The BOJ expands purchases and eases further

The Bank of Japan adds more monetary easing to the government's large Covid-19 fiscal stimulus package

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More monetary policy support

The Bank of Japan on Monday became the latest major central bank to take further easing actions to combat the fallout from the Covid-19 outbreak. The measures seek to address growing concerns over the macro and liquidity conditions in Japan, and include:

- Unlimited and more proactive purchases of Japanese government bonds (JGBs), scrapping the previously indicated annual purchase cap of 80 trillion yen (around $745 billion).
- Almost tripling the corporate bond/commercial paper (CP) purchase program to total 20 trn yen, from 7.4 trn yen previously; and
- Enhancing the 'Special Funds-Supplying Operations' to facilitate further smooth lending to small and medium-sized enterprises by financial institutions.

The latest measures follow the BOJ's decision back in March to lift the upper limit on purchases of stock ETFs to an annual 12 trn yen (from 6 trn yen); to increase the corporate bond/CP purchase program to a cumulative 7.4 trn yen (from 5.4 trn yen).

At the same time as it announced the expanded stimulus measures, the BOJ published its newest growth and inflation forecasts through fiscal 2023. It now expects deepening deflation in the current fiscal year ending in March 2021, with core consumer price inflation (CPI) hovering in the range of 0.4 per cent to 1 per cent even through fiscal 2022 - far below its official target of 2 per cent inflation.

Help to the real economy

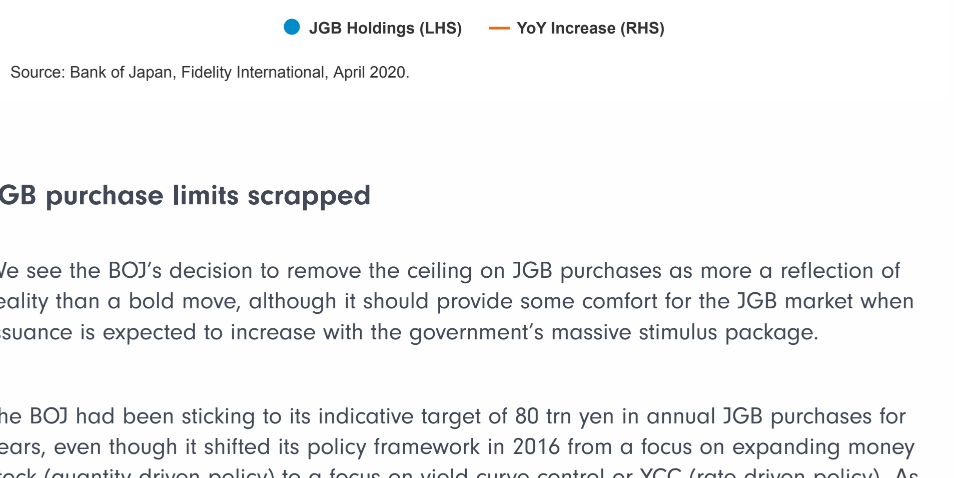
We believe that the top priority for the BOJ (and many other central banks) at the moment is to deliver support the real economy rather than be concerned with inflation targets. Many corporates and households are struggling with the sudden evaporation of demand or cash-flows as economic activities collapse in the wake of the Covid-19 outbreak. Providing sufficient liquidity is the BOJ's most important job, so in this regard, corporate bond/CP purchases as well as easing collateral eligibility for the Special Funds-Supplying Operations would both be of additional help to smooth financing . Specifically, the BOJ said it would expand the corporate bond/CP purchase program by 15 trn yen (allocating 7.5 trn yen for each of corporate bonds and commercial paper). It would ease the limits on the size of bonds/CP it can buy or hold, and also extend the outstanding maturity requirement of those bonds, to as much as 5 years from 3 years.

