Summary of Discussion at Financial Markets Panel
(Fortieth Meeting)

February 16, 2017

Topic	Policy Issues for central banks in the US and the Euroarea and the Bank of Japan's Experience
Date	January 11, 2017 (1:55pm - 3:25pm)
Panelists	**Mr. Yukio Egawa,** Chief Strategist, Research Division, Shinsei Securities **Mr. Amane Oshima,** Managing Executive Officer (Joint Head of Markets Unit), Mizuho Bank **Mr. Izuru Kato,** President, Chief Economist, The Totan Research **Mr. Hajime Takata,** Managing Executive Officer and Chief Economist, Mizuho Research Institute **Mr. Katsuyuki Tokushima,** Chief Pension Consultant, NLI Research Institute **Tetsuya Inoue,** General Manager, Nomura Research Institute (Moderator)

Key Discussion Points

1. **Euroarea policy issues**
2. **US policy issues**
3. **Free discussion**

Summary of Comments

1. Euroarea policy issues

Inoue (Moderator):

・As Executive Director Amamiya, the Bank of Japan, noted in his keynote address, Japan has a great deal of experience with unconventional monetary policy, and today I would like to consider whether this experience can be applied to the issues the euroarea faces today or will face in the future.

・I have informed the panelists in advance the issues we would like to discuss today. One is how the central bank can help facilitate balance sheet adjustments. European businesses and households continue to suffer from a debt overhang and remain vulnerable to shocks. Japan's experience suggests that the inefficient allocation of resources due to delays in balance sheet adjustments can have an adverse impact on medium-term economic growth. The second concerns how the central bank can help restore the financial intermediary role needed for a recovery of economic growth in the euroarea. Needless to say, the banking system accounts for a large portion of financial intermediation in the euroarea, as in Japan. The third issue involves the central bank's ability to help isolate the euroarea economy and financial sector from external shocks. If resolving these problems takes time, it will be necessary to isolate the euroarea economy and financial sector from a variety of financial shocks, including appreciation of the euro at a time of low inflation and a re-pricing of risk assets due to a rise in global long-term interest rates.

Mr. Takata:

・The euroarea experienced the impact of credit expansion more than a decade after Japan did, but there are many common aspects. One is that the entities needing to make balance sheet adjustments are mostly found in the corporations in housing and real estate sectors. Loan-to-deposit ratios in the euroarea remain high at around 100%. Inasmuch as this ratio fell to 70-80% in Japan and the (post-subprime-crisis) US following adjustments in the form of reduced lending, balance sheet adjustments in the euroarea would appear to be insufficient. I believe that euroarea businesses continue to hold excessive assets and liabilities along with potential nonperforming loans (NPLs). This trend is especially pronounced in southern Europe, and recently we have seen NPL problems surface in Italy.

・When Japan experienced its own financial crisis, the authorities provided administrative guidance to individual institutions in order to stabilize the financial system. In terms of macro-level policy, the BOJ unveiled a series of pioneering monetary policy measures that included zero interest rates, quantitative easing, qualitative easing, negative interest rates, and a target for long-term interest rates. In a sense, this is because Japan was the first economy to confront the limits of monetary policy. From that perspective, the current government's economic policy package―the "three arrows" of Abenomics―represents a new attempt to overcome the limitations of monetary policy by fully mobilizing economic policy.

・Meanwhile, monetary policy in the euroarea has largely been an exchange rate policy. I believe the adoption of negative interest rates in particular represented the use of monetary policy to keep euro strength in check while helping to stabilize the financial system. One reason why these measures have not had a dramatic impact thus far is that constraints stemming from the need to maintain the single-currency zone along with tough fiscal discipline have forced the authorities to concentrate on monetary policy, with much less progress made on the fiscal policy and growth strategy fronts.

・The euroarea has also used exchange rate policy as a first line of defense against external shocks. The increasingly apparent limits to what exchange rate policy can achieve by itself at times of major global financial and economic stress, such as in 2016, have led to greater discussion of fiscal policy, including the fiscal theory of the price level (FTPL) and helicopter money. The process of cleaning up the public finances is also a work in progress in Japan, and it is important to maintain a balance between those efforts and the ability to apply flexible fiscal stimulus.

