Discussion of potential policy decision at April MPM

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Introduction

The BOJ will hold the regular MPM on Apirl 27th. Press reports speculate the “unlimited” amount of JGB purchase, which has attracted attention in the domestic markets. This is not the only focus of discussion at April MPM, however.

Measures to support funding by the firms

The MPM may like to enhance measures to support corporate finance, while they already increased the size of purchase operations of corporate bonds and commercial paper at the previous meeting in March.

Their previous decision was effective in preventing stress in these markets, especially in comparison with its overseas peers. Nevertheless, we could observe another round of stress due to a different source of factors.

Previous round of stress was largely caused by the rapid spread of risk averse attitudes by investors. This was the reason why the BOJ’s role as “market maker of last resort” was required and effective.

Looking ahead, however, an emerging source of stress is the fundamental concerns about credit risks of potential borrowers. Because of such nature, stress would be concentrated to specific range of industries. Moreover, this kind of issue could last much longer than the issue of market functions.

While the enhancement of credit asset purchases at this juncture would be necessary and important, their role could become considerably different. The BOJ might need to take non-negligible magnitude of credit risks for a number of months.

In light of the above discussion, it would be appropriate to introduce a different set of purchase of corporate bonds and commercial paper in preparation for different treatment of potential losses including the introduction of a special loss reserves.

Readers may also like to note another caveat. Because of our financial system is bank-centric, larger part of funding by the large firms that are eligible to issue bonds and CPs would tap credit lines at the large banks.

Ironically, our banking system could absorb such liquidity needs from macro-perspectives, as their loan/deposit ratios have been extremely low. Nevertheless, their capacity to absorb potential credit costs should be enhanced in any case.

If the large banks would transfer such risks to the capital markets either through securitization of loans or persuading the borrowers to tap the markets, the BOJ’s enhanced operations of credit asset purchases could still be effective.

Otherwise, macro-prudential measures may be required to support financial intermediation by the banks. Readers would like to understand that the JSFA has the policy mandate in Japan, and they already encouraged the banks to manage the buffers of capital and liquidity flexibly.

Moreover, supporting the functions of regional banks would be another important issue, while it would not be the focus of discussion at April MPM. Author suspects that a different set of measures might be necessary, including establishing a nationwide SPV to deal with increasing credit costs.

Enhancement of JGB purchase

“Unlimited” purchase of JGBs would indeed be impressive. Nevertheless, readers would need to take account of the practices of JGB purchases by the BOJ.

Before our economy and financial markets were affected by the Covid-19, the annual pace of increase of JGB holding by the BOJ had been close to ¥20tn, in spite of its “official” guidance of ¥80tn. It was possible under the YCC.

Under the current framework, the BOJ could flexibly and substantially increase the actual amount of JGB purchase as far as it would not breach the official guidance above. Moreover, the MPM could argue that a temporary overshooting of the size of JGB purchase could be allowed if the guidance has flexibility in both directions.

One potential reason to announce “unlimited” purchase of the JGB in spite of the existing flexibilities could be the announcement effect to the markets. There has been persistent views in the market that the BOJ would lack the policy spaces in comparison with overseas peers.

Among all, very rapid expansion of fund provision of US dollar could be the source of instabilities of Yen exchange rates, as in the case of post global financial crisis. While US dollar could appreciate due to capital outflows from emerging economies for the time being, there could be uncertainty further ahead.

Looking from different perspectives, enhancement of JGB purchase could have substantial implications for the relationships between monetary policy and fiscal policy.

On the one hand, the announcement of “unlimited” purchase of JGBs at April MPM could reinforce the message of close coordination of policy mix, because the parliament is very close to the agreement of the supplementary budget.

Moreover, the BOJ’s support could enhance the flexibility of further fiscal stimulus by the government, which would be highly probable in light of depth and duration of the impacts of Covid-19.

On the other hand, the policy decision could misguide the public to believe it could be a normal course of business and/or could always avoid the side-effects. With tis respect, our underlying fiscal condition should be taken into account.

In order to minimize the potential side effects, the government and the BOJ could also collaborate in terms of debt management policy. For example, the MOF may increase the issuance of medium-term notes reflecting the duration of economic stimulus and the BOJ may increase the share of purchase of such maturity segment.

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