

Potential issues with BOJ's exit from unconventional monetary policy

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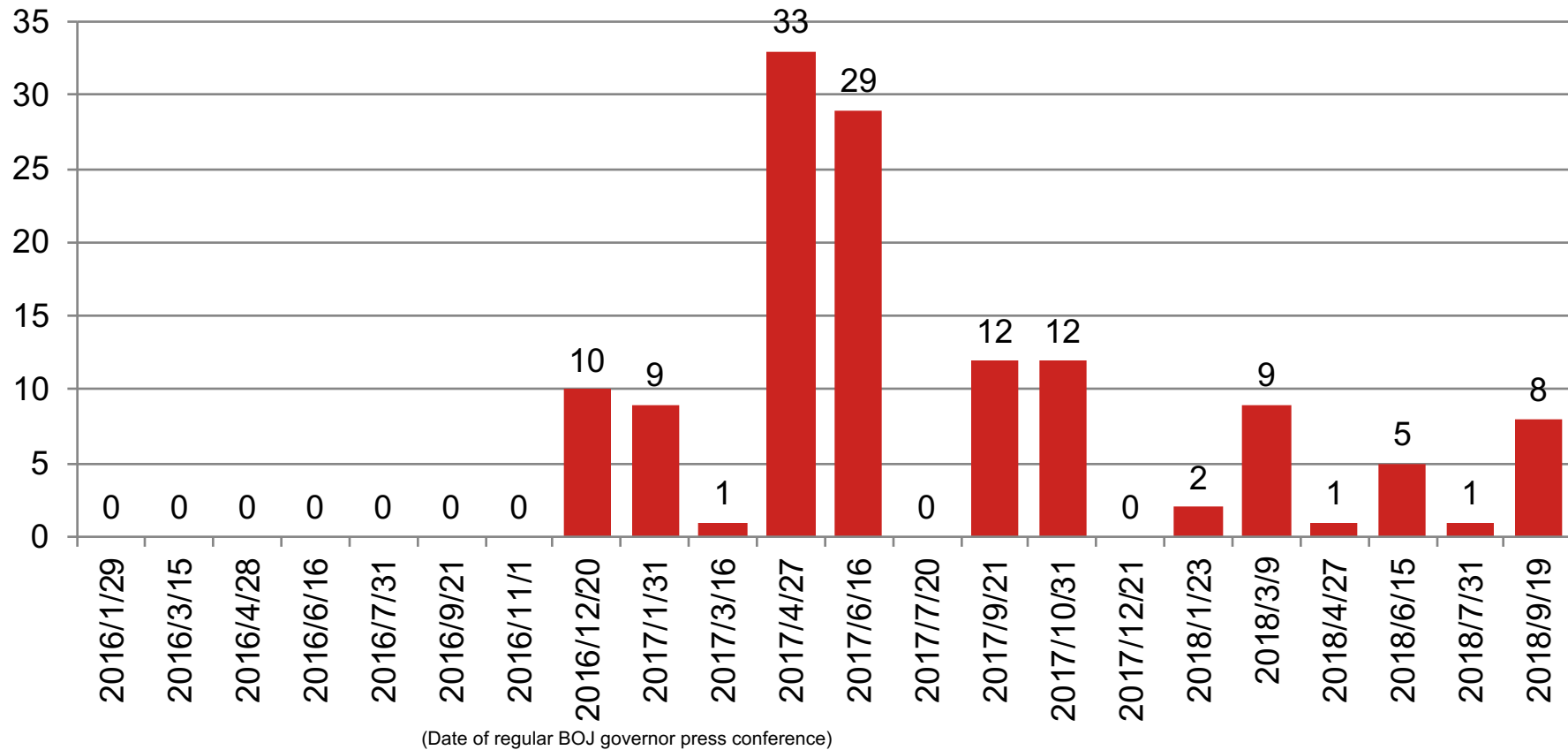
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- Introduction
- A template in 'exit policy' – the case of US Federal Reserve
- A brief history of the Bank of Japan's unconventional monetary policy – how far is the central bank from the exit?
- The idiosyncrasies of BOJ's unconventional monetary policy
- A simulation
- Essence of exit problem
- Conclusion

Introduction – how ‘hot’ is the debate on an ‘exit’?