Mr. Egawa:

・Current asset purchases by the European Central Bank (ECB) are managed via four programs: the covered bond purchase program (CBPP3), the asset-backed securities purchase program (ABSPP), the public sector purchase program (PSPP), and the corporate sector purchase program (CSPP). Altogether, the ECB is buying €80bn in assets each month. CBPP3 and ABSPP were announced by the ECB in the second half of 2014 and were launched around the same time. The latter in particular received a great deal of attention because it had no precedent in the West, but as of end-2016 (over two years since the introduction) the Bank's outstanding purchases under this program amounted to only as small as €23bn. Data show the ECB's weekly ABS purchases totaling several tens of millions of euros, which is tiny in terms of both the central bank's balance sheet and the broader ABS market.

・Turning to the securitization market, the ECB and the Bank of England (BOE) in May 2014 jointly issued a report titled, "The case for a better functioning securitization market in the European Union." The report proposed to offer preferential regulatory treatment to securitizations meeting certain quality standards. It was roughly half a year after this report was published that the ECB launched the ABSPP, and in September 2015 the European Commission released a package of proposals that would grant preferential treatment to securitizations as a centerpiece of the Capital Markets Union. These were approved at the committee of the European Parliament late last year following deliberation by the European Council and the Parliament, and are expected to be effective very soon. Throughout this process the ECB has provided detailed opinions to the European Parliament.

・Thus we can see that work on building a structural and legislative framework for the securitization market in the EU has proceeded on the basis of proposals made by the ECB and BOE. In my view, the ECB's purchases of ABS were intended not so much to add to the total value of its asset purchases but rather to provide support for securitization, which is an extremely effective tool for financial intermediation but which had fallen out of use after the financial crisis. In that sense, I think it was similar in some respects to the BOJ's purchases of asset-backed commercial paper and ABS for a time starting in 2003.

・The ECB's purchases of government bonds began quite some time after it started buying covered bonds and ABS. Unlike its purchases of covered bonds and ABS, it is very clear just how many of respective countries' bonds have been acquired under the public sector purchase program (PSPP). This program is therefore vulnerable to criticism for being a form of fiscal assistance and for being biased towards certain countries. I think part of the reason why the ECB introduced the CSPP simultaneously was to stave off such criticism. An analysis of bonds bought under the PSPP shows that purchases of bonds issued by Germany, France, and Italy are roughly in line with the size of those nations' economies, but are not necessarily consistent with the amount of long-term bonds outstanding in the market.

・The EU framework makes it difficult to provide direct public assistance to Italian banks suffering from bad loan problems. Hence the use of indirect tools, one of which is the securitization of loans (including NPLs) held by the banks, with the securitized assets then being guaranteed by the Italian government to facilitate their sale on the market, which eventually provides liquidity to the banks. These securities can also be bought under the ABSPP, so the ECB itself is helping to clean up the NPLs in the Italian banking system.

Mr. Tokushima:

・I visited Europe in late November and early December, and the impression I received was that when Europeans talk about overseas economies they tend to focus on the US. The prevailing view is that the US economy is strong and is far from overheating. However, some were concerned about what would happen if US long-term interest rates overshot to the upside following the election and what sort of impact that would have on equity prices. Meanwhile, European pension funds have refused to take on equity risk and are opting exclusively for credit risk despite the low-interest-rate environment. Like Japan's public and private (corporate) pension systems, they are trying to expand their investment universe within the fixed income space. The current trend is for pension funds to invest in the ABS and covered bonds noted by Mr. Egawa in order to isolate themselves from equity risk.

・When the BOJ introduced quantitative and qualitative easing in 2013, the framework had little flexibility because the Bank presented its own concrete targets—i.e., it pledged to double its asset purchases in order to achieve a CPI inflation rate of 2% within two years. In contrast, the ECB has adopted a fairly flexible policy framework. It has communicated to the markets that it will continue buying €80bn a month until March 2017, after which it will scale back its purchases to about €60bn a month. This has reassured market participants and should make it possible for the market to absorb the impact of even a large external shock. The fact that the ECB's policy quiver already contains programs to acquire a wide range of assets, coupled with the expectation that it will use those tools flexibly, should also be extremely effective in isolating the euroarea from such a shock. Japan had a variety of asset purchase tools but has largely exhausted them, and now the size of the markets involved has become more of an issue than the constraints of individual programs. Meanwhile, the ECB's substantial scope for increasing purchases has helped to reassure the markets. And while the BOJ's purchase of ETFs may have created distortions in the stock market, the ECB has yet to start buying equities.

・I do not think there has been enough discussion in Europe of how to prepare for a shock originating in China. Analysts seem to be taking a fairly short-sighted view of the situation in Asia's largest economy. Also, while the broader euroarea remains in a gradual but steady recovery, there is substantial variation among the member countries. The need to conduct monetary policy with an eye on these differences also complicates the ECB's job.

Inoue (Moderator):

・I would now like to hear what our other panelists have to say.

Mr. Oshima:

・Since the financial crisis, difficulties posed by the structures of the euroarea have forced the ECB to focus on stimulating the economy via the channel of exchange rates while also utilizing communication policy. The central bank's quantitative easing program has functioned as a life-support device for the European financial system by lowering government bond yields (and by extension lending rates) and easing the lending attitudes of private-sector financial institutions in the peripheral nations even though their loan-to-deposit ratios remain at elevated levels. This is particularly true in the case of Italy. However, it is hard to reject the argument that the authorities have also encouraged excessive credit creation by euroarea financial institutions, as reflected in the abnormally high NPL ratios of Italian banks. Financial institutions should have restructured and reorganized while on life support, but unfortunately there does not appear to have been meaningful progress on this front. Additionally—and this is something that was also seen in Japan and the US—financial institutions' ability to withstand financial shocks diminishes under the "anesthetic" of low interest rates because their spreads steadily shrink. The ECB did not use a tiered structure like the one adopted by the BOJ when it introduced a negative-interest-rate policy (NIRP), and this has also weighed heavily on financial institution earnings. While many issues remain in terms of cleaning up the balance sheets of euroarea financial institutions, the ECB appears to be of the view that the only possible response is to continue quantitative easing—which is serving as a form of exchange rate policy—while encouraging financial institutions to undergo surgery.

Mr. Kato:

・The complex financial and economic structures of the euroarea have also had a major impact on policy. For instance, the decision not to adopt a tiered structure for the rates applied to excess reserves under NIRP—unlike in Japan and Switzerland—reflects the diversity in euroarea financial institutions and the tendency for a tiered structure to create a sense of unfairness.

・German politicians' severe criticism of the ECB's enhancements to quantitative easing in March 2016 also appeared to have influenced the subsequent policymaking process. Even German Finance Minister Wolfgang Schäuble, who was viewed as a supporter of central bank independence, attacked ECB President Mario Draghi. Last autumn I spoke with a Merkel administration official in Berlin, and he took the opportunity to express his anger over NIRP. The reason was the danger that the current interest rate environment might lead to a crisis for the German pension system, along with a concern that little structural reform would be forthcoming as long as interest rates were kept low to help the nations of southern Europe. Europe has been in a gradual recovery since last autumn, and the need for additional easing has diminished for now, in part because of tailwinds from overseas. But if the ECB finds itself forced to ease policy again via the channel of exchange rates, political considerations may well shake the foundations of the euroarea.

・The single currency zone's experience shows that there are limits to what monetary accommodation alone can achieve, and that the financial and economic framework will be strained unless accommodation is accompanied by efforts to address structural issues. This is something in common with Japan's own experience. The ECB decided last December to reduce the scale of its asset purchase program starting this April, and I expect further steps toward "normalization" in 2018. However, inasmuch as the ECB's inflation outlook remains below 2.0% (1.7%) even in 2019, I think we are still far from a real exit from ECB monetary easing. And if the gradual steps being made towards normalization were to be reversed before then, there is still the potential for fresh conflict within the euroarea caused by a resumption of monetary easing.

2. US policy issues

Inoue (Moderator):

・I have also informed panelists in advance of the issues we would like to discuss with regards to the US. One is the question of how to address structurally low growth rates. Developments in stocks and the dollar since the presidential election would seem to suggest US market participants have completely forgotten this structural issue, but many experts have noted structural changes such as under-investment and falling growth in labor productivity and suggested that the US has entered a period of secular stagnation. Most of the private-sector economists I spoke with in New York at the beginning of this year also questioned the ability of the US to address such challenging issues as changing demographics and the skills mismatch in the labor market. The first issue I would like to discuss in this regard is whether the central bank can do something to help address this structurally low growth. The second concerns financial system stability. The US credit market had been expanding at a fairly rapid pace for some time prior to the November election. How would the Fed respond if this growth were to continue, placing a variety of stresses on the financial system? Interestingly, the views being heard today are starting to diverge from those expressed immediately after the financial crisis.

Mr. Kato:

・Whereas Japan's working-age population is rapidly shrinking, the working-age population in the US is expected to continue growing, helped by immigration and a relatively high birthrate among white Americans. That said, the number of people aged 65 and over (as a percentage of the working-age population) is expected to increase as the baby boomers retire, with a variety of implications for the labor market. Last year, both the FRB and the FRBNY published papers citing changing demographics as a cause of reduced growth in labor productivity. Inasmuch as the FRB previously did not endorse the BOJ's views regarding the relationship between low growth and the aging population, this suggests the direction of discussion in the US may have changed.

・But in the US, unlike in Japan, the working-age population is not shrinking. Hence it is something of a puzzle that productivity would fall because of a rising percentage of senior citizens, or that productivity would not increase despite the greater adoption of IT. The FOMC's projection for longer-run growth, published in the Summary of Economic Projections (SEP) each December, has now fallen to 1.8% from 2.7% in 2009. The unemployment rate has dropped from 5.55% to 4.8% over the same period, and long-term projections for fed funds have slipped from 4% in 2012 to 3% at the end of last year. Inasmuch as little attention was focused on the decline in the potential growth rate in May 2013, when former Fed Chairman Ben Bernanke began to talk about a possible tapering of QE3, this suggests the longer-term economic outlook has changed dramatically in just three years.

・The decline in the potential growth rate of the US economy has also had a major impact on the FRB's strategy for normalizing its balance sheet. The minutes of the November and December FOMC meetings indicated the FRB is now taking a more cautious approach to the exit process, including reductions in its holdings of long-term bonds. This newfound circumspection appears to be the result of concerns that sharp reductions in the FRB's bond holdings could send long-term market rates higher and further depress the economy's potential growth rate. That would lead to additional declines in the natural rate of interest–the neutral level for the policy rate–which could leave the FRB without adequate room to lower rates (under a nominal zero bound) in response to some future shock.

・From a shorter-term perspective, and at a time of renewed optimism over global economic activity along with high hopes for the new administration, it is important for the FRB to strike a balance between the possible side effects of excessive accommodation and the risks to delaying a normalization of monetary policy. Both the core PCE and the inflation indicators collected by regional Fed suggest that, on the whole, US inflation is rising, but it has not accelerated significantly. Additionally, inflation expectations as reflected in TIPS yields have climbed sharply since last autumn, but 5-10 year household inflation expectations as measured by a University of Michigan survey have fallen to a new low of 2.3%. While households cannot be expected to react to changes in the external environment as quickly as market participants, there would seem to be little visible acceleration of price growth. Meanwhile, inflation fears could pick up if the US were to engage in expansive fiscal policy at a time of almost full employment. The word "uncertain[ty]" appeared 15 times in the minutes of the December FOMC meeting, versus an average of 6.6 times over the last three years, suggesting the FRB is well aware of the current uncertainty. Hence the FRB would hesitate to engage in forward-looking policy conduct for the time being.

