Daiwa Securities

Daiwa's View

Structure of current accounts when ending NIRP: Additional considerations

- Is single-tier structure with +0.1% interest rate possible?

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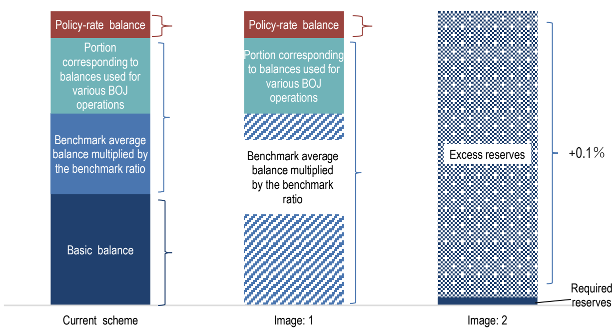
Since the beginning of this year, when ending the BOJ's negative interest rate policy (NIRP) started to come into view, we have again received an increasing number of questions about the structuring of the BOJ's current accounts. In a previous report covering potential new current account structures once NIRP is ended, we presented a "two-tier structure" with different interest rates depending on the balance as our main scenario (left chart: image (1)). However, once the BOJ actually modifies its current account structure, we will need to consider cases other than the two-tier structure that we presented, as other options are available. In this report we will examine the BOJ's current account structure before the introduction of NIRP, specifically a single-tier structure in which an interest rate of +0.1% was applied to overall excess reserves (left chart: image (2)).

We again confirmed that the purpose of NIRP, as it has been introduced so far, is to lower the market interest rate by lowering into negative territory the interest rate (uncollateralized overnight call rate) at which private banks lend and borrow among each other. If that is the case, the important point when ending NIRP will be to move the uncollateralized overnight call rate, which is currently in negative territory, into positive territory. Under that objective, for example, a structure in which the BOJ applies a +0.1% interest rate to overall excess reserves is conceivable. In other words, this would be the case of reverting back to the structure used immediately prior to the introduction of NIRP (left chart: image (2)).

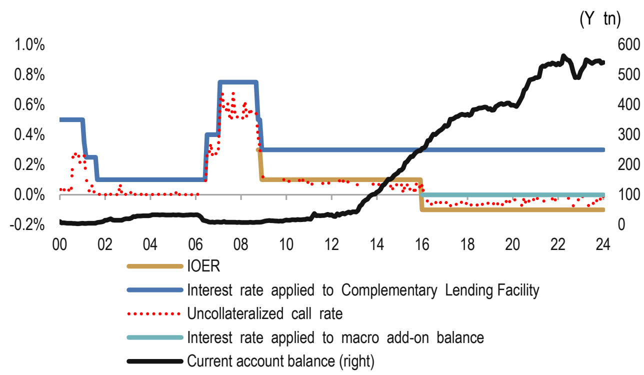
At this time, we would expect the uncollateralized overnight call rate to move close to the applied interest rate (+0.1%). Actually, after the launch of the Complementary Deposit Facility in 2008, the uncollateralized overnight call rate remained below the applied interest rate level until NIRP was introduced in 2016 (right chart).

Current Account Structure Images



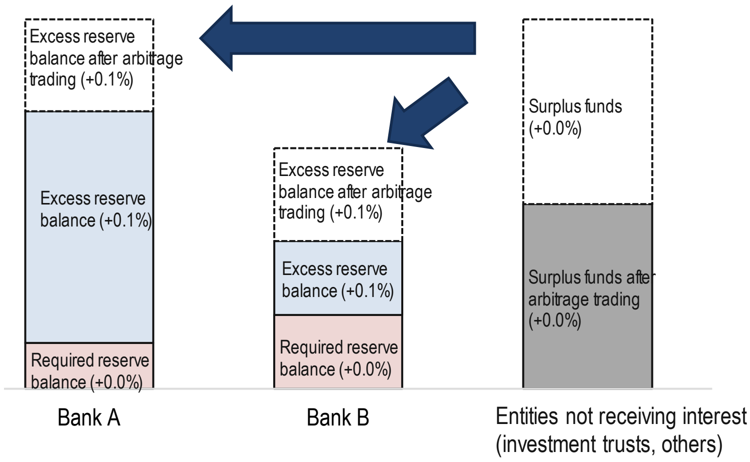
Source: Compiled by Daiwa.

