Daiwa's View

Implications of BOJ emergency Monetary Policy Meeting

- Increasing similarity with Europe

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Increasing similarity with Europe

At its emergency Monetary Policy Meeting (MPM) held last Friday, the BOJ introduced a "New Fund-Provisioning Measure to Support Financing Mainly of Small and Medium-Sized Firms[1]." The short-term implications of this for the market are not great, so we focus on the following long-term implications.

Similarity with Europe

The nature of this measure is to promote loans to SMEs via incentives to financial institutions. In that sense, it is similar to the ECB's TLTRO. Both measures encourage financial institutions to extend loans in line with the policy target by providing sweeteners, rather than imposing heavier penalties. Given the fact that financial institutions play a large role in Japan where the weighting of indirect financing is largely similar to Europe, it is not surprising that measures in Japan and Europe would take similar directions.

The difference between Japan and Europe is that the ECB directly supplies funds to financial institutions at a negative interest rate (-1%) against the balance utilized vs. the BOJ which has expanded the base to apply +0.1% IOER by using the outstanding balances of current accounts (plus additions to the macro add-on balances). The BOJ's new scheme is well devised in terms of avoiding excessive loan competition that weakens the capacity of financial institutions. This is because the scheme makes linkages with individual loans obscure by providing sweeteners (detours) via current accounts in line with the amount of outstanding loans provided through this measure. In addition, from a longer-term perspective, the fact that the BOJ has expanded the base to apply +0.1% IOER may have major implications. Although this new scheme is a time limited measure, it has enabled us to assume the possibility that the BOJ could use the IOER as a future tool to cope with the side effects of monetary easing.

Solid support to regional financial institutions

Even before the pandemic, regional financial institutions had larger outstanding loans guaranteed by credit guarantee corporations than mega banks (see chart next page). Regional financial institutions will greatly benefit from the decision that loans guaranteed by credit guarantee corporations will be approved as the amount of outstanding loans under this new scheme. In addition, the maximum amount for each eligible counterparty is set at Y100bn, which is also beneficial for regional financial institutions, whose amount of outstanding loans is relatively small.

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[1] In the new fund-provisioning measure, the BOJ will provide funds to eligible counterparties against pooled collateral for up to 1 year at the loan rate of 0% for the maximum amount of outstanding eligible loans reported by those counterparties. Eligible Loans are (1) loans based on the government's programs (interest-free and unsecured loans based on the government's emergency economic measures and loans guaranteed by the credit guarantee corporations in response to COVID-19) and (2) loans equivalent to the aforementioned loans (loans to SMEs affected by COVID-19 which are equivalent to the aforementioned loans in terms of loan conditions [a maximum amount for each eligible counterparty of Y100bn]). In addition, twice as much as the amount of outstanding loans will be included in macro add-on balances in the BOJ's current accounts held by financial institutions. Moreover, +0.1% IOER will be applied to outstanding balances of the BOJ's current accounts held by financial institutions. At the moment, the BOJ assumes use amounting to around Y30tn.

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While SMEs have been hit hard by the COVID-19 pandemic, the latest measure is an excellent move towards providing strong support for financial institutions that have a large amount of loans to SMEs. Such benefits are expected to spread in a broad way to regional financial institutions. In particular, the smaller the financial institution is, the larger the ratio is of proper loans (Y100bn) to total loans. Therefore, loans are likely to extend to every part of the country.

Chart: Amounts Outstanding of Credit-guaranteed Loans (Y mn)

FY ended in Sep 2019	Three mega banks	Other regional financial institutions	Total
(term average)	1,895,582	18,760,867	20,656,449

Source: Credit guarantee corporations; compiled by Daiwa Securities.

Extension of CP and corporate bond purchase operations

At the April MPM, CP and corporate bond purchase operations were introduced as a time limited measure until the end of September. The deadline has been extended to end-March 2021. We were surprised by the decision to extend the period just after three weeks, but the BOJ probably intended to emphasize this as a part of the policy package totaling Y75tn. Moreover, given the result of the first operation in May, the BOJ may have judged that there isn't enough time to buy corporate bonds worth Y7.5tn by end-September. This appears to have been what was behind the extension2.

This pandemic has brought a very heavy burden in financing. A great need for funds is a common phenomenon in Japan, the US, and Europe. It is testing how each nation/region will support this need according to the characteristics of each nation/region. In the US, where the ratio of direct financing is high, the public sector is able to directly absorb a large proportion of funding needs that have increased due to the pandemic via the Fed's large-scale facilities (such as PMCCF/SMCCF), which separate credit risk from the private sector. Since direct financing is the main source of financing in the US, the authorities can address these issues relatively easily.

On the other hand, Japan and Europe rely mainly on indirect financing, so using the same method as the US is only able to absorb a part of the funding needs caused by the pandemic in those countries. Therefore, as Japan and Europe need more complex measures than the US, it would be appropriate to respond to funding needs as follows: (1) central banks directly absorb funding needs in the private sector via corporate bond/CP operations and CSPP for major companies that can issue corporate bonds and (2) authorities establish a TLTRO-type measure that provides incentives (virtual subsidies) to policy-based financial institutions and private-sector financial institutions to lend money. Since the burden at private-sector financial institutions is still too great, the only solution in Japan is a triune response that includes policy-based financial institutions. From the perspective of reducing the burden at private-sector financial institutions as well, we take a positive view of the fact that corporate bond purchase operations (for which the upper limit was raised in a time limited manner) are positioned as the "Special Funds-Supplying Operations to Facilitate Financing in Response to the Novel Coronavirus."

Considering the above, we are more concerned about Japan and Europe than the US. Since Japan and Europe rely on indirect financing, it would be easier for the support network to collapse once the capacity at private-sector financial institutions weakened. If that happened, a capital increase or injection of public funds would be needed. However, since bank share prices have been even more sluggish since the pandemic, there would be major obstacles to choosing capital injection. If the economy worsens due to a second wave of infections, Japan and Europe, which rely mainly on indirect financing, will be more vulnerable than the US. It is therefore important to prepare for every potential scenario, without second guessing the outcome.

[2] There is a risk that unnecessary volatility will be created at the end of the period due to paperwork at companies not being filed in time for the majority of bond issuance windows for which bids can be placed at the BOJ's corporate bond purchase operations.

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■ Credit Rating Agencies

[Standard & Poor's]

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