

# Daiwa's View

## Points of BOJ measures related to climate change

- BOJ doing what it can within its mandate

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**Policy unchanged at Jul meeting; dissenting vote only from board member Kataoka**

**In Jul Outlook Report, inflation is expected to finally reach 1% in FY23**

## Points of BOJ measures related to climate change

With the Tokyo Summer Olympics just days away, coronavirus cases in Japan (especially of the Indian Delta variant) are again on the rise, particularly among younger people, for whom the vaccination rollout has been slow. Amid this elevated uncertainty about the future, the BOJ held its Monetary Policy Board meeting on 15-16 July. By an 8-to-1 vote, the Policy Board decided to maintain the monetary policy status quo (with a dissenting vote from Goushi Kataoka, and new member Junko Nakagawa voting in favor). The BOJ also released its July *Outlook for Economic Activity and Prices* report (*Outlook Report*), which serves as an important examination of economic and financial conditions. The economy continues to stagnate, and for now risks are skewed to the downside, but the Bank maintains its recovery scenario assuming a gradual easing of coronavirus impacts. In terms of prices, the board raised its CPI forecast for FY21 significantly to reflect the current jump in crude oil prices, but still expects sluggish growth overall, with 1% inflation finally reached in FY23. Prices are likely to remain stagnant in Japan, unlike the US where discussion is ongoing about whether inflation is transitory. It is no wonder that interest in the BOJ's monetary policy is declining.

**Chart 1: FY21-23 Forecasts of Majority of Policy Board Members (y/y % chg)**

	Real GDP	CPI (all items less fresh food)
FY21	+3.5 ~ +4.0 [+3.8]	+0.3 ~ +0.6 [+0.6]
As of Apr 2021	+3.6 ~ +4.4 <+4.0>	0.0 ~ +0.2 <+0.1>
FY22	+2.6 ~ +2.9 [+2.7]	+0.8 ~ +1.0 [+0.9]
As of Apr 2021	+2.1 ~ +2.5 <+2.4>	+0.5 ~ +0.9 <+0.8>
FY23	+1.2 ~ +1.4 [+1.3]	+0.9 ~ +1.1 [+1.0]
As of Apr 2021	+1.2 ~ +1.5 [+1.3]	+0.7 ~ +1.0 [+1.0]

Source: BOJ; compiled by Daiwa Securities.

Notes: (1) Figures in brackets indicate the medians of the Policy Board members' forecasts (point estimates).

(2) The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate -- namely, the figure to which they attach the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.

(3) Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.

(4) A reduction in mobile phone charges by major carriers conducted in spring 2021 is estimated to directly push down the CPI for fiscal 2021 by around 0.6 percentage points.

(5) The CPI forecasts in this Outlook Report are based on the current 2015-base index. The statistics authority that compiles the CPI has announced its plan to rebase the CPI to the base year of 2020 and retroactively revise its figures for the year-on-year rate of change from those for January 2021 onward, both in August 2021. With the rebasing, the reduction in mobile phone charges will have a larger impact than the current index, mainly because the weight of such charges in the CPI will rise. Therefore, the year-on-year rate of increase in the CPI is highly likely to be revised downward for the 2020-base index.

**Climate scheme falls under Category III of Interest Scheme to Promote Lending; applied interest rate is 0%**

**Loans are provided for one year, but flexible, with refinancing possible within outstanding balance**

At this meeting the BOJ also unveiled the main points for a new scheme to provide funding (back finance) for activities combating climate change (hereafter “climate scheme”) first announced in June (Chart 2). The climate scheme is positioned as a successor to the outgoing facility for promoting growth-supporting loans, which is due to expire at the end of June 2022. Using this climate scheme, which is included in Category III of the Interest Scheme to Promote Lending introduced in March, the BOJ will offer banks long-term loans at zero interest with efforts made to remain market-neutral. As an incentive, application of the macro add-on balance will double. In principle, the loans are for up to one year, but are renewable during the duration of the scheme set to end in FY30. The approach is flexible, with refinancing possible within the outstanding balance. Depending on the case, loans can be provided for a period longer than the maximum four-year period under the growth-supporting lending facility.