Mr. Oshima:

・When I visited Washington last week, the prevailing view was that implementing the new administration's policies was likely to take substantially longer than expected given the time needed to move the bills through Congress. And with the heavy uncertainty surrounding fiscal stimulus—including corporate tax cuts and infrastructure investment—it remains questionable whether market expectations can be sustained until the details of the policies are known.

・Meanwhile, I think the question of whether the FRB's conduct of monetary policy should be based on the assumption of a continued massive balance sheet or whether the FRB should also seek to normalize its holdings of long-term bonds will become more important going forward. US long-term interest rates have risen sharply since last November, but inflationary pressures have actually weakened, which suggests money flowed out of Treasury securities and into stocks and corporate bonds, leading to a re-adjustment in market supply and demand that reflects increased uncertainty regarding the outlook for economic policy. If so, the FRB will face the new challenge of learning how to manage the relationship between long-term interest rates, which are determined by the market mechanism of supply and demand, and short-term interest rates, which are determined by monetary policy.

・In 2018, banks will become subject to a capital charge for interest rate risk in the banking book (IRRBB). This is likely to affect long-term bond supply/demand by increasing market volatility. As the FRB searches for an exit from its accommodative regime, it will need to adjust the shrinkage of its balance sheet and extend its timetable for doing so while keeping a close eye on new financial regulation and financial institutions' observance of the same. The concern is that if the FRB were to deliver a major shock to the markets similar to the 2013 "taper tantrum," a larger-than-expected fluctuation in long-term interest rates could affect Japan and Europe via channels of international financial markets.

・Yield spreads between loans and deposits at US financial institutions have continued to shrink since 2010. It is difficult to envision substantial improvements in the earnings environment for financial institutions inasmuch as 1) it takes time for a rise in long-term interest rates to feed through to lending rates and thereby improve spreads and 2) the resulting impact is not expected to be particularly large in any case. A major issue for financial institutions is therefore going to involve how they deal with rising overhead ratios, including their response to financial regulation. Proposals to reduce the regulatory burden for community banks in the US make sense from this perspective. Meanwhile, the large banks have improved their resistance to a potential shock by substantially increasing their holdings of held-to-maturity securities in the past few years.

・Demand for credit products is rising in US bond markets, and there is a growing sense that the market has overheated. This year has brought large moves in the currency markets and in short-term interest rates in China and Hong Kong, and shocks originating in emerging markets will continue to be a potential risk factor. Additionally, linkages between major financial markets are weakening—a phenomenon underscored by the continued expansion of the implied yields of USD/JPY basis swaps—as tougher financial regulation drains liquidity from the system. Viewed overall, these phenomena suggest the US financial system is somewhat more vulnerable to external shocks than it previously was.

・In 2014, the FRB's economic outlook was largely in accordance with that of the market, and the Treasury curve was just where the FRB wanted it. In 2016, however, the projections of the FRB and the market diverged significantly, although the gap subsequently narrowed as the FRB nudged its own views closer to those of the market. The gap remains today, however, with driving factors including the uncertainty noted earlier in this discussion along with the decline in the economy's potential growth rate. This year as well, attention will focus on whether the FRB's outlook moves closer to that of the market.

Inoue (Moderator):

・I now welcome comments from other panelists.

Mr. Egawa:

・Compared with Europe and Japan, where indirect finance forms the heart of the financial system, the capital markets play a much larger role in the US. Hence I think the purchase of long-term bonds and other financial assets under monetary policy has a greater impact. Accordingly, much more attention is focused on the question of how to manage the FRB's long-term bond holdings. In the US, for instance, residential mortgage rates are determined by adding a spread onto the cost of issuing MBS. The nonbank financial institutions supplying these loans securitize them after obtaining guarantees from organizations like the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA) and sell the resulting securities to Fannie Mae or Ginnie Mae. In Europe, meanwhile, banks are responsible for originating mortgage loans, and its securitization is viewed as a minor tool for fundraising. That is why residential mortgage rates remain in the 2-3% range in the euroarea and in countries like Sweden and Switzerland in spite of the adoption of negative interest rates.

