (selling) conventional assets and selling (purchasing) unconventional assets and by increasing the prices of conventional (unconventional) assets, with the balance sheet size unchanged.

In such identification of the short-term policy rate shock, the long-term nominal interest rate (10YJGB) immediately and substantially falls and the yield curve temporarily flattens. By contrast, the stock price (SP), the commercial bank holdings of risky assets (BRISK), the GDP gap (GGAP), and the price indicator (CPI) do not significantly respond to the short-term policy rate shock when the balance sheet is of a given size. These neutral effects of the policy rate shock on the stock price and real economy differ from those demonstrated in the VAR literature for conventional monetary policy effects.[27] This difference suggests that if the central bank keeps the size of its balance sheet unchanged in controlling the short-term policy rate (as seen in the normalization of the U.S. monetary policy since December 2015), the stock price and real economy could be neutral to the policy rate change.

In Section 5, we extend our impulse response analysis by conducting a robustness check based on the alternative identification scheme in which the central bank sets its policy rate before it sets its balance sheet structure.

5. Unconventional Monetary Policy Effects and Robustness

In this section we conduct a robustness check based on an alternative identification strategy in which the central bank is assumed to control the short-term policy rate before it plans its balance sheet structure. We also explore several implications of the unconventional monetary policy effects on the macroeconomy by focusing on comparisons with the existing VAR studies and hypotheses to be further investigated on the topic of unconventional policy effects.

5.1 Alternative Identification and Robustness

To conduct a robustness check based on the alternative identification strategy, we introduce two additional identifying constraints besides constraints (16) to (21):

$$\tilde{r}_{31} d_{1,1} + \tilde{r}_{32} d_{2,1} + \tilde{r}_{33} d_{3,1} = 0, \tag{22}$$

and

$$\tilde{r}_{31} d_{1,2} + \tilde{r}_{32} d_{2,2} + \tilde{r}_{33} d_{3,2} = 0, \tag{23}$$

where $\tilde{r}_{31}$, $\tilde{r}_{32}$, and $\tilde{r}_{33}$ indicate the element of the third-row vector of $\tilde{R}^{MP}$ related to the policy rate response to monetary policy shocks.

[27] See, e.g., Bernanke and Blinder (1992), Christiano, Eichenbaum, and Evans (1996), and Bernanke and Mihov (1998) for details on the U.S. conventional monetary policy. See, e.g., Miyao (2000, 2002), Nakashima (2006), and Shibamoto (2016) for details on the Japanese conventional monetary policy.

The two constraints ensure that the central bank controls its policy rate before it controls its evolution of balance sheet. Put differently, the quantitative and qualitative monetary policy shocks have no immediate impacts on the short-term policy rate.[28] Figure 3 reports estimated impulse responses to the quantitative, qualitative, and short-term policy rate shocks based on this alternative identifying scheme.

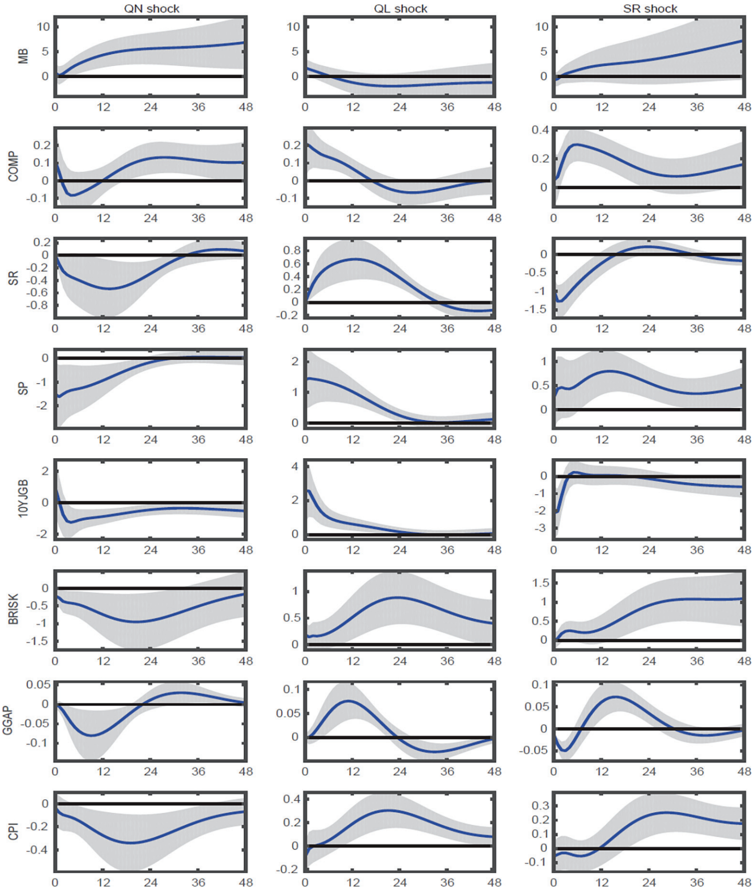
The left and middle columns of Figure 3 clearly show that although the quantitative and qualitative easing shocks reflect no instantaneous response of the short-term policy rate in accordance with the predetermined policy rate assumption, the unconventional policy easing shocks generate the same patterns of impulse responses as those based on the predetermined balance sheet assumption (see Subsection 4.3). In this sense, our unconventional policy effects are robust irrespective of those different identifying schemes.

Unlike the policy rate shock under planning balance sheet operations, under the assumption that the BOJ sets policy rate before determining the balance sheet size and composition, the policy rate shock basically produces impulse responses similar to those demonstrated in the VAR literature for conventional monetary policy effects (see the right column of Figure 3). In this sense, the policy rate control that comes before the balance sheet setting can be seen as the conventional monetary policy even in an extremely low interest regime, while the policy rate control subject to the long-term balance sheet control can be seen as an unconventional policy option in the central bank's balance sheet operations.

This contrast between the two types of short-term policy rate shocks can also be observed in their different results for the variance decomposition of the three monetary policy indicators. Table 5 reports results for the variance decomposition attributable to the associated monetary policy shocks. Compared with the policy rate control subject to the balance sheet control (see Subsection 4.2),

[28] More precisely, once the policy rate shock is determined before the quantitative and qualitative policy shocks under identifying restrictions (22) and (23) and the quantitative shock is determined before the qualitative shock by solving maximization problem (16) and obtaining $\hat{d}_1$, the qualitative shock is automatically determined without solving maximization problem (21). As far as this identification strategy in maintained, however, such automatic determination of the qualitative shock is formally equivalent to solving maximization problem (21).

Figure 3. Impulse Responses to the Monetary Policy Shocks under Alternative Identification



Note: Subsection 5.1 discusses the details of identification of the monetary policy shocks. Also see the note to Figure 2.

the assumption that the BOJ sets the policy rate prior to setting other policy tools generates the estimation result showing substantive increases in the contribution of the short-term policy rate shock to the variance of each of the policy indicators.

In this type of identification of the policy rate shock, Figure 3 shows that the policy easing that immediately decreases the

Table 5. Forecast Error Variance Decomposition of Monetary Policy Indicators under Alternative Identification

Policy Indicator →	**Monetary Base**			**Composition**			**Short-Term Rate**		
Policy Shock →	***QN***	***QL***	***SR***	***QN***	***QL***	***SR***	***QN***	***QL***	***SR***
$h = 0$	0.25	98.63	1.11	47.54	21.78	30.68	0	0	100
$h = 12$	57.76	5.39	36.85	34.51	18.63	46.86	42.84	3.68	53.48
$h = 24$	66.76	1.66	31.58	39.33	14.76	45.94	56.87	3.80	39.34
$h = 36$	71.36	1.18	27.46	50.64	11.52	37.84	53.81	9.51	36.68
$h = 48$	74.15	1.22	24.63	56.19	10.17	33.65	46.12	18.85	35.04

Note: This table shows the estimated percentage share of the forecast error variance of each monetary policy indicator attributable to each monetary policy shock for h months ahead.

short-term policy rate (SR) leads to an increase in both the monetary base (MB) and unconventional assets ratio (COMP). The estimated impulse responses of the stock price (SP) remain less than significant for about one year after the policy rate shock, then increase steadily from the end of the first year to the end of the third year. The long-term nominal interest rate (10YJGB) immediately decreases and the long-short spread narrows, responding to the policy rate shock. From the positive responses of the commercial bank holdings of risky assets (BRISK), we can infer that the policy easing shock causes a portfolio rebalance. The policy rate shock leads to increases in both the GDP gap (GGAP) and price indicator (CPI), though the former initially decreases in the first few periods. The GDP gap peaks after the price indicator begins to increase, at about the one-year point after the policy rate shock.

5.2 Comparison with Unanticipated Policy Shocks

As discussed in the Introduction, a number of previous studies have assumed that monetary aggregates such as the monetary base and excess reserves represent the central bank's policy stance. These studies have thus employed the standard recursive VAR approach or extensions of that approach, such as regime-switching or time-varying parameter VAR models. Another VAR approach employed in previous studies assumes that unconventional monetary policy shocks can be represented collectively as a single unobservable policy shock. This other VAR approach, therefore, imposes sign restrictions on the instantaneous responses of macroeconomic variables to a single policy shock or imposes heterogeneous variance restrictions on the intensity of structural shocks, including single policy shocks.

Regardless of the difference in identification strategy, the exogenous components of the unconventional monetary policy identified in the previous studies are characterized as "unanticipated" unconventional monetary policy shocks. We describe such a shock as "unanticipated" because, in contrast to an "anticipated" policy shock, it provides no prior insight into the current and future paths of the monetary base and unconventional assets ratio. In addition, none of those previous studies took our approach of using the composition of the central bank's assets as an unconventional monetary policy indicator. In this subsection we compare the macroeconomic effects of our anticipated unconventional policy shocks (reported in Subsection 4.3) with the effects of our unanticipated unconventional policy shocks. For the comparison, we adopt the standard recursive VAR approach based on the Cholesky decomposition to extract an unanticipated unconventional policy shock. We employ the recursive approach because the sign restrictions (Schenkelberg and Watzka 2013) and the heterogeneous variance restrictions (Shibamoto and Tachibana 2017) yield qualitatively the same impulse responses as the recursive ones when using the data from Japan.[29]