**Chart 2: Preliminary Outline of Fund-Provisioning Measure to Support Efforts on Climate Change (16 Jul 2021)**

Eligible counterparties	Eligible counterparties will be financial institutions that disclose a certain level of information on their efforts to address climate change and wish to be counterparties for the measure among the counterparties for the Funds-Supplying Operations against Pooled Collateral
Eligible investment or loans	Eligible counterparties' investment or loans, which contribute to actions to address climate change (1) Green loans/bond (2) Sustainability-linked loans/bonds with performance targets related to efforts on climate change (3) Transition finance
Method of fund-provisioning	Yen-denominated funds will be provided against pooled collateral
Interest rate	0% Twice as much as the amount outstanding of funds counterparties receive will be added to the macro add-on balances Category III in the Interest Scheme to Promote Lending
Duration of fund-provisioning	One year in principle Until the end of the implementation period of the measure (FY30 in principle) , rollovers can be made within the amounts outstanding of eligible investment or loans for an unlimited number of times * Scheduled launch timing: Within 2021

Source: BOJ; compiled by Daiwa Securities.

**BOJ's comprehensive strategy on climate change**

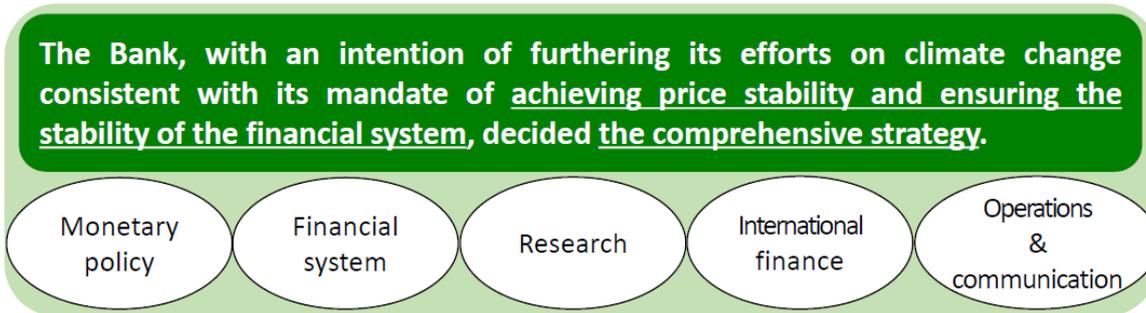
**Climate scheme designed as monetary policy; challenge from now on is measures for financial system**

