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## Comments on Bank of Japan Governor's Speech

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Warren Mosler  
(340) 692-7710

[wmosler@valance.us](mailto:wmosler@valance.us)

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Toward the Reform of Corporate Finance in Japan  
Keynote Speech given by Toshihiko Fukui, Governor of the Bank of Japan,  
at the JSLA Symposium on  
*"New Corporate Finance to Revitalize Japan,"*  
in Tokyo, on November 17, 2003

### **COMMENTS IN CAPS.**

#### VI. The Bank of Japan's Initiatives

##### A. Three Pillars of the Monetary Easing Policy

The Bank of Japan is making every possible effort to ensure that the effects of monetary easing permeate the economy more fully, so as to overcome deflation and put the economy back on a sustainable growth path. Let me elaborate on our efforts in this regard.

First, the Bank is providing extremely ample liquidity to financial markets. This so-called quantitative monetary easing acts to ensure the stability of financial markets, thereby firmly supporting economic activity.

THERE IS NO TRANSMISSION MECHANISM BEYOND THAT OF THE RESULTING INTEREST RATE STRUCTURE. ALSO, (EXCESS) BANK RESERVES ARE A 'BANK TAX' AS THEY REQUIRE BANKS TO HOLD THAT MANY ASSETS IN NON INTEREST BEARING RESERVE ACCOUNTS AT THE BOJ, RATHER THAN INTEREST BEARING ALTERNATIVES, SUCH AS JGB'S, AS OUTLINED IN ALL BASIC MONEY AND BANKING TEXTS.

Second, the Bank has committed itself to continue this quantitative easing policy. Often termed the "policy duration effect," the effect of this commitment is to stabilize public expectations about the direction of future policy, and to keep relatively long-term interest rates at lower levels.

THE TERM STRUCTURE OF RATES CAN BE CONTROLLED DIRECTLY RATHER THAN INDIRECTLY.

Specifically, the Bank's commitment is to keep the current framework until the annualized growth rate of the consumer price index (CPI) stabilizes above zero percent. At the Monetary Policy Meeting in October, the Bank further clarified its commitment in simple and clear terms.

YES, BUT AS ABOVE, THERE IS NO TRANSMISSION MECHANISM, BEYOND THE INTEREST RATE STRUCTURE PER SE, FROM QUANTITATIVE EASING TO THE CPI.

Third, the Bank is striving to enhance the transmission mechanism of monetary easing.

RIGHT NOW THERE AREN'T ANY, APART FROM THE RESULTING INTEREST RATES.

For the effects of quantitative monetary easing to reach every corner of the corporate and household sectors, credit should be extended either by banks and other financial services providers, or through financial markets, not only widely but also effectively.

LENDING IS NOT RESERVE CONSTRAINED, SO INCREASING EXCESS RESERVES MAKES NO DIFFERENCE BEYOND (MODESTLY) REDUCING BANK EARNINGS, AS ABOVE.

In this regard, the reform of corporate finance is intimately related to the Bank's current conduct of monetary policy. Such reform is also extremely important for the future of Japanese economy because, in the creative and dynamic economy that we envision for the future, I believe that it will be essential that the firms intending to identify new sources of value-added, which are actively undertaking risks, should be able to obtain sufficient support to meet their specific financial needs.

HE IS SAYING BANKS ARE NOT DOING A GOOD JOB OF LENDING, AS THEY ARE EXCLUDING CREDITWORTHY BORROWERS, PERHAPS DUE TO THE INSTITUTIONAL STRUCTURE?

#### B. Efforts to Revitalize Credit Markets

Based on this thinking, the Bank has stepped up its efforts to revitalize credit markets in Japan. First, the Bank has provided substantial support for private efforts to improve the functioning of such markets. In addition to the traditional credit markets such as for loans, commercial paper (CP), and corporate bonds, we consider it crucial to promote the development of new credit markets for syndicated loans, ABSs, and credit derivatives.

THIS ONLY MAKES A DIFFERENCE IN THE MACRO ECONOMY IF IT ALTERS ACTUAL LENDING TO BORROWERS. FOR EXAMPLE, IF BANKS MAKE LOANS WHICH THEY WOULD HAVE MADE ANYWAY, BUT INSTEAD OF HOLDING THEM THEY SECURITIZE AND SELL THEM, THERE IS NO ECONOMIC DIFFERENCE. IF SECURITIZATION SOMEHOW LEADS TO EXPANDED CONSUMER AND BUSINESS LENDING, THERE IS A DIFFERENCE. I CAN ONLY THINK OF TWO REASONS IT COULD MAKE A DIFFERENCE- EXPANDED MARKETING TO CONSUMERS AND BUSINESSES AND ALTERING CREDIT STANDARDS.

The Bank, in cooperation with the JSLA and a large number of market participants, has continued to support steadily efforts to improve new credit markets, in such areas as devising standard forms for contracts, streamlining transaction practices, as well as collecting market data and publishing statistics. A recent example is the Bank's decision to start publishing statistics on syndicated loans from December 2003, in response to earnest requests from market participants. The Bank has also conducted quantitative and theoretical research using a variety of data to

capture movements in financial markets and at financial services providers, and has sought to share professional views with market participants by publishing the results of its analyses.

THIS IS A SUBSTANTIAL REAL EXPENSE TO JAPAN. AT THE MOMENT THEY ARE SUFFICIENTLY UNDEREMPLOYED SO THAT THE REAL COST IS STILL MINIMAL. BUT WHEN THE ECONOMY DOES RECOVER THIS INFRASTRUCTURE BECOMES A DRAG ON THE REAL STANDARD OF LIVING. LIKEWISE, ANY REDUCTION IN BANKING INFRASTRUCTURE PