

Daiwa's View

Looking back on the BOJ in 2021

- Things are looking slightly better regarding normalization of Japan's economy, but 2% inflation target is still far off

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BOJ's final MPM in 2021 decided on revisions to COVID-19 special program

Careful wording in title of explanatory material

BOJ's three major events in 2021

First event: Mar assessment meeting; demonstrated flexible policy response, which has stabilized long-term yield

ETF purchases became more flexible and well-prioritized, which put brakes on stock market's dependence on BOJ and balance sheet expansion

Looking back on BOJ in 2021; Indirect support to government and flexible, well-prioritized decision-making

At its Monetary Policy Meeting (MPM) held on 16-17 December, the final MPM in 2021, the BOJ decided to revise the Special Funds-Supplying Operations to Facilitate Financing in Response to the Novel Coronavirus (COVID-19 special program, Chart 1). Specifically, the lending facility for large companies will come to an end as scheduled at end-March, but that for SMEs will be extended by six months under the current terms and conditions, as their financing conditions are still unfavorable. We see it as positive that the BOJ demonstrated flexible, well-prioritized decision-making by (1) quickly bringing an end to the part of the program that fulfilled its role after achieving a certain degree of effectiveness, while (2) maintaining the part of the program for which there are still lingering concerns. The BOJ's explanatory material mentions a partial extension, but the scale of the operations coming to an end is much larger than that of the operations being extended¹. The careful wording indicates the BOJ's intention to avoid revealing the degree of tightening regarding the scaling-down of crisis-response measures, or it being seen as a policy revision.

Looking back on the BOJ in 2021, there were three major events. The first was the assessment meeting in March (decisions made on 19 Mar). In order to achieve the 2% price stability target, the BOJ implemented an assessment for further effective and sustainable monetary easing. (1) With a view to making it possible to cut short- and long-term interest rates nimbly, the BOJ established the "Interest Scheme to Promote Lending," which is linked to the short-term policy interest rate. (2) Regarding the yield curve control, the central bank clarified that the range of long-term yield fluctuations would be between around plus or minus 0.25% from the target level. At the same time, "fixed-rate purchase operations for consecutive days" were introduced. (3) With respect to purchases of ETFs and J-REITs, the BOJ did away with the purchase target of about Y6tn and about Y90bn, respectively, on the annual pace of increases in their amounts outstanding, which had been temporary measures in response to the pandemic. An additional easing tool was provided with (1). Also, the range of long-term yield fluctuations with (2) was clarified by being widened from the previous about double the range of around plus or minus 0.1%, and a preparative tool for a surge in the yield was shown. Since then, the long-term yield has been stable within a limited range thanks to these moves. Since April, (3) has been the most successful—i.e., the purchase stance has become more flexible and well-prioritized. The BOJ steered towards a favorable path to constrain expansion of its balance sheet and to put the brakes on the stock market's dependence on the BOJ.

¹ Currently, under the COVID-19 special program, it is estimated that loans against private debt pledged as collateral, government-supported loans, and non-government-supported loans amount to around Y50tn, Y20tn, and Y5tn, respectively.

**Second event:
Response to climate
change**

**Provision of indirect
assistance to
government within
scope of central bank's
service**

The second event was its response to climate change. At the June MPM (18 Jun), the BOJ judged it appropriate to introduce a new fund-provisioning measure through which it provides funds to financial institutions for investment or loans that they make to address climate change issues based on their own decisions. At the July MPM (16 Jul), the stance and preliminary outline of the measures were disclosed, after which, the outline of climate response financing operations was formally decided at the September MPM (22 Sep). In line with global trends, the BOJ established the scheme within the scope of the central bank's service. This will provide indirect assistance to the government's growth strategy. The third event was the revision to the COVID-19 special program at the December meeting (17 Dec).

Chart 1: Extension of Financing Support for SMEs

Partial Extension of the Special Program to Support Financing in Response to COVID-19 (until end-March 2022 → until end-September 2022)			
Purchases of CP and corporate bonds	Special Funds-Supplying Operations to Facilitate Financing in Response to COVID-19		
	Against private debt pledged as collateral	Against government-supported loans	Against non-government-supported loans
Additional purchases to be completed Continue purchasing the same amount as prior to the COVID-19 pandemic	To be completed	<p>Extend by six months the fund-provisioning to financial institutions against their loans</p> <ul style="list-style-type: none"> Under the revised terms and conditions <ul style="list-style-type: none"> Applied interest rate: 0% Amount added to the Macro Add-on Balances: the amount outstanding of funds provided 	<p>Extend by six months</p> <ul style="list-style-type: none"> Under the current terms and conditions <ul style="list-style-type: none"> Applied interest rate: 0.2% Amount added to the Macro Add-on Balances: twice as much as the amount outstanding of funds provided
Mainly for large firms and housing loans		Mainly for SMEs	

Source: Extracted from BOJ materials (17 Dec 2021).

In 2021, BOJ made all decisions at meetings when Outlook Report was not issued

Given situation with Japan's economy and prices, it is unavoidable that Japan is one lap behind in terms of policy

Governor Kuroda's press conference offered concrete comments on pace for reducing CP/corporate bond purchases

Things are looking slightly better regarding normalization of Japan's economy, but 2% inflation target is not just around the corner

BOJ will not move toward monetary policy normalization

Among the eight MPMs in 2021, all decisions and announcements were made in March, June, September, and December, except for meetings when the *Outlook for Economic Activity and Prices* report (*Outlook Report*) was issued (Jan, Apr, Jul, Oct), as mentioned above. As such, the BOJ appears to have had plenty of issues to discuss amid the pandemic in 2021. Meanwhile, the US economy recovered to pre-pandemic levels in Apr-Jun 2021, but Japan's economy is expected to do so in Jan-Mar 2022 at the earliest, or Apr-Jun, one year later than the US. Moreover, the y/y change in Japan's core CPI is expected to rise to the 1% level in April 2022 in the absence of the impact from a cut in mobile phone communication fees in April 2021. Nevertheless, compared to the US and Europe, Japan is still far off from the 2% inflation target. Therefore, it is unavoidable that Japan is one lap behind in terms of policy.

At this year's final regular press conference by Governor Haruhiko Kuroda, new information regarding revisions to the COVID-19 special program was provided. Asked about the pace for reducing CP/corporate bond purchases, he indicated a concrete time frame, saying that, as CP is short term, the pace would return to pre-pandemic levels in six months, but that for corporate bonds, it would take about five years, and that the outstanding amount would likely converge very moderately. Regarding his response to questions in the Diet on 15 December (he said that CPI would approach 2%), he gave a detail explanation in order to avoid incorrect interpretations, saying that that, based on the output price DI in Tankan and various price projections in the private sector, it was true that overall prices have been rising gradually, but that this did not necessarily mean that inflation of 2% was just around the corner. He also made it clear that the BOJ would continue on with monetary easing persistently, and that Japan's monetary policy would not start to move toward normalization like the US and Europe, although things are looking slightly better with regard to normalization of the economy.

Jan Outlook Report will be important material for analyzing inflation in Japan

In the near term, the BOJ will continue to carefully watch the extent of the economic recovery and price trends in the Oct-Dec quarter onwards. In the latest economic assessment, a clear upward revision was made only for private consumption (Chart 2). Given the uncertainty surrounding the Omicron variant and the delay in a resolution to supply constraints (catch-up production), the BOJ cannot do away with caution regarding downside risks. The January 2022 *Outlook Report* (to be released on 18 Jan), which will factor in the latest economic measures, will be important material for analyzing inflation in Japan.

Chart 2: Change in Description of BOJ's Economic Assessment on Current Conditions

Dec-21	
Current conditions	Text in red shows revisions ⇒ Revision status
Japan's economy	Has picked up as a trend, although it has remained in a severe situation due to the impact of COVID-19 at home and abroad ⇒ Unchanged
Overseas economies	Have recovered on the whole, albeit with variation across countries and regions ⇒ Unchanged
Exports	Have continued to increase as a trend, despite remaining weak due to the effects of supply-side constraints ⇒ Removal of "in some areas" regarding supply-side constraints, and revision to "remaining weak"
Business fixed investment	Has picked up, although weakness has been seen in some industries ⇒ Unchanged Corporate profits and business sentiment have continued to improve on the whole ⇒ Unchanged
Private consumption	Has picked up gradually, with downward pressure stemming from COVID-19 , particularly on services consumption, waning somewhat . ⇒ Upward revision from "Has shown signs of a pick-up recently, although downward pressure has remained strong"
Public investment	Has been relatively weak, albeit at a high level ⇒ Downward revision from "has been more or less flat"
Housing investment	Has picked up ⇒ Unchanged
Industrial production	Have continued to increase as a trend, despite remaining weak due to the effects of supply-side constraints ⇒ Revision alongside exports
Financial conditions	Have been accommodative on the whole, although weakness in firms' financial positions has remained in some segments ⇒ Unchanged
Prices	Y/y change in CPI (all items less fresh food) has been at around 0%, mainly due to a rise in energy prices, despite being affected by a reduction in mobile phone charges. Meanwhile, inflation expectations have picked up. ⇒ Unchanged

Source: BOJ; compiled by Daiwa Securities.

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