Easing the way for banks

In our view, enhancing the Special Funds-Supplying Operations will provide more incentive for the banking sector to utilize this scheme, as today's action would ease potential negative impacts on the banks if they provide further loans to corporates. With the 'three-tier system' of the BOJ's current account under its negative interest rate policy, banks are subject to a sliding scale of interest credits/charges as follows: Basic Balance (0.1 per cent positive rate), Macro Add-on Balance (0 per cent rate) and Policy Rate Balance (-0.1 per cent negative rate). As such, they have been making efforts to minimize the Policy Rate Balance to avoid negative rates.

Today's decision by the BOJ not only includes the expansion of eligible collateral to debt in general" (to total 23 trn yen from 8 trn yen), but, significantly, also applies a 0.1 per cent *positive* interest rate to the outstanding balances on the current accounts that banks hold at BOJ and that correspond to the amounts outstanding on loans provided via this scheme. In other words, Japanese financial institutions would not need to worry about facing negative interest rates (-0.1 per cent) even if they extend more loans that in turn come back to them as deposits, which would previously have led to further increases to the current account balance where banks could be charged the 0.1 per cent negative policy rates. This subtle but meaningful change would make the policy framework for commercial banks more consistent with the BOJ's emergency support policy objectives and will help support the healthier functioning of the financial system.

BOJ's JGB holdings and YoY increase



Source: Bank of Japan, Fidelity International, April 2020.

JGB purchase limits scrapped

We see the BOJ's decision to remove the ceiling on JGB purchases as more a reflection of reality than a bold move, although it should provide some comfort for the JGB market when issuance is expected to increase with the government's massive stimulus package.

The BOJ had been sticking to its indicative target of 80 trn yen in annual JGB purchases for years, even though it shifted its policy framework in 2016 from a focus on expanding money stock (quantity driven policy) to a focus on yield curve control or YCC (rate driven policy). As Chart 1 shows, the net increases in the BOJ's JGB holdings have come down meaningfully, to a recent pace of below 20 trn yen per year, but 80 trn yen was kept as an indicative target because the market might perceive its removal as a sign of policy tightening. However, the current crisis mode has turned expectations around, to the point that scrapping the target is regarded as a sign of further easing.

Adding up the monetary and fiscal measures

The latest monetary measures come on the back of a 108 trn yen fiscal package announced by the Japanese government earlier this month.

Those measures included increasing the cash handout to 100,000 yen per person without restrictions for income (this would require more than 12 trn yen in fiscal expenditure), up from an originally planned 300,000 per selected households (for around 4 trn in fiscal expenditure).

The Ministry of Finance planned to issue debt of 32.5 trn yen in its original budget for fiscal 2020. But the supplemental budgets and fiscal stimulus including the expanded cash handout would lead to an additional funding needs of 22 trn yen. Furthermore, we have to consider the potential decline in tax revenues as corporate earnings drop.

The BOJ mentioned in its statement that it would "conduct further active purchases of JGBs and T-Bills for the time being, with a view to maintaining stability in the bond market and stabilizing the ***entire*** yield curve at a low level" (our emphasis, not the BOJ's). We believe the BOJ's purchases will continue to support the demand-supply dynamics in the JGB markets even if government financing rises further.

While the central bank's current policy focus should and does prioritise the smooth functioning of the financial system, it also means the BOJ's involvement in various markets - including the JGB and stock markets - continues to deepen. It makes coming up with a future exit strategy an even more daunting task when we start to think of the post-coronavirus world.

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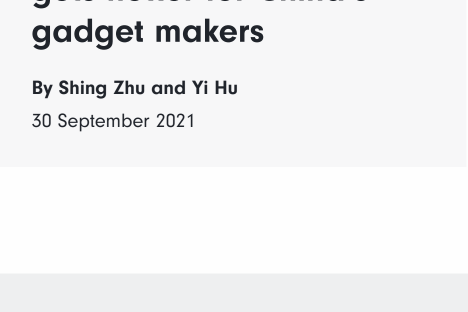

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