It is obvious that the introduction of YCC policy in September 2016 provoked more heated discussion on ‘exit’

Number of mentions of the word "exit" in the regular press conferences of BOJ governor Haruhiko Kuroda



- May. 2013** **Fed Chair Bernanke suggested the end of QE3**
- Dec. 2013** **Start ‘Tapering’ of asset purchase program**
- Oct. 2014** **FOMC decided complete end of APP**
- Dec. 2015** **The first lift of FF rate target (the end of ZER)**
- Sep. 2017** **Start of gradual reduction in reinvestment of redeemed assets (gradual shrinkage of B/S)**

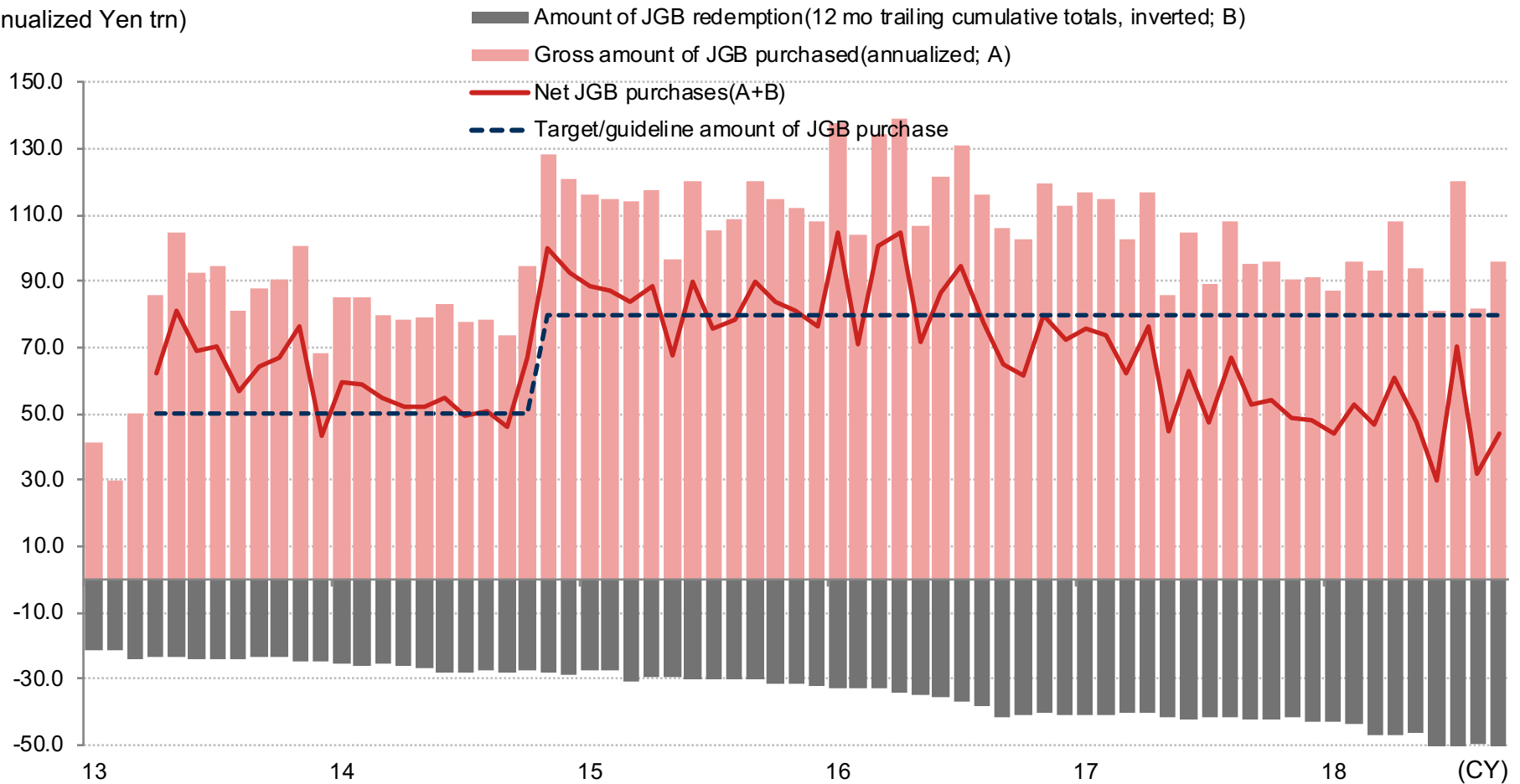
- Jan. 2013** **Joint accord with govt. on 2% inflation goal**
- Apr. 2013** **Start of Gov. Kuroda's 1st term and QQE**
- Oct. 2015** **QQE2 ('Bazooka 2')**
- Jan. 2016** **QQE with Negative Interest Rate Policy**
- Sep. 2016** **Comprehensive assessment and introduction of QQE with Yield Curve Control Policy**
->de facto start of a normalization
- Jul. 2017** **Enhancement of YCC policy (with introduction of forward guidance)**

