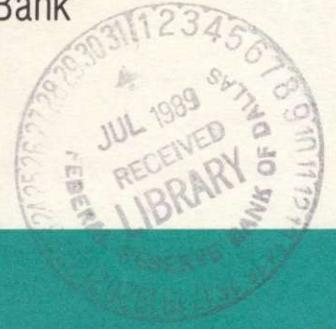


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In This Issue

The Yen to Save: Query . . .

Has Japan's postwar saving rate been consistently higher than the U.S. rate? No, argues Fumio Hayashi in "Is Japan's Saving Rate High?" (p. 3). He shows that the apparent gap between the two countries' saving rates is caused mainly by differences in their national income accounting. When Hayashi computes the saving rates on a comparable basis, they are seen to eventually converge: the Japanese rate falls from its peak in 1970 to the U.S. rate in the late 1970s and early 1980s. Hayashi conjectures that the Japanese saving behavior is consistent with what a standard neoclassical growth model predicts would happen after a large part of a country's capital stock is destroyed. That is, the Japanese compensated for the destruction of their capital stock in World War II by initially increasing their saving rate and then letting it taper off.

Since 1983, however, Japan's saving rate has started to rise again, diverging from the U.S. rate. Hayashi acknowledges that this divergence doesn't fit his conjecture, and he offers two competing explanations for it. The first says that the Japanese are saving more to offset capital losses due to the U.S. dollar's depreciation against the yen. The second says the divergence is due to differences in the two countries' budget deficit policies. If the first explanation is correct, the saving rates of the two countries will converge again; however, if the second is correct, the rates won't converge until their budget policies do.

. . . And Inquiry

How plausible is Fumio Hayashi's hypothesis (above) that reconstruction of the capital stock destroyed in World War II accounts for Japan's postwar saving rate behavior, as a neoclassical growth model would predict?

In the context of a standard model of this type, the hypothesis is implausible. Lawrence J. Christiano demonstrates in "Understanding Japan's Saving Rate: The Reconstruction Hypothesis" (p. 10). Christiano uses a standard neoclassical growth model with a very low capital stock to project the path of the Japanese saving rate since the war and compares that projection with the rate's actual path. The result shows that the hypothesis has two major problems. The standard model predicts that the Japanese saving rate would move to the steady-state saving rate (assumed to be the U.S. rate) much more quickly than it has. And the model predicts that the Japanese saving rate would peak immediately after the war rather than in 1970, as it did.

This does not settle the issue, however. Christiano goes on to argue that the standard version of the neoclassical growth model may not be the proper version with which to test this hypothesis: it may not capture some important features of an economy which has suffered capital stock destruction of the magnitude of that suffered by Japan. By exploring one possible modification of the standard model, he is able to get capital stock reconstruction to account reasonably well for the Japanese experience. Christiano cautions that without independent evidence (such as out-of-sample predictions and micro data estimates) his result does not mean that the reconstruction hypothesis is correct. Yet it does suggest that the hypothesis is not implausible after all.

The Sense of Expectations

More and more, debates about monetary and fiscal policy are conducted within the framework of economic models that assume people form their expectations rationally. This assumption, called the *rational expectations hypothesis*, says that when people make predictions, they efficiently use all the information they have at the time. Because the hypothesis is so widely used in current economic thinking and because it can dramatically alter a model's policy implications, economists have tried to test whether the hypothesis is supported by empirical evidence.

Many empirical tests of the rational expectations hypothesis have looked at people's predictions about prices, and most of these have rejected the hypothesis. This result is challenged by Michael P. Keane and David E. Runkle in "Are Economic Forecasts Rational?" (p. 26). They argue that earlier studies of the rationality of price forecasts have used incorrect data and have not allowed the errors of individual forecasters to be correlated. By correcting these faults, Keane and Runkle overturn the previous studies, finding instead that the rational expectations hypothesis is not rejected.

Warren E. Weber
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