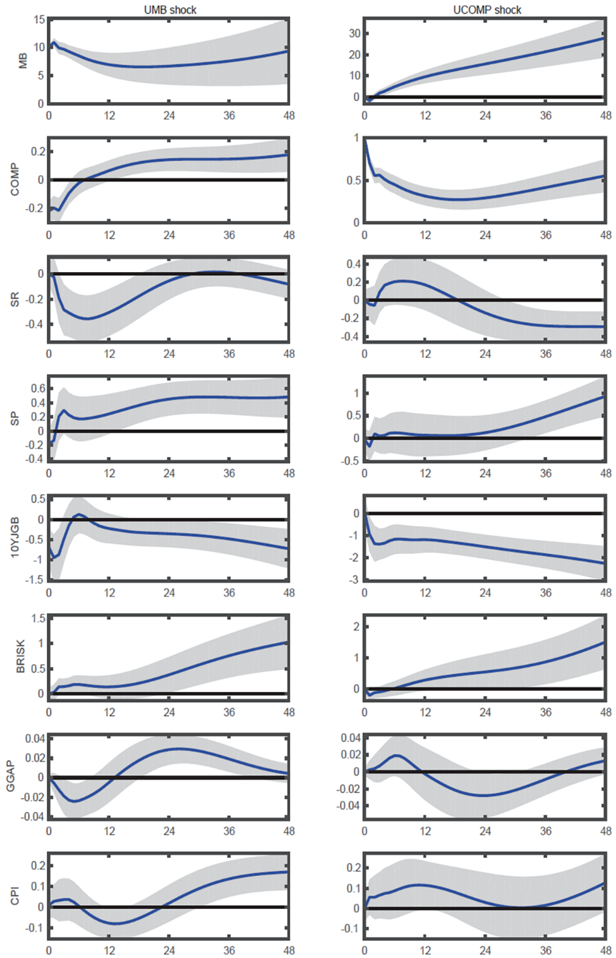
In doing so, we focus on four dimensions in particular: (i) effects on the monetary base, (ii) effects on the interest rate of long-term government bonds, (iii) effects on real economic activity, and (iv) the exogeneity of unconventional monetary policy shocks.

Figure 4 shows estimated impulse responses to the unanticipated monetary base shock (left column) and composition shocks (right column) obtained using the Cholesky decomposition in the eight-variable VAR system, respectively.[30] We find that the evaluation

[29]Schenkelberg and Watzka (2013) and Shibamoto and Tachibana (2017) focused on the BOJ's quantitative easing period from 2001 to 2006. We found, however, that the three alternative approaches yielded qualitatively the same impulse responses across sample periods.

[30]More specifically, in the eight-variable VAR system we order the variables in the conventional manner: output and prices (GGAP, CPI), policy indicators

Figure 4. Impulse Responses to Unanticipated Policy Shocks



Note: Subsection 5.2 discusses the details of identification of the unanticipated monetary policy shocks. Also see the note to Figure 2.

(MB, COMP, SR), and the four financial variables, including the stock price index (SP). For comparison with the anticipated monetary base and composition shocks (i.e., the quantitative and qualitative shocks defined in Section 3), the eight-variable VAR system imposes a recursive restriction for the three monetary policy indicators, in which three unanticipated monetary shocks are determined in the order of an unanticipated policy shock to the monetary base (MB), the of unconventional policy effects heavily depends on whether quantitative and qualitative easing shocks are identified as anticipated (Figure 2) or unanticipated shocks (Figure 4).

5.2.1 Effects on the Monetary Base

The difference in the dynamics of monetary aggregates conditioned on unconventional policy shocks is the most notable when comparing the anticipated and unanticipated shocks. Existing VAR studies identifying unconventional monetary policy shocks as unanticipated shocks have demonstrated a contemporaneous impact on monetary aggregates.[31] Indeed, as shown in the left column of Figure 4, the unanticipated monetary base shock leads to an immediate increase in the monetary base (MB), while the anticipated monetary base shock (i.e., our quantitative easing shock) leads to a gradual increase (see Figure 3).

Also note that, as emphasized in Subsection 3.3, we do not impose any restrictions other than the maximization of the forecast error of the current and future paths of the monetary base when identifying the anticipated monetary base shock by imposing restrictions (16) and (17). Hence, our strategy for identifying the anticipated monetary base shock lets the data speak more for unconventional policy effects on the monetary base, compared with our strategy for identifying the unanticipated monetary base shock. Given this point, the non-contemporaneous response and the gradual increase of the monetary base are the most distinguished features of the anticipated monetary base shock and reflect more of the actual

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unconventional assets ratio (COMP), and the short-term policy rate (SR) (see Section 3). We find that the impulse responses yielded by the short-term policy rate shock (related to the SR) identified in this recursive VAR system are substantially the same as the impulse responses shown in Figure 2. Hence, we do not report them here.

[31]Such a contemporaneous impact on monetary aggregates can be observed in Japanese VAR-based studies: e.g., Iwata and Wu (2006) for M1, and Honda, Kuroki, and Tachibana (2013), Schenkelberg and Watzka (2013), Kimura and Nakajima (2016), Miyao and Okimoto (2017), Shibamoto and Tachibana (2017), and Hayashi and Koeda (2018) for bank reserves. In one VAR-based study on the United Kingdom and United States, Weale and Wieladek (2016) showed a contemporaneous impact on asset purchases. Gambacorta, Hofmann, and Peersman (2014) showed a contemporaneous impact on the total assets of central banks in industrialized countries.

dynamics of the monetary base: the targeted monetary base level is achieved gradually after a policy change announcement, but not abruptly in the announcement.

We can observe the same tendency in the difference between the anticipated composition shock (i.e., our qualitative easing shock) and the unanticipated composition shock: the unanticipated composition shock has an contemporaneous impact on the unconventional assets ratio (COMP), as shown in Figure 4, while the anticipated composition shock does not, as shown in Figure 2.

5.2.2 Effects on Long-Term Government Bond Yields

Some VAR-based studies of the unconventional monetary policy, particularly in the United Kingdom and the United States, have emphasized the policy's causal effect on long-term bond yields (e.g., Kapetanios et al. 2012, Wright 2012, Baumeister and Benati 2013, and Weale and Wieladek 2016).[32] Their motivation stems from the assumption that unconventional policy interventions in the Treasury market would lower the long-term bond yields and then spur real economic activity. Under this assumption they identify an unanticipated policy shock, thereby demonstrating that a stimulative unconventional policy shock would lower the long-term bond yields and narrow the long-short spread of government bonds. Such results for an unanticipated policy shock in the United Kingdom and United States are observed for the anticipated monetary base shock (i.e., our qualitative policy shock) and the two unanticipated shocks in Japan, as shown in the impulse responses of the 10-year government bond yield (10YJGB) (see Figures 2 and 4), but not for the anticipated composition shock (i.e., our qualitative policy shock).