Not really stealthy...

Investors sometimes ask me when BOJ will start stealth tapering, but in fact, the tapering has already started in a not stealthy manner.

Amount of JGBs purchased via BOJ operations

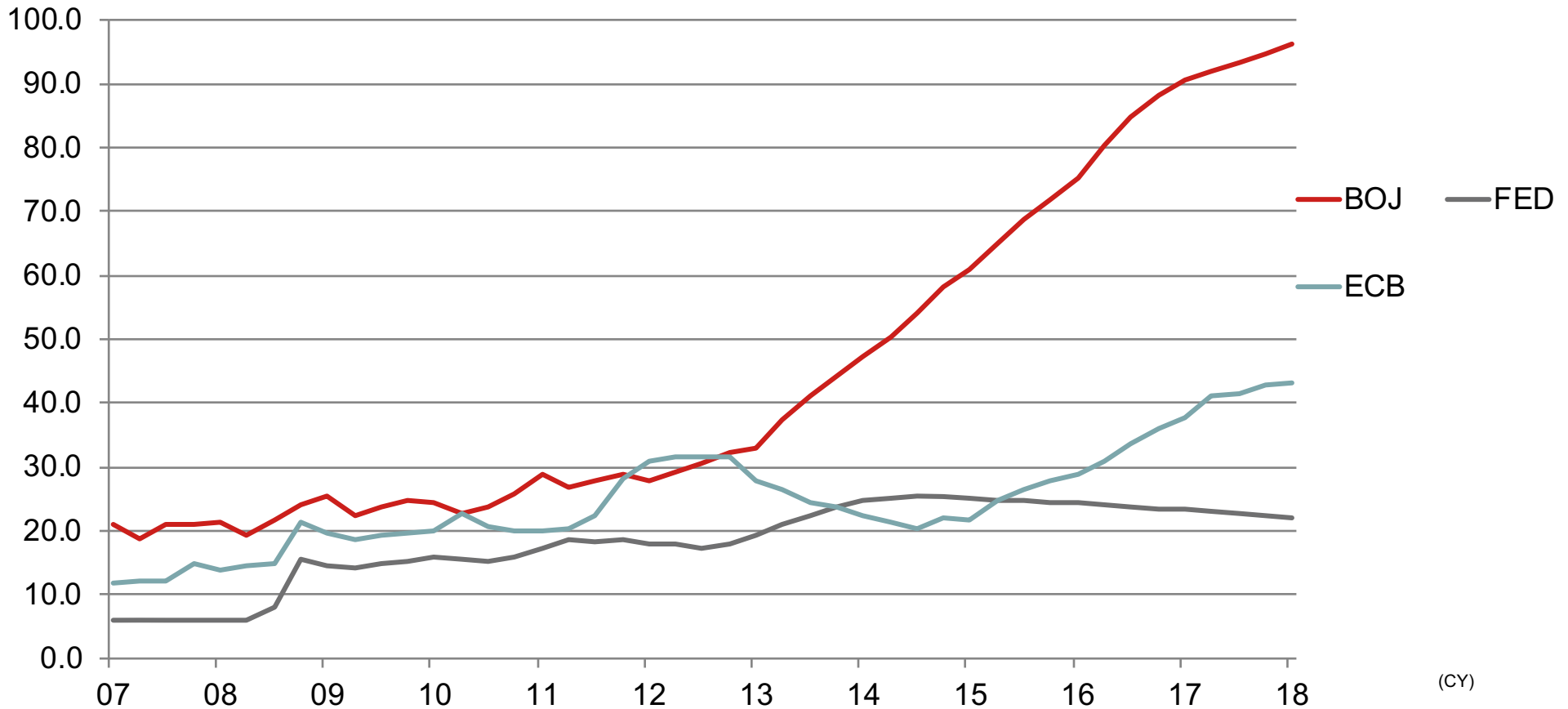
(Annualized Yen trn)