**International finance cooperation does not constitute monetary policy**

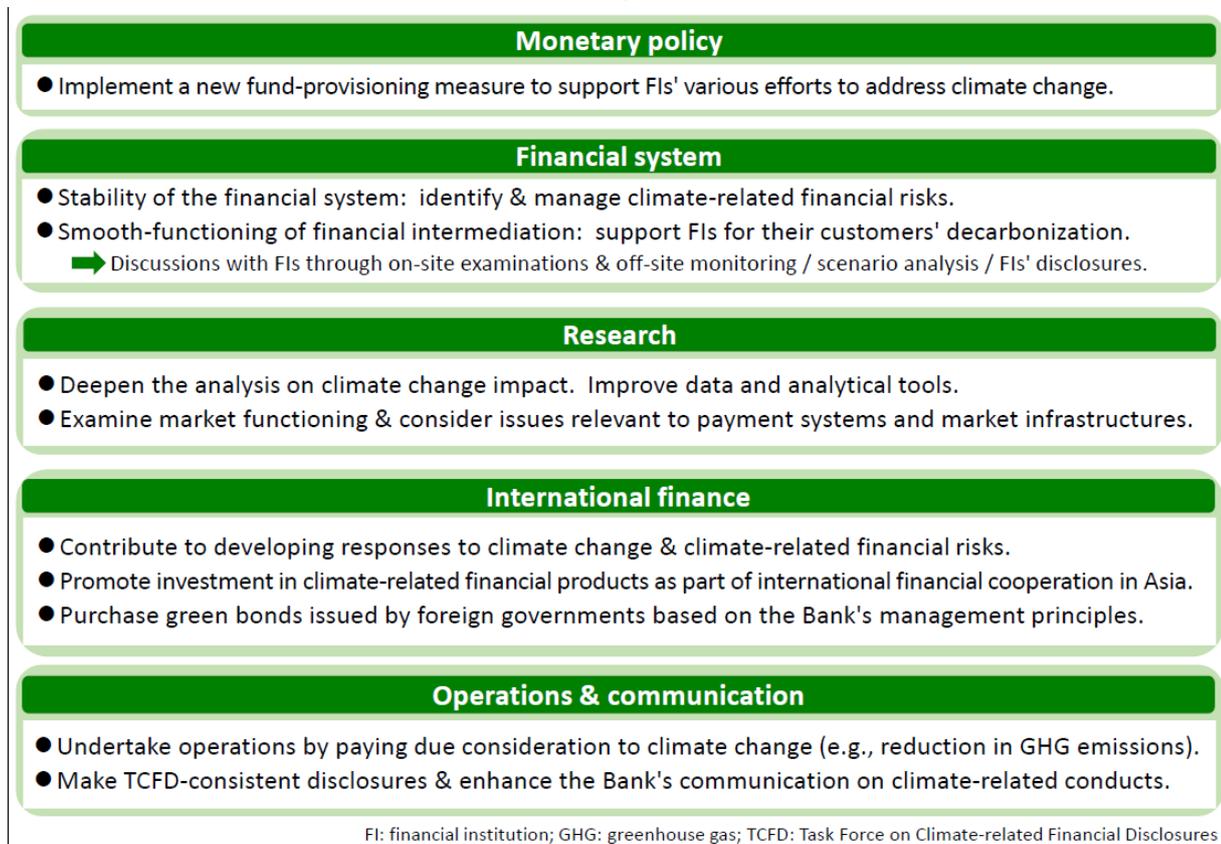
At the beginning of “[The Bank of Japan's Strategy on Climate Change](#)” announced on the afternoon of the 16<sup>th</sup>, the central bank emphasized that it enhanced bank-wide initiatives on climate change by setting up an internal network, the *Climate Coordination Hub*. The central bank explained the strategy, divided into five types of measures: (1) monetary policy, (2) financial system, (3) research, (4) international finance, and (5) the Bank's business operations and external communication (charts 3 and 4). This time, the climate scheme was designated under (1). A challenge facing the BOJ from now on is (2)<sup>1</sup>. It is important that measures in (2) move forward for the new scheme to operate smoothly. In (3), it clearly states that the BOJ will deepen its analysis and that findings will be shared. They are likely to be announced once compiled. Measures in (4) have already begun amid global trends<sup>2</sup>. This is positioned as international finance cooperation from the perspective of fostering the market. This is simply fund management via foreign assets held by the BOJ, with purchases of foreign currency-denominated sovereign green bonds not constituting monetary policy. Regarding (5), a new “[climate change](#)” webpage was established on the BOJ's website.

<sup>1</sup> Concretely, it was stated that “the Bank, in collaboration with the Financial Services Agency, is working on pilot exercises of scenario analysis targeting large financial institutions by using common scenarios” and it “will encourage financial institutions to enhance their disclosures, both qualitatively and quantitatively, based on the Task Force on Climate-related Financial Disclosures (TCFD) framework, which has been incorporated in the revised Japan's Corporate Governance Code.”

<sup>2</sup> On 12 Jul, BOJ [announced](#) that it has reached an agreement to promote investment in green bonds through the Asian Bond Fund (ABF) jointly with ten other member nations in the EMEAP (the Executives' Meeting of East Asia-Pacific Central Banks).

**Chart 3: BOJ's Strategy on Climate Change** (16 Jul 2021)


Source: Extracted from BOJ materials.

**Chart 4: BOJ's Measures to Further Efforts on Climate Change** (16 Jul 2021)


Source: Extracted from BOJ materials.