Note that while the two anticipated shocks, our quantitative and qualitative easing shocks, both have substantial impacts on the long-term government bond yield (10YJGB) and long-short spread of the long-term yield and short-term policy rate (SR), the dynamics are quite different: the quantitative easing shock has an immediate and

[32]To examine unconventional policy effects on the long-term bond yields, Wright (2012) employed the heterogeneous variance restriction approach, whereas Kapetanios et al. (2012) and Baumeister and Benati (2013) used the sign restriction approach. Weale and Wieladek (2016) employed four alternative approaches, including the recursive and sign restriction approaches.

persistent effect on the long-term government bond yield and causes a contraction of the long-short spread, while the qualitative easing shock has a slow and less persistent effect and generates a steepening yield curve. The unconventional policy effects on the yield curve depend on the policy tools, as well as the anticipated and unanticipated policy shocks.

5.2.3 Effects on Real Economic Activity

Our quantitative easing and qualitative easing shocks exert opposing effects on not only the long-term government bond yield but also real economic activity. While the quantitative easing shock has contractionary effects on output (GGAP), prices (CPI), and the risk appetite of banks (BRISK), the qualitative easing shock has expansionary effects (left and middle columns of Figure 2). These effects imply that a decrease in the long-term government bond yield stemming from the expansion of the monetary base cannot be presumed to be associated with a rise in real economic activity (Okina and Shiratsuka 2004 and Ugai 2007), and that unconventional policy effects on real economic activity are likely to be heavily dependent on the policy tools.[33]

Both the anticipated and unanticipated composition shocks have expansionary effects on output, prices, and the risk appetite of banks, though the magnitude and persistency of the effects differ between the two composition shocks (right columns of Figures 2 and 4). Regarding the quantitative policy tools, the anticipated monetary base shock has no such expansionary effects (left column of Figure 2), whereas the unanticipated base shock has expansionary effects about one year after the shock arrival (left column of Figure 4).[34]

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[33] Okina and Shiratsuka (2004) empirically demonstrated that although the BOJ's quantitative easing was effective in stabilizing market expectations about the future path of short-term interest rates, and thereby brought longer-term interest rates down, these effects were not transmitted to the whole economy in Japan. Ugai (2007) similarly pointed out that the BOJ's quantitative easing had only a limited effect on raising aggregate demand and prices, though it succeeded in lowering the yield curve.

[34] Previous VAR-based studies emphasizing the expansionary effects of the BOJ's quantitative easing policy focused on the quantitative easing from March

5.2.4 Exogeneity of Unconventional Monetary Policy Shocks

Why the unanticipated monetary base shock has expansionary effects remains an open question. To explore this question, we examine the associations among the unanticipated monetary policy shocks and global economic variables out of the eight-variable VAR. The linkages between the Japanese economy and global economy may endogenously determine the unanticipated changes in the policy indicators, including the monetary base. From this analytical viewpoint, we conduct the following system regression of the unanticipated monetary policy shocks on global economic factors:

$$UP_t = R_u^{GF} GF_t + e_t^u, \tag{24}$$

where UP_t denotes the vector variable composed of the unanticipated monetary policy shocks in month t obtained from the eight-variable recursive VAR, and GF_t denotes a vector variable composed of five global economic variables expected to have substantive effects on the Japanese economy: the oil price (OIL), global index of industrial production (GIP), U.S. economic policy uncertainty index (USEPU), U.S. TED spread (USTED), and federal funds rate (FFR). We use the log differences of the oil price and the economic policy uncertainty index, while we multiply the log difference of the global index of industrial production by 100 for illustrative purposes. For the two interest rates, we use their first differences.

In another exercise we examine whether our identified monetary policy shocks can be determined from the global economic variables using the following system regression:

2001 to March 2006 (e.g., Honda, Kuroki, and Tachibana 2013, Schenkelberg and Watzka 2013, Shibamoto and Tachibana 2017, and Hayashi and Koeda 2019). We also examined the impulse responses to the anticipated and unanticipated monetary base shocks obtained during the quantitative easing period from 2001 to 2006. While we found that the anticipated monetary base shock still yielded a gradual increase in the monetary base and exerted contractionary effects on real economic activity even in the quantitative easing period, the unanticipated monetary base shock and contemporaneous increase in the monetary base had expansionary effects, as demonstrated in the previous studies. We also found that both the anticipated and unanticipated composition shocks had expansionary effects in the qualitative easing period.