Remaining issues arising from the idiosyncrasies of BOJ's monetary easing (1)

International comparison of total assets at central banks

(as % of nominal GDP)

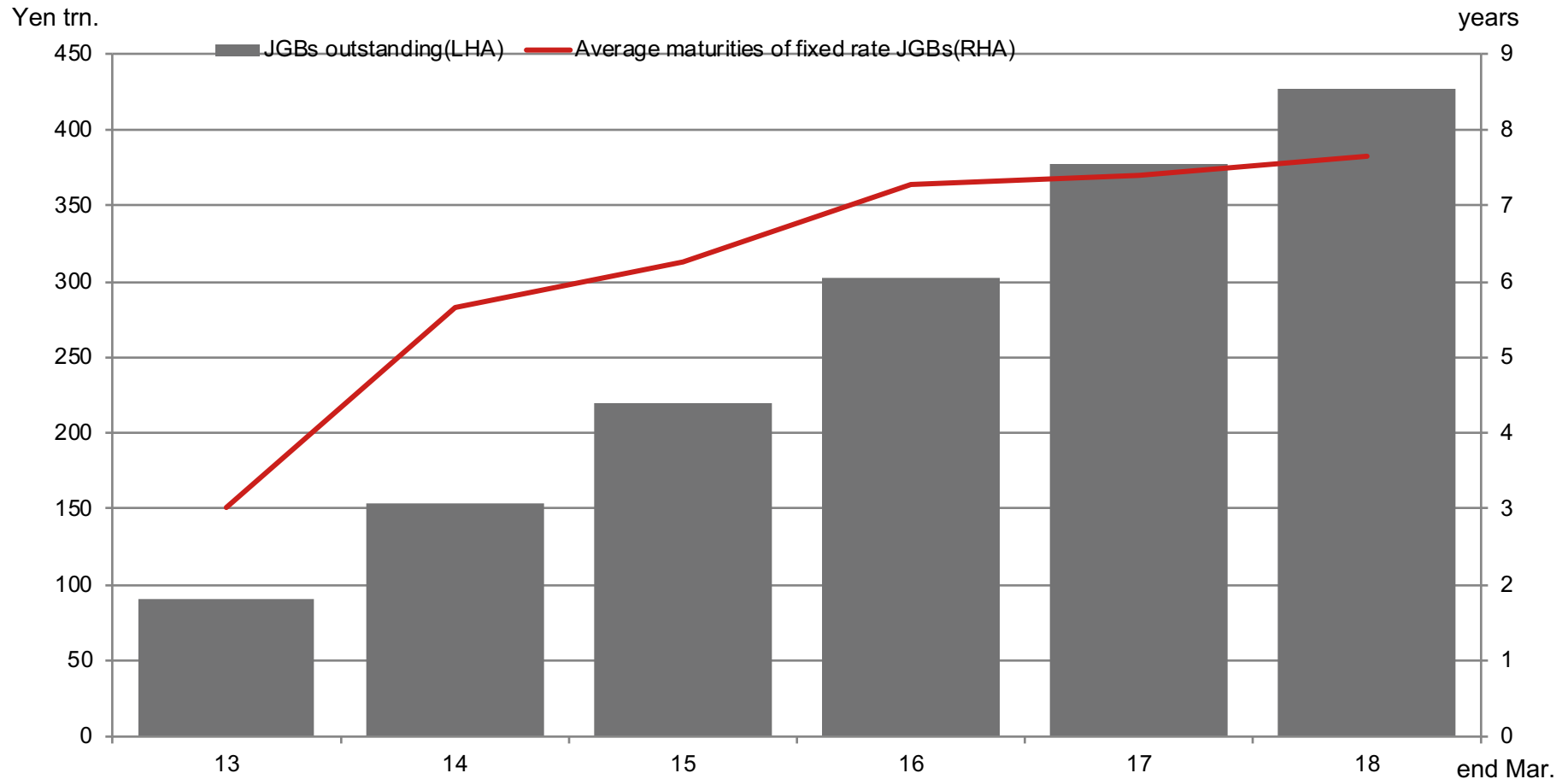


Source: Nomura, based on BOJ, Fed, and European Central Bank (ECB) data

Remaining issues arising from the idiosyncrasies of BOJ's monetary easing (2)

While not-really-stealthy tapering goes forward, average maturities and durations of JGBs held by BOJ still continue to get longer.

JGBs outstanding held by BOJ and their average maturities



Note: Variable rate JGB and JGBI-s are excluded from the calculation.
Source: Nomura based on the Bank of Japan data

Key variables:

- 1) JGBs outstanding at the beginning stage of the exit (depends on the length of time it continues to pursue monetary easing)
- 2) Average maturities of JGBs held at the stage

How would the above factors affect net interest earnings of BOJ in exit phase?

