Comment on Tomo Kinoshita’s Paper “In Search of Post-QQE Monetary Policy for Japan” by A. Rozanov
Diagnosing the Problem with QQE

• Open-ended commitment to grow monetary base by ¥80 trillion per year
• By 2018, BOJ demand for JGBs will run into supply constraints
• BOJ may run out of ammunition before it hits 2% inflation target
• Monetary policy sustainability and credibility are at stake
• So what can be done about that?
Three Logical Solutions

• Option #1: increase supply of JGBs (fiscal monetary cooperation)
• Option #2: decrease demand for JGBs (BOJ tapering)
• Option #3: rebalance QQE from JGBs to various risk assets
• The paper focuses on Option #2 via a change in monetary policy regime
• Proposal: move away from monetary base target to real yield framework...
• ...while maintaining the beneficial effect of QE on real yields
• “On-demand QE” / “QE on Tap”
My Three Concerns

• The proposal ignores ‘portfolio substitution’ effect, where size matters
  • QE programme in 2001-06: buy short-term government bonds from banks
  • QQE programme: buy long-term bonds + risk assets from non-banks

• There are risks to inflation expectations and potential impact on nominal yields
  • In 2 years of QQE, 10-year ‘natural’ vs. real rate gap expanded from 20 bps to 110 bps
  • Two forces at work: rising inflation expectations and declining term premium

• There are questions about BOJ’s ‘new’ ammunition to fight deflationary shocks
  • Two hard constraints: JGB supply and/or zero lower bound on the whole yield curve
  • Raising inflation expectations remains the only option, but how?
The Other Two Options

- Increasing JGB supply via fiscal monetary cooperation
  - This can only be part of a broader political decision to rebalance Abenomics
  - Requires BOJ-MOF coordination (but so does the author’s proposal!)
  - Additional issues: Japan’s debt sustainability, fiscal space for more expansion, etc.
  - Deserves a mention and perhaps a brief discussion, but outside the scope of paper

- Rebalancing QQE from JGBs to a variety of risk assets
  - Two standard objections: (1) potential losses for BOJ and (2) market capacity
  - (1) is not about real economic or solvency risks, but accounting and political risks...
  - ...so can be mitigated by proper communications strategy and gov’t assurances
  - (2) is only an issue if risk asset universe is limited to ETFs and J-REITs...
  - ...but there are at least four creative ways to broaden the universe
Four Ideas for Expanding Risk Asset Universe

- Buy stock baskets underlying ETFs and convert into ETF shares
  - Market capitalisation is larger and liquidity is deeper than ETF shares on their own
  - Mechanism similar to HKMA’s purchase of HSI stocks and conversion into TraHK

- Purchase real estate directly to use as the basis for launch of new J-REITs
  - Implementation possible in partnership with existing J-REIT sponsors
  - Injecting new liquidity into property market + J-REIT market development

- Include gold bullion in the QQE risk asset purchasing programme
  - Legitimate asset to hold on central bank balance sheet
  - Japan’s holding of 2.4% of FX reserves is way below G-7 average of 41% (WGC, 2014)

- Expand BOJ’s current lending facilities to include two new agencies
  - Mortgage lending to households at negative rates
  - Corporate lending to SMEs at negative rates
  - Negative rates to reflect BOJ income, adjusted for a credit cushion for default risks
Conclusion

• BOJ has 2-3 years before it starts running into JGB supply constraints
• BOJ can start expanding risk assets while buying JGBs at current pace
• Once risk assets grow to a certain size, BOJ can start tapering JGB purchases
• The author’s new monetary policy regime can be implemented with less risk