Notes on Financial Markets Vol.184

Introduction of a new support measure by the BOJ

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Introduction

The MPM of the BOJ decided to introduce a new fund-proving measure today at its unscheduled meeting. Readers may remember that Governor Kuroda instructed the staff to prepare it at the previous MPM (in late April).

Backgrounds

Before discussing the scheme in detail, readers may like to note its backgrounds for reference.

Like other major economies, our government introduced special lending program for SMEs. Such lending was provided with 0% interest rate without any collateral. While they were extended only through several government owned financial institutions initially, eligible financial institutions were expanded to private players in earlier this month in light of urgency of funding needs of the firms.

For such lending by private financial institutions satisfying specific conditions (discussed below), the credit guarantee corporations (CGCs) provide 100% credit enhancements and prefecture governments pay all of the interest costs to such financial institutions or to the borrowers.

The CGCs are permanent entities and have played the important roles in supporting bank lending for decades. While they are owned by the governments of respective prefectures, they have been financially supported by the central government at significant margin.

In order to support firms against the impacts of Covid-19, the central government designated section-4 and section-5 of safety-net guarantees and emergency guarantee by the CGCs as the eligible schemes.

While section-4 covers the firms already suffering from natural disasters in the past, both section-5 and emergency guarantee cover the firms with emerging impacts by Covid-19. Major conditions of the decreases (Y-on-Y) in monthly sales is 20% for section-4 and 15% for section-5. Emergency guarantee is available only during the period of nationwide crisis (as designated by the central government), providing extra amount of credit guarantees.

Policy decision

The MPM of the BOJ decided to provide back-finances at very accommodative conditions to private financial institutions that provide lending to customers based on the framework as explained above.

Specifically, the BOJ will provide loans with maximum amounts outstanding to the eligible lending. The eligible lending include not only the interest- and collateral-free ones, but also those with the credit guarantees by the CGCs but without interest supports. The MPM may intend to cover the bank lending extended before the central government expanded the eligible financial institutions in early this month.

Moreover, the BOJ will include lending to SMEs with equivalent terms as eligible lending. As discussed above, conditions for eligible guarantees by the CGCs might be somewhat tight for firms in some industries. Nevertheless, it is important to cover these firms from political point of view.

Terms and conditions are basically the same as “special fund-supplying operations to facilitate financing in response to Covid-19” which was introduced at March MPM and reinforced at April MPM. The BOJ provides loans against the pooled collateral for maximum period of one year at 0% interest rate. The measure will be available until the end of March 2021.

Interest rate of +0.1% will be applied to the outstanding amount of current accounts held by financial institutions at the BOJ corresponding to the outstanding amounts of such loans. And twice the correspondence amounts of such loans will be included in the “macro add-on balances” of current accounts held by financial institutions at the BOJ.

The MPM combined this new fund-supply measure with two other existing measures (CP and corporate bond purchase and special fund-supplying operations in response to Covid-19), and re-packaged as “Special Program to Support Financing in Response to Covid-19”. The MPM also extended the eligible period to March 2021, and announced that the aggregate size of support is ¥75 trillion.

Other than those, the MPM decided to maintain the existing measures to support credits to firms and households, and to sustain functions of financial markets. Lastly, the MPM reiterated its commitment to conduct additional stimulus without hesitations when necessary.

Implications

Ironically, private financial institutions (especially regional ones) maintain abundant amount of funds with their ratios of lending to deposit far below 100%. In light of this structure, the most important effects of a series of fund-supplying operations to financial institutions would not be to ease their liquidity constraints.

Nevertheless, financial institutions could benefit from utilizing the measures in terms of profits. Not only the corresponding amounts are include in “macro add-on balance”, but also the BOJ will pay 0.1% interest rate on its twice the amounts. These would provide incentives to extend credits to firms, and could contribute to enhance buffers against potential increase in credit costs.

One technical but non-negligible issue would be a mis-match of maturity between underlying lending and the BOJ’s loan.

Under the government emergency measures, the firms could borrow the funds for five years with special guarantees. While financial institutions could sustain lending with their own funds after expiring the BOJ’s back-finances, it would be probable that the BOJ’s measures would be extended due to stronger requests by the industry.

Author: Tetsuya Inoue
Chief Researcher
Financial Market and Innovation Research Department
Nomura Research Institute