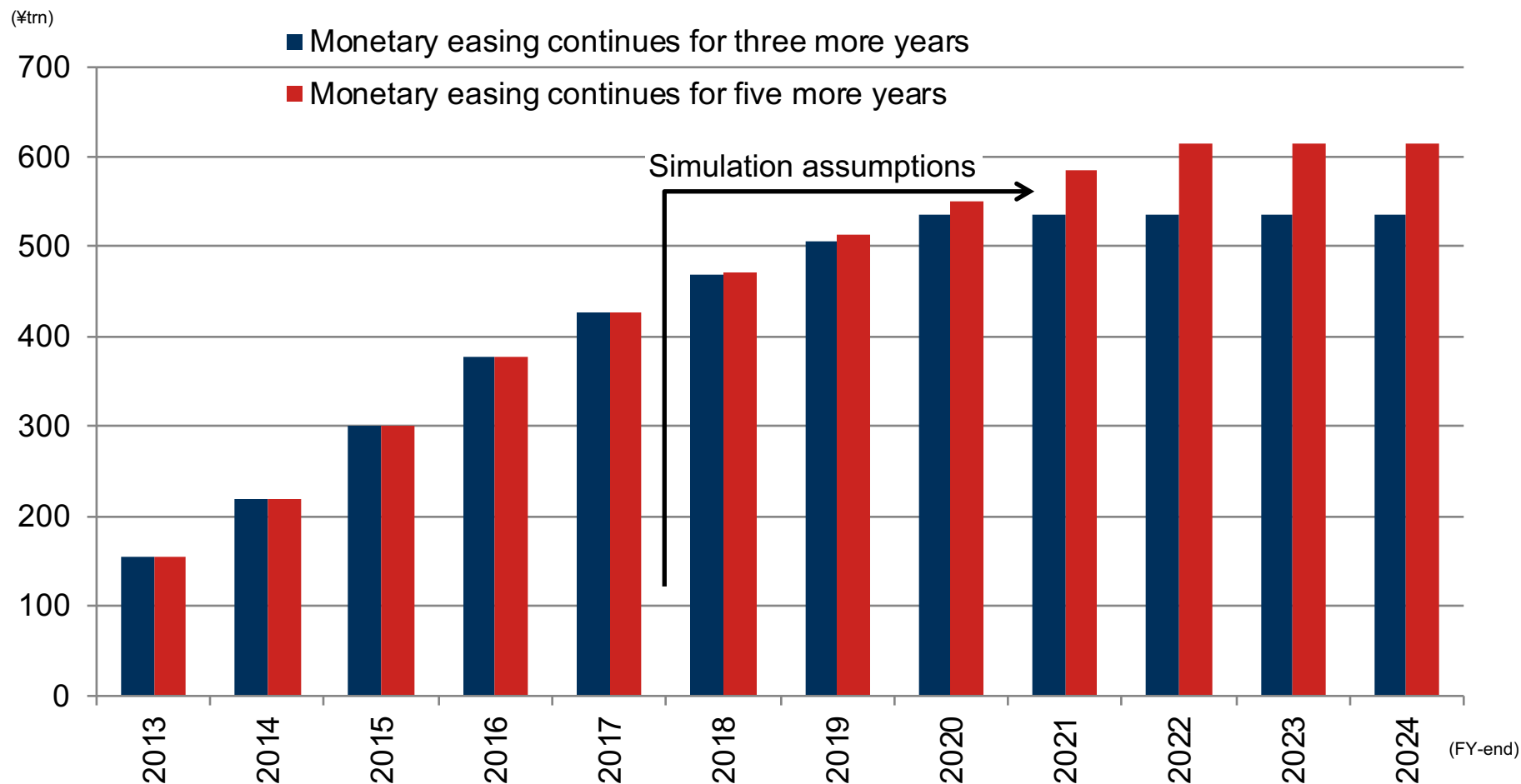
Other assumptions

- ✓ Short term policy rate will be raised to 0.5% in three years after exit
- ✓ Cash in circulation will grow at the average rate during 2013-17

Assumption (1): the length of time it continues to pursue monetary easing

The longer monetary easing continues, the larger outstanding JGB holdings in BOJ's book will be.