Mr. Tokushima:

・I believe demographics have the potential to influence the potential growth rate and, by extension, the level of interest rates. As far as the inflation do not accelerate, Japanese interest rates are not going to rise while the population is shrinking. As such, the recent surge in long-term interest rates in the US and Japan triggered by Mr. Trump's election victory is unlikely to last for long.

・Market participants have taken a largely optimistic view of the Trump administration's economic policy since the November election, but with the president-elect's first press conference scheduled for January 11 and his inaugural speech on January 20, a great deal of uncertainty remains. The question of who Mr. Trump appoints to serve on the FRB's governing board will also offer key clues to the outlook for US monetary policy. Inasmuch as Chair Janet Yellen's term of office expires in February 2018, we need to carefully examine the new administration's impact on monetary policy. Despite this uncertainty, however, I think that—viewed from a fundamental perspective—the US remains the only attractive investment destination among the developed economies. This view is shared by investors in Europe and by Japanese pension funds and insurance companies as well.

Inoue (Moderator):

・At the beginning of this year I had the opportunity to speak with a number of economists in New York. Many seemed to see substantial uncertainties about the feasibility and the magnitude of impact of the new administration's economic policies. They noted three pillars of Mr. Trump's economic policy: tax reform, trade policy, and deregulation.

・Tax reform has previously been supported by the Republican Party, and inasmuch as—for the moment, at least—there are no major differences between the proposals of Mr. Trump and the Republican Party, the prevailing view was that these policies are likely to be implemented. There was unanimous agreement that large corporate tax cuts would be carried out from the standpoint of enhancing the global competitiveness of the US economy. As for the income tax, some felt the new administration would be able to achieve large tax cuts while others thought it would incorporate an effective tax hike (paired with a simplification of the tax code) to ensure consistency with the Republican Party's core belief in balanced budgets. Many believe that, as Mr. Oshima noted, it may take a great deal of time to push the tax cuts through Congress. And when we take into account businesses' marginal propensity to spend, it may be difficult to judge both when and by how much a tax cut would boost the real economy.

・On the subject of trade policy, from a political perspective attention is focused on the expected abandonment of TPP and NAFTA and the shift to bilateral trade negotiations. From a standpoint of economic policy, however, there has been a great deal of discussion of so-called border adjustments, which involve levying tariffs on imports and exempting exports from taxes. But inasmuch as low-income households have benefited from lower import prices via an increase in real purchasing power, it remains to be seen whether the new administration will push through these measures despite the possibly negative implications for the mid-term elections. Apart from their role in trade policy, a case can be made for these measures inasmuch as they would ensure consistency with the tax systems in trading partners with VATs. Ironically, Mr. Trump's "jawboning" via Twitter seems to be having a real impact, although the sustainability of this approach remains to be seen.

・Compared with tax reform and trade policy, the new administration has released few details of its plans for deregulation, making it difficult to project the macroeconomic impact. But equity investors are following developments in this area closely insofar as deregulation can have a major impact on specific sectors.

・Finally, it is not clear from my discussions about the new administration's policies whether they will contain the sorts of concrete measures needed to address the long-term decline in productivity that is a key structural issue for the US economy. The decline in the labor force participation rate is attributable not only to an aging population but also to a drop in the participation rate of the prime-age group (those aged 25-54), and many suggested the skills mismatch also had something to do with it.

Mr. Oshima:

・While "animal spirits" are relatively plentiful at US companies, the question is whether businesses will actually devote surplus funds to business investment. If there is a possibility that residential investment, which has been supported by low interest rates, will fade to some extent, continued economic growth will require either more active capital investment or larger inflows of funds to new industries. The key point is how quickly the new administration can pave the way for such investment by implementing policies to reassure investors. Amid the uncertain outlook for the strong dollar and its impact on the economy, it remains to be seen whether the new president's surgical attacks on Twitter will provide a broad-based boost to business investment and employment.