**Questions at Governor Kuroda's press conference focused on climate change**

**As climate scheme takes over from the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth, the same incentives are sufficient**

**BOJ's new scheme hoped to trigger greater response by companies to climate change**

**Disclosure based on TCFD guidelines said to be among strong options**

**Setting definitions for green difficult; room for doubt about whether objective judgment possible or whether greenwashing is preventable**

**Agreement on international taxonomy unlikely to be reached for now; BOJ to adjust scheme in line with situational changes**

**Adopting stance of doing what it can as a central bank within its mandate**

**Government is the main player in achieving green society, with BOJ focusing on supportive measures**

**BOJ is Japan's largest organization for macro economists; it's a pity to waste their skills**

At a regular press conference held by Governor Haruhiko Kuroda, questions focused on climate change, the only topic that attracted attention. Firstly, asked about the preliminary outline, he stated that they discussed what they could do as a central bank. Regarding special operations in response to COVID-19, he said that they were offering relatively high incentives by applying a positive interest rate, given the need to quickly support financing. However, he said they thought that it should be appropriate to make other points the same as those of the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth because the interest rate would be 0% and application of the macro add-on balance would double. He stated that at this point, these were sufficient incentives. With the climate scheme positioned as the successor to the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth, this is an appropriate judgment in terms of the current scale of loan demand and urgency. In principle, funds will be provided for one year, but refinancing is possible within the outstanding balance, which is useful for providing long-term loans. Mr. Kuroda pointed out that companies will need to invest in hardware and software over a long period of time to address climate change. He also commented that he hoped that the BOJ's new scheme would trigger a greater response by companies.

Regarding details about disclosure, Mr. Kuroda stated that disclosure based on TCFD guidelines would be among strong options, which was in line with the aforementioned strategy. As of 28 June 2021, the number of Japanese organizations that announced agreement with the TCFD proposals was 365, with financial institutions accounting for around 25% of the total. Asked about setting definitions for green, he replied that he didn't deny that there could be global agreement on taxonomy at some point. He explained, however, that it was unlikely in the near term. He stated that, this time, they had established a scheme that could cope with changes in the situation. This approach, in which the BOJ leaves judgment to financial institutions and discipline is maintained via disclosure, is certainly flexible. However, there is room for doubt about whether this can be regarded as objective judgment or whether this can prevent greenwashing. Initially, relatively large projects are likely to become the target of the scheme according to judgements based on TCFD guidelines. Later, the BOJ is likely to reconsider the target of this scheme in line with changes in the situation. If a broad range of financial institutions join the scheme (not just major banks), the scale of funds supplied could change. Nevertheless, the cumulative amount of loans made and issuance in (1)-(3) of Chart 2 reaches no more than Y1-1.5tn. If financial institutions see incentives as unattractive, the scale may become smaller.

Regarding climate change strategy, Governor Kuroda repeatedly emphasized a stance of doing what it could as a central bank within its mandate of price stability and stability of the financial system. With the government the main player in achieving a green society, the BOJ is likely to focus on supportive measures. Basically, the target for investment/loans is limited to Japan. The BOJ plans to buy green bonds via its foreign assets held as part of its international financial cooperation. However, it still thinks that purchases as a monetary policy are not appropriate. Under the comprehensive strategy related to climate change (charts 3 and 4), the BOJ is likely to formulate concrete measures and emphasize cooperation with the government for the timing being.

Lastly, asked about the available capacity of personnel resources amid the increasing specialty of operations at the BOJ, Governor Kuroda replied with confidence that the BOJ was Japan's largest organization for macro economists and experts. He said they were exchanging opinions with academic circles and the economic community, and were also cooperating with international organizations. However, in the current economic/financial circumstances in Japan, experts are unable to fully exhibit their skills and lead to important policy decisions. This results in a major loss of opportunities for Japan, and a waste of their skills, which is very regrettable. I hope they will plug away at daily work to achieve their mandate while waiting for an end of the pandemic.

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