Table 6. Results for the Regression of Alternative Instruments on Global Economic Factors

	VAR Innovation			Monetary Policy Surprise		
	MB	**COMP**	**SR**	PS^1	PS^2	PS^3
Oil	16.46	–1.00	–0.50	0.40	–0.12	0.47
	(17.89)	(1.90)	(2.29)	(0.61)	(0.47)	(0.32)
GIP	–4.28*	0.13	0.34	–0.04	–0.07	0.07
	(2.34)	(0.20)	(0.31)	(0.08)	(0.06)	(0.05)
USEPU	11.28*	–1.32***	–0.14	0.14	0.09	–0.11
	(5.99)	(0.43)	(0.66)	(0.19)	(0.15)	(0.10)
USTED	–1.83	0.14	1.38	–0.39	0.59	0.19
	(4.73)	(0.54)	(1.41)	(0.30)	(0.41)	(0.13)
FFR	–8.66	–0.12	–0.62	–0.28	–0.25	0.14
	(5.53)	(0.57)	(0.84)	(0.21)	(0.22)	(0.09)
χ^2	8.04	9.87	4.35	3.52	4.30	9.28
	[0.15]	[0.08]	[0.50]	[0.62]	[0.51]	[0.10]

Note: This table shows the estimated coefficients in Equations (23) and (24). Values in parentheses are robust standard errors. *** and * indicate significance at the 1 and 10 percent levels, respectively. χ^2 indicates chi-square statistics (p-values in brackets) resulting from tests of the null hypothesis that the estimated coefficient on the global economic factors are jointly zero.

$$PS_t = R_p^{GF} GF_t + e_t^p, \tag{25}$$

where PS_t represents the three monetary policy surprises, that is, the basis of our qualitative, quantitative, and short-term policy rate shocks.

Table 6 reports the estimation results for the two system equations (24) and (25). As the left panel of Table 6 shows, the unanticipated policy rate shock is not associated with any of the global economic factors. The unanticipated monetary base shock (UMB), on the other hand, is negatively and positively associated with the global index of industrial production (GIP) and the U.S. economic policy uncertainty index (USEPU), respectively. This indicates that the unanticipated monetary base shock increases as an endogenous response to the deterioration in the global economic condition.

The unanticipated composition shock (UCOMP) is also significantly associated with the U.S. economic policy uncertainty index, though in contrast to the unanticipated monetary base shock, its correlation with the index is negative. We find, therefore, that the unanticipated composition shock endogenously increases in response to the improvement in the global economic condition.

In contrast, as the right panel of Table 6 shows, none of the monetary policy surprises are significantly associated with the global economic variables at the 5 percent level of significance. This estimation result ensures that our anticipated monetary policy shocks are exogenous to global economic shocks left out of the VAR system.

The above analysis suggests that the simple use of the unanticipated changes in the unconventional monetary policy indicators (i.e., the monetary base and unconventional assets ratio) can lead to biased estimates of the policy effects (see Gertler and Karadi 2015 for details on the U.S. conventional monetary policy effects). In particular, the unanticipated monetary base shock, which was mainly utilized by Japanese VAR-based studies to measure unconventional monetary policy effects, is negatively associated with the global economic condition, which is not controlled in the VAR model. Hence, unlike the anticipated monetary base shock, the unanticipated shock captures the global economic condition and accordingly cannot be considered a "pure" monetary policy shock. Given this negative association with the global and U.S. economic conditions, the favorable effects of the unanticipated monetary base shock presumably arise from the coordination of central banks around the world, along with the global spillover effects from that coordination, such as the provision liquidity to malfunctioning financial markets. This may be one reason why the unanticipated monetary base shock has expansionary effects on real economic activity.

5.3 Importance of Monetary Policy Surprises

In this subsection, we briefly discuss the importance of combining the monetary policy surprises with the MFEV approach in identifying the quantitative and qualitative policy shocks.[35] To examine

[35] Estimated impulse responses discussed in this subsection are available upon request.

the importance of using the monetary policy surprises, or the three principal components, as external instruments, we apply the MFEV approach directly to the variance-covariance matrix of the reduced-form VAR innovations u_t, but not to that of fitted values generated from system regression (10). Thus, we found that the resulting impulse responses show some implausible size of the effect and unreasonable moves of the monetary policy instruments, implying that the identification based on the VAR residuals would be contaminated by the endogeneity problem.[36]

5.4 Hypotheses about Unconventional Monetary Policy Effects

We have thus far found that our quantitative easing shocks, or the anticipated monetary base shocks, have no favorable effects on the real economy, although they do precipitate decreases in the long-term nominal interest rate, as expected by the BOJ. On the contrary, our qualitative easing shocks, or the anticipated composition shocks, cause favorable effects not only on the long-term interest rate but also on real economic activity. In this subsection we draw from these findings to propose three interrelated hypotheses about the unconventional policy effects, to explore in future research.

One hypothesis holds that the ineffectiveness of quantitative easing shocks can be explained by their effect in raising concern about the future fragility of the real economy. According to Romer and Romer (2000), Ellingsen and Söderstrom (2001), Campbell et al. (2012), Claus and Dungey (2012), Nakamura and Steinsson (2018), and Munakata, Oi, and Ueno (2019), monetary policy actions provide the public with signals of a central bank's information. If the quantitative easing by the BOJ worked as a signal presaging future decreases in output and inflation, this signal would suppress firm investment and wage growth.

The second hypothesis involves economic uncertainty and its effect in instilling caution in real economic activity. Bekaert, Hoerova, and Lo Duca (2013) used stock market option-based implied volatility data, or VIX data, to demonstrate that

[36]See also Kim (2017), Lakdawala (2019), and Kim, Laubach, and Wei (2020) for other recent approaches to identifying multiple policy shocks using external instruments in a VAR setting.

conventional policy easing through reductions in the short-term interest rate decreases economic uncertainty, which in turn leads to favorable effects on the real economy (see also Aastveit, Natvik, and Sola 2017 and Creal and Wu 2017).[37] If the quantitative easing shock elevates economic uncertainty while the qualitative easing shock contributes to its reduction, the difference in the estimated responses of the real economic variables to the two unconventional policy shocks can be explained along this line. Figure 5 reports estimated impulse responses of two uncertainty indices, Japan's monetary policy uncertainty index (JMPU) and the volatility index Japan (JVIX), to the quantitative and qualitative monetary policy shocks. As this figure clearly shows, the quantitative easing shock can be expected to increase both the uncertainty indices, while the qualitative easing shock can be expected to decrease them.[38]