・In both the US and Europe, immigration is a major issue that is closely tied to the distribution of wealth, and politicians are being asked to do something about it. We need to watch out for the possibility that the exclusion of immigrants will divide markets and thereby increase the cost of economic activity, create an uneven distribution of funds and localized rises in interest rates, and trigger minor crises in emerging economies. The authorities' approach to financial regulation will also be in the spotlight. The position of Federal Reserve Vice Chairman with responsibility for overseeing financial regulation, which was created under the Dodd-Frank Act, is currently open but is being informally filled by Fed Governor Daniel Tarullo, a strong proponent of regulation. An official decision by the Trump administration to appoint someone to this position could bring about changes in regulation and financial intermediation. That, as noted above, may influence the authorities' approach, including their stance on the normalization of monetary policy.

Inoue (Moderator):

・What sort of impact is the strong dollar having on FRB's policy?

Mr. Kato:

・Viewed in terms of the nominal effective exchange rate (BIS estimates), the US dollar traded flat from the beginning of 2016 until the November election, but has since surged 5.1% in an outsized advance relative to other major currencies. However, I believe the current economic expansion will be able to at least partly absorb an appreciation of this scale.

・The FRB's latest dot chart indicated the likelihood of three rate hikes in 2017. At her press conference following the December FOMC meeting, Fed Chair Yellen attempted to discourage the market from pricing in that outcome by repeatedly emphasizing that this represented only a small change. I think one of the reasons she did so was to avoid generating further upward pressure on the dollar by creating the impression the FRB had become more hawkish. Talk of the FRB's tapering the reinvestment of MBS principal payments could also lift the dollar if the market focuses on it excessively. Meanwhile, a stronger dollar would be welcomed if the new government administers fiscal stimulus at a time of near-full employment and it becomes necessary to rein in inflation. Inasmuch as the dollar's current strength helps reduce inflation by lowering the price of imported goods, it removes the need for the FRB to think about forward-looking rate hikes for the time being.

3. Free discussion

Inoue (Moderator):

・What sort of role do you think debt management policies can play in stabilizing long-term interest rates in the euroarea?

Mr. Tokushima:

・In Europe, there is continued demand for long-dated bonds from pension funds and the insurance sector. When the ECB adopted a negative-interest-rate policy, European pension funds responded more quickly than their Japanese counterparts because they had achieved a better matching of assets and liabilities. Continued robust demand for high-yielding, long-dated bonds has enabled issuance in the 40y and 50y sectors.

Inoue (Moderator):

・Are the programs and policies that have been created to revitalize Europe's securitization market sufficient?

Mr. Egawa:

・From a global standpoint, most of the assets being securitized are performing loans; NPLs are a rare exception even in historical terms. While it is easy to estimate the cash flows in the future, that is not true in the case of nonperforming loans since the borrows already fail to meet the redemption schedule, which makes them fundamentally unsuitable for securitization.

・That said, there were instances of NPL securitizations in Italy and China last year. In Italy this was possible because the NPLs backing the securities were secured by real estate and the securities themselves were then guaranteed by the Italian government. As such, investors were assuming the credit risk of the Italian government, not the original borrowers. In China, only "senior" NPLs, which have a high probability of recovery, are being sold as securitized assets. Inasmuch as these securities are actually being issued, the necessary framework appears to be in place to some extent.

・In Europe, the European Investment Bank (EIB) has launched a program to invest in securitized assets and is already making strategic investments in NPL securitizations. As for the ECB's ABSPP, the central bank has created a template for underlying assets, asked involved parties to report and disclose the date in the standardized format, and in general is seeking to establish the infrastructure needed to achieve greater standardization and quality control of securitizations, including the requirement that securitizations satisfy the same criteria as assets eligible for repos and central bank purchases in order to receive preferential treatment.

Inoue (Moderator):

・Thank you all for your time today.

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