Short-term Market Rates



Source: BOJ materials compiled by Daiwa.

Trading Incentives After Introduction of Complementary Deposit Facility



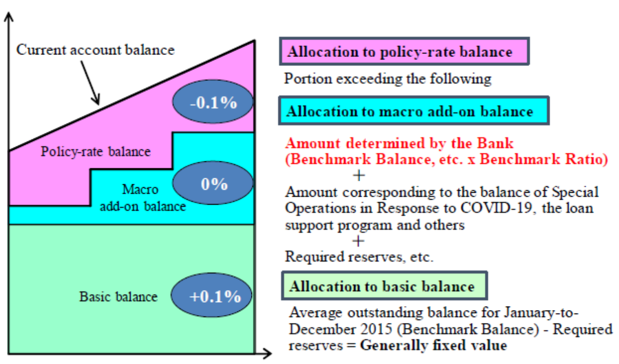
Source: BOJ materials compiled by Daiwa.

Here, the balance of surplus funds belonging to investment trusts that do not hold current accounts, as well as entities not covered by the Complementary Deposit Facility (entities not receiving interest), are used for fundraising by depository institutions and other financial institutions within the system at a level below the interest rate, as well as for arbitrage trading utilizing current accounts (above chart).

However, a “single-tier structure” after ending NIRP would entail the possibility of decreased incentives for conducting such arbitrage transactions. It is conceivable that the unused allowances within macro add-on balances, in accordance with the amounts for various operations, have played an important role in arbitrage transactions.

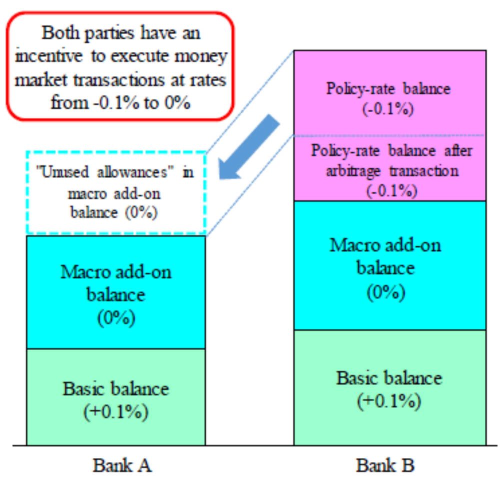
Usually, financial institutions have shouldered more negative interest rate burdens when policy-rate balances increase. The policy-rate balance is the balance derived by subtracting (1) the upper bound of the “basic balance” and (2) the upper bound of the “macro add-on balance” from the current account balance, for which an interest rate is applied. As such, the larger the “macro add-on balance,” the smaller the balance subject to negative interest rates, which in turn reduces the burden on financial institutions.

Overview of Current Three-tier System



Source: Reprinted from BOJ materials.

Arbitrage Transactions Under NIRP



Source: Reprinted from BOJ materials.

However, under a "single-tier structure" after ending NIRP, a uniform +0.1% will be applied to excess reserves, which will reduce the incentive to use the operations offered by the BOJ. Naturally, a decrease in the use of BOJ operations would reduce the money supply and, as a result, put downward pressure on the monetary base. This could hinder maintenance of the inflation-overshooting commitment, for which expansion of the monetary base by the BOJ is a component. There are also concern that the effectiveness of operations targeting specific sectors, such as the "Funds-Supplying Operations to Support Financing for Climate Change Responses," will be diminished.

As such, rather than a "single-tier structure," we currently expect the BOJ to adopt a "two-tier structure," which maintains these effects.

However, this assumes that no changes at all are made to the BOJ's current system. When considering the possibility that the BOJ could adjust how it applies the various operations, the Bank might, for example, consider changing the interest rate applied to the "Interest Scheme to Promote Lending." That would help to maintain incentives for using the various operations provided by the BOJ.

Also, the "Summary of Opinions" for the January 2024 Monetary Policy Board meeting suggested that the inflation-overshooting commitment could be revised when ending NIRP.

After all, it is impossible to predict what structure will actually be adopted after ending NIRP as assumptions vary widely depending on how the overall system design will change.

On top of that, it appears that uncollateralized overnight call rate will remain at 0~+0.1%, regardless of which current account structure is adopted.

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