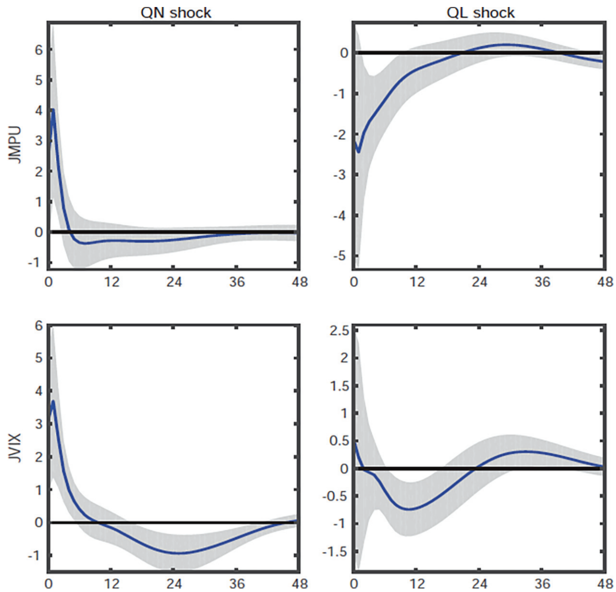
The third hypothesis is based on the growing risk of a government debt crisis comparable to an aggressive expansion of the central bank's balance sheet. Some theoretical studies have pointed out that such a sovereign debt crisis risk can lower not only the government bond yield but also the output (e.g., Kozlowski, Veldkamp, and Venkateswaran 2015), the rate of output growth (e.g., Kobayashi and Ueda 2018), and the price level (e.g., Saito 2020). Given that Japan's gross government debt exceeds 200 percent of the nominal GDP, this third hypothesis, which conjectures a loss of market confidence in government debt that forces the government to collect large tax revenues, seems to convincingly account for the contractionary effects of the quantitative easing.[39]

[37]Gürkaynak and Wright (2012) pointed out that the instability in investors' inflation expectations could stem from a lack of central bank credibility, a problem that might drive a wedge between actual and perceived inflation targets.

[38]We found that the short-term policy rate shock under planning balance sheet operations did not affect the two uncertainty indices, while the policy rate shock followed by the quantitative and qualitative policy shocks decreased them. This result is consistent with the findings reported in Subsections 4.3 and 5.1.

[39]Cúrdia and Woodford (2011) theoretically demonstrated that while quantitative easing is likely to be ineffective, qualitative easing due to the central bank's targeted asset purchases can be effective when financial markets are disrupted (see also Chen, Cúrdia, and Ferrero 2012). In terms of the risk-taking of Japanese commercial banks in lending, Nakashima, Shibamoto, and Takahashi (2020) empirically showed that the BOJ's qualitative easing stimulated bank risk-taking, while the quantitative easing did not.

Figure 5. Impulse Responses of Uncertainty Indicators



Note: The solid lines represent the point estimates of the impulse responses of the monetary policy uncertainty indicator (upper row) and VIX (lower row) in Japan. The impulse responses of the two uncertainty variables are obtained as their responses to the quantitative and qualitative easing shocks, by including each of the indicators into the eight-variable VAR model and employing the identification method developed in Section 3. Also see the note to Figure 2.

6. Conclusion

Previous VAR-based studies have evaluated the central bank's balance sheet operations in an unconventional monetary policy by assuming either that the central bank uses monetary aggregates such as the monetary base and excess reserves as unconventional monetary policy measures, or that the underlying unconventional monetary policy shocks can be captured collectively by a single monetary policy shock. Hence, the previous studies that make these assumptions neglect to distinguish between quantitative and qualitative monetary policy shocks, which prevents them from correctly disentangling the policy effects. In the present study we proposed a new method to separately identify the quantitative and qualitative monetary policy shocks, as well as the short-term policy rate shock, using the unconventional monetary policy the Bank of Japan has kept in place since 1999.

Rather than assuming how a policy indicator responds to an associated policy shock, our method for identifying shocks makes only one assumption, namely, that agents revise their expectations about the path of a policy indicator in accordance with the central bank's announcement of its scheduling action for the indicator. In this sense, our method is agnostic in identifying a particular type of policy shock relating to a monetary policy measure. By demonstrating that the quantitative and qualitative policy measures differ from the policy rate, with neither showing any immediate responses to the central bank's announcement, we have determined that the existing identification methods that cause unconventional policy measures to immediately respond are unsuited for identifying the associated policy shocks.

By defining the two unconventional policy shocks as anticipated shocks, we observe in a robust manner that the qualitative easing shock, which involves a gradual increase in the ratio of the BOJ's unconventional asset to its total assets, yields expansionary effects, whereas the quantitative easing shock, which involves a gradual increase in the size of the BOJ's balance sheet, does not. In future research we will explore why these two unconventional policy shocks yield such different policy effects along the lines suggested in this paper.

Appendix A. Variable Definitions

- Monetary base (MB): seasonally adjusted series, monthly average, retrieved from the Bank of Japan statistics.
- Composition ratio of the BOJ's unconventional assets to total assets (COMP): the BOJ's unconventional assets are defined as the sum of the BOJ's holdings of Japanese government bonds, commercial papers (from February 2009), corporate bonds (from March 2009), asset-backed securities (from July 2003 to September 2006), stocks held as trust property (from November 2002), index-linked exchange traded funds held as trust property (from December 2010), and Japan real estate

investment trusts held as trust property (from December 2010) (end of month), retrieved from the Bank of Japan statistics. The BOJ's total assets (end of month) retrieved from the Bank of Japan statistics.