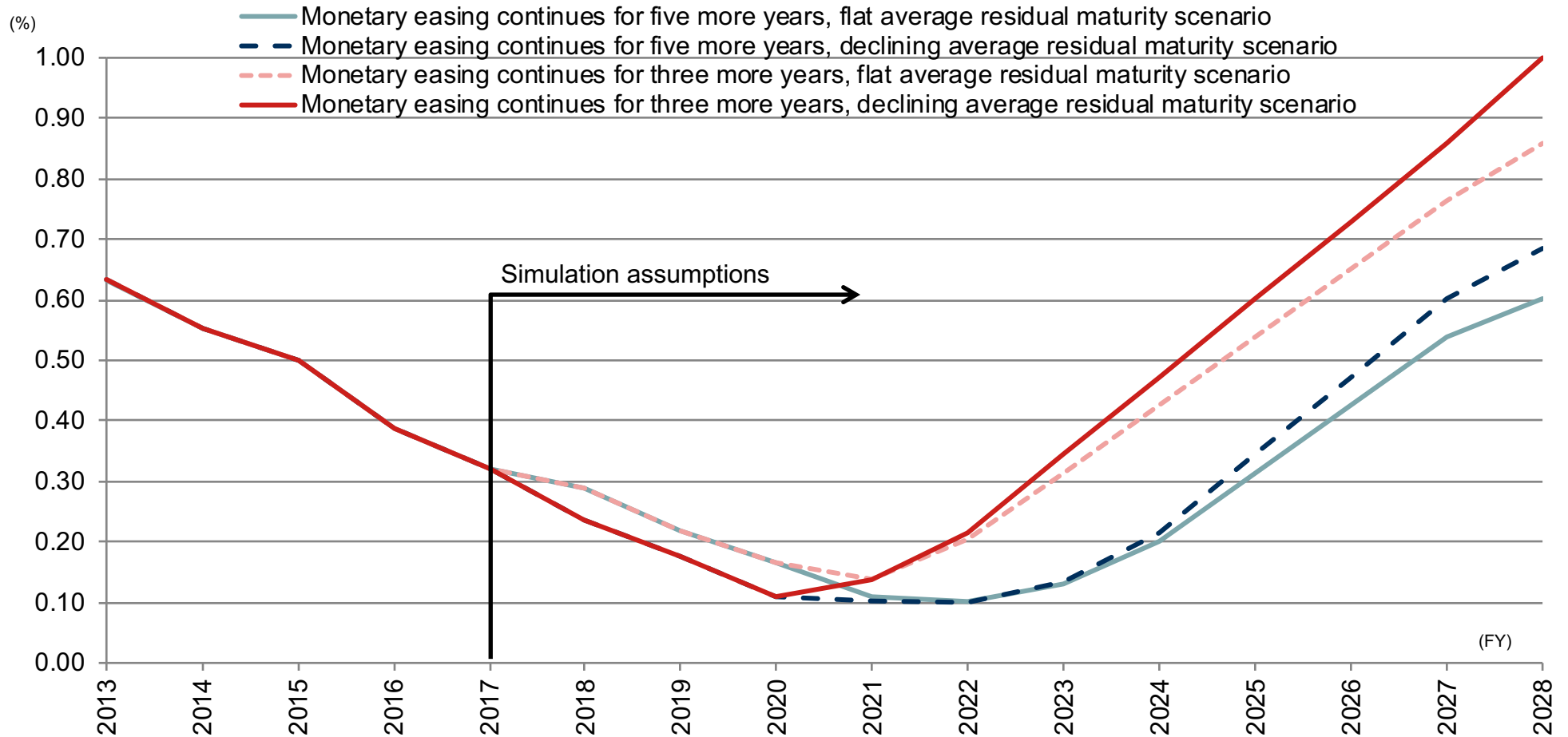
Assumptions for outstanding JGB holdings used in our simulation for exit from monetary easing



Assumption (2): varying path of effective long term yields, depending on the average maturities of JGBs **NOMURA**

The longer the average maturities at the beginning of exit, the slower the rise in effective long-term yields on JGBs held in BOJ's book

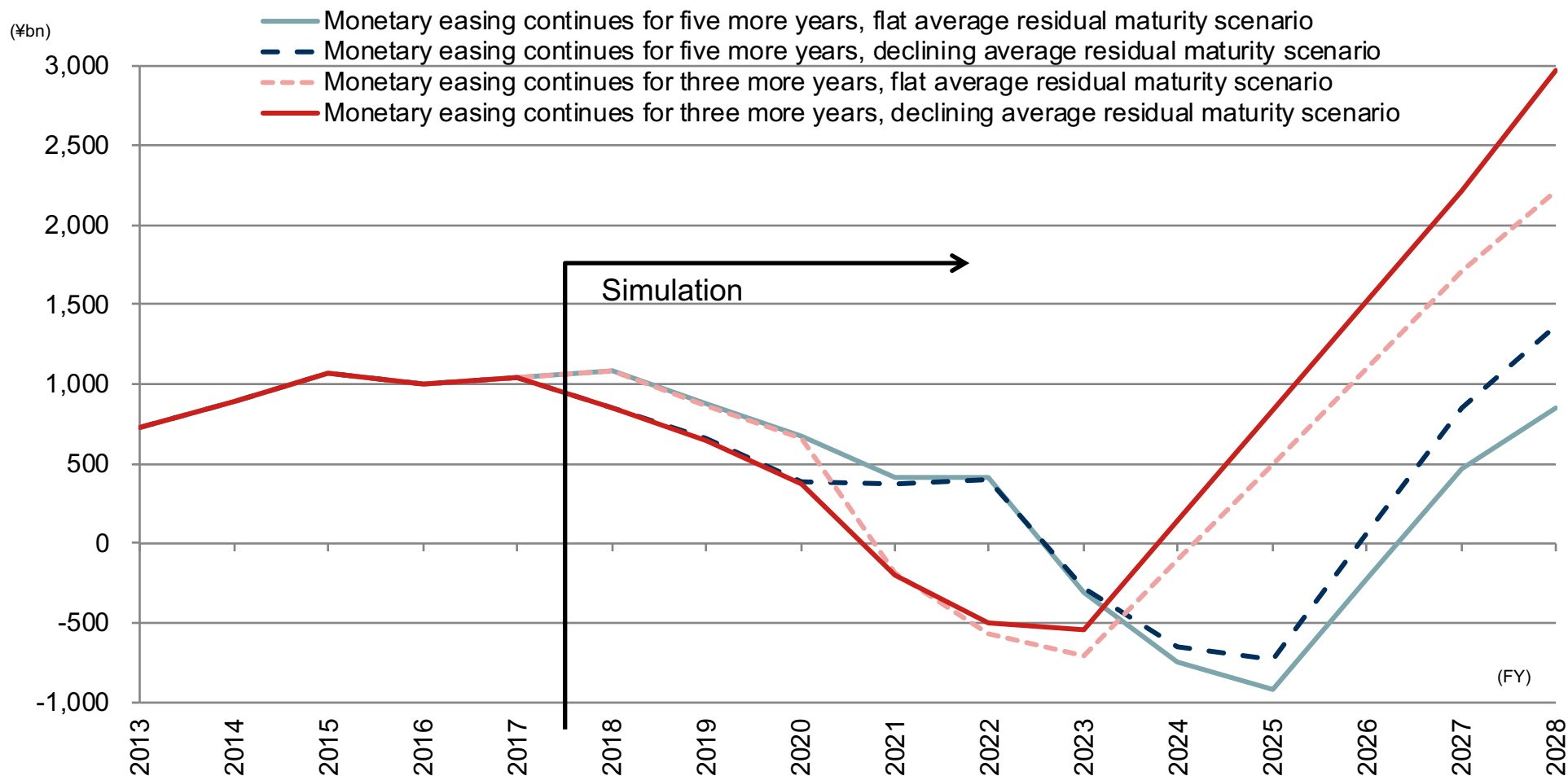
Assumptions for the effective yield on long-term JGBs used in our simulation of an exit from BOJ monetary easing



The results of the simulation

Net interest income loss could double if monetary easing continues two more years and BOJ fails to shorten average maturities of long term JGBs.

Results of simulation of BOJ earnings (net interest income) during the exit phase



- **Based on its characteristics as a special corporation defined in the Bank of Japan Act, the BOJ's financial strength as seen in its income and capital ratio does not have an impact on monetary policy management, and a system is in place so that this does not happen.**
- **What would be problematic would be if the government has not achieved fiscal consolidation at the exit phase; then a decline in the BOJ's payments to the national treasury, or a significant increase in the government's interest payments, would create additional risk for the government's fiscal management.**

- **The idiosyncrasies of BOJ's monetary easing, compared with other central banks, could make net interest loss larger at the exit phase.**
- **What would be problematic, would be neither the loss itself nor the volume of the loss, but the fiscal dominance and deprivation of BOJ's political independence that it might cause.**

Thank you very much!