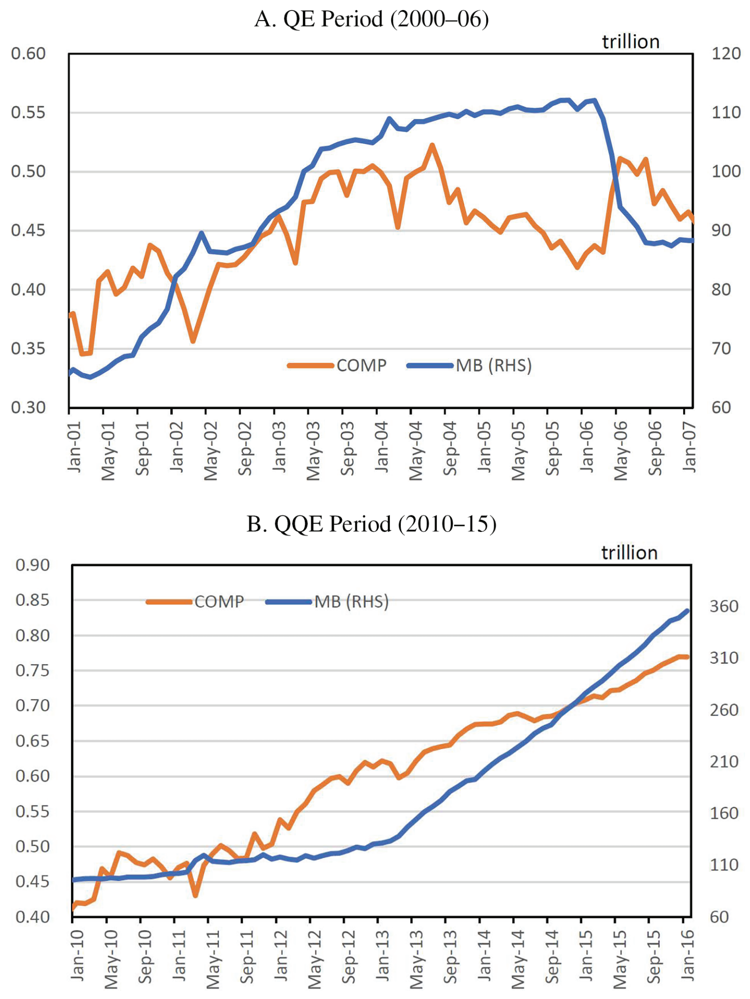
- Short-term policy rate (SR): uncollateralized overnight call rate, monthly average, retrieved from the Bank of Japan statistics.
- Stock price index (SP): Nikkei Stock Average (Nikkei225) index (end of month) retrieved from Nikkei NEEDS FinancialQuest.
- Long-term government bond yield (10YJGB): 10-year Japanese government bond yields (end of month) retrieved from Nikkei NEEDS FinancialQuest.
- Commercial bank holdings of risky assets (BRISK): difference between the risky assets and safe assets held by commercial banks. Risky assets are defined as the sum of the commercial bank holdings of bank loans, stocks, corporate bonds, and foreign securities (end of month) retrieved from the Bank of Japan statistics. Safe assets are defined as the commercial bank holdings of Japanese government bonds (end of month), retrieved from the Bank of Japan statistics. We obtain seasonally adjusted series using the Census X-12.
- GDP gap (GGAP): Quarterly GDP gap series retrieved from the Bank of Japan statistics and interpolated to obtain monthly observations.
- Consumer price index (CPI): consumer price index, excluding fresh foods (2015=100), consumption-tax-adjusted series for the period from April 1998 to December 2014, retrieved from the Ministry of Internal Affairs and Communications. We obtain seasonally adjusted series using the Census X-12.
- Oil price (OIL): Crude Oil Prices: West Texas Intermediate (WTI) (monthly average) retrieved from Federal Reserve Economic Data (FRED).
- Global index of industrial production (GIP): World Industrial Production, excluding construction (Import-Weighted, 2010=100), retrieved from Haver Analytics.
- U.S. economic policy uncertainty index (USEPU): A news-based policy uncertainty index retrieved from the following website: http://www.policyuncertainty.com/.

- U.S. TED spread (USTED): the spread between the three-month LIBOR based on U.S. dollars and three-month Treasury bill (monthly average) retrieved from FRED.
- Federal funds rate (FFR): effective federal funds rate (monthly average) retrieved from FRED, shadow federal funds rate series of Wu and Xia (2016) from January 2009 to November 2015, retrieved from Jing Cynthia Wu's website: https://sites.google.com/view/jingcynthiawu/shadow-rates.
- Japan's monetary policy uncertainty index (JMPU): Japan's Monetary Policy Uncertainty Index constructed by Arbatli et al. (2022), retrieved from the following website: http://www.policyuncertainty.com/.
- Japan's volatility index (JVIX): Volatility Index Japan, retrieved from the following website: http://www-mmds.sigmath.es.osaka-u.ac.jp/structure/activity/vxj.php? (monthly average).

Appendix B. Development of Monetary Base and Unconventional Asset Ratio

We plot the two policy instruments of the monetary base (MB) and the unconventional asset ratio (COMP), focusing on the two distinct periods: the first half of the 2000s for the QE and the 2010s for the QQE in Figure B.1. The monetary base and risky asset ratio have enough variation to allow us to identify two different shocks, although there are some periods when the two indicators share a trend. In fact, as the left-hand panel shows, when the first QE was implemented in the 2000s, the two indicators show a large variation. For example, when the BOJ started the QE, the risky asset ratio increased swiftly, but the monetary base increased gradually. On the other hand, when the BOJ exited the QE in 2006, the MB decreased while the COMP increased. This is partly because the reduction of the balance sheets was mainly conducted through the reduction of holdings of short-term government debts. From these examples, we can infer that the MB and COMP reflect different information about the monetary policy stance. In addition, in the 2010s, the MB and COMP show different changes depending on the

Figure B.1. Monetary Base and Risky Asset Ratio



Note: COMP indicates the ratio of the amount of unconventional assets to the BOJ's total assets. MB indicates the monetary base in trillion yen.

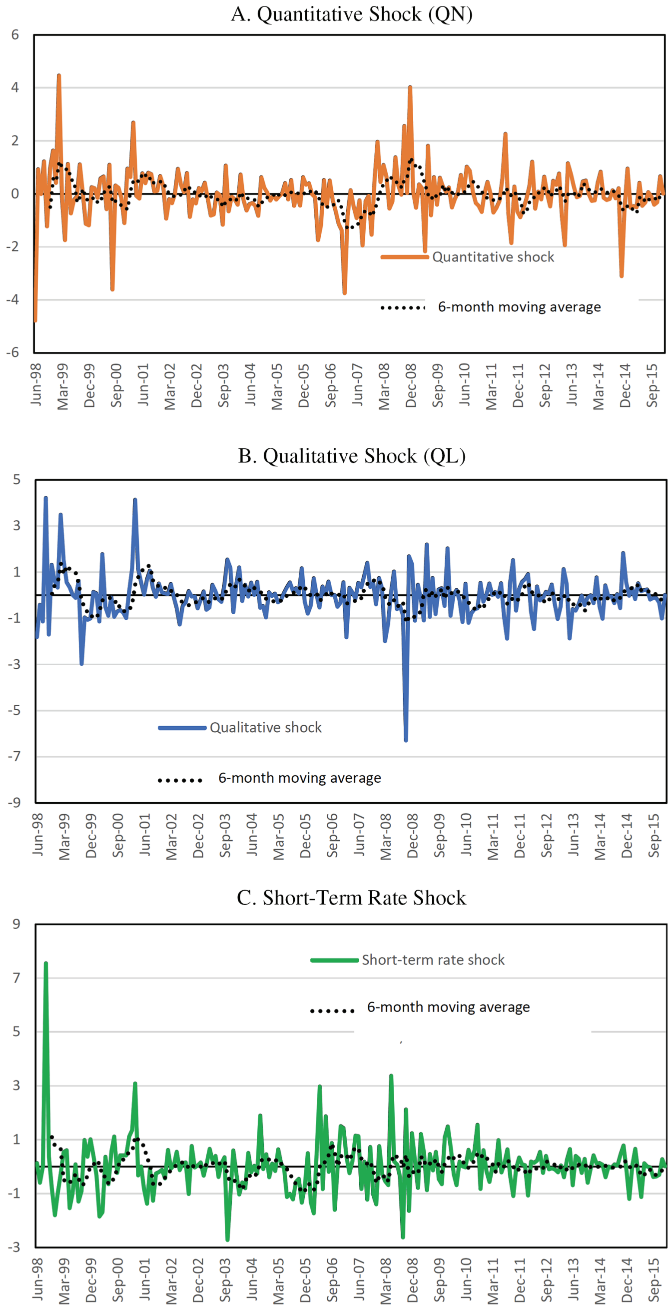
policy actions that the BOJ took. For example, before the introduction of the QQE in 2013, the COMP increased over time due to an increase in the purchase of long-term government bonds, ETFs, and real estate investment trusts. During this period, the MB only gradually increased. On the other hand, after 2015, both the MB and

COMP have increased almost monotonically. However, even after the introduction of the QQE, especially in 2014, the COMP had remained almost flat, while the MB continued to increase substantially. These observations clearly show that the COMP and MB do not always share a trend; rather, they show a wide variation depending on periods.

Appendix C. Estimated Monetary Policy Shocks

The estimated shocks are shown in Figure C.1. There are several observations worth mentioning. First, as Figure C.1 shows, the quantitative shock (QN) saw a significant negative value when the BOJ exited from the zero interest rate policy in August 2000. In addition, in March 2001, when the BOJ decided to implement the quantitative easing (QE), the QN shock reached its peak. The QN also captures the timing when the BOJ exited the QE and increased the policy rate in July 2006. After the GFC, the BOJ expanded its balance sheets immediately and continued the expansion of QE and QQE in the 2010s. In this period, the QN shocks stayed positive on average. As for the qualitative (QL) shock, there was a sharp hike in the QL shock in March 2001 when the BOJ started the QE. In the monetary policy meeting in March 2001, the BOJ also decided to increase the purchasing amount of long-term bonds, which we categorized as unconventional assets. Therefore, the QL shock tracks the change in asset composition successfully. In addition, in October 2008, the QL shock dropped and increased substantially in the next period. This swing reflects the aggressive monetary policy stance of the BOJ to address the turmoil in the GFC. In the meeting on October 14, 2010, the BOJ decided to increase especially the provision of short-term liquidity. This policy decreased the share of unconventional assets temporarily. However, in the later meetings, the BOJ decided to increase the purchasing amount of longer-term bonds, which is reflected in the hike in the QL shock. Moreover, in April 2013, when the BOJ announced the introduction of QQE, the QL shock increased substantially. In the meeting, the BOJ decided to increase the purchase of ETFs and other risky assets. Overall, the development of the estimated shocks indicates that our identification methodology works well.

Figure C.1. Estimated Monetary Policy Shocks



Note: The figure shows estimated monetary policy shocks using monetary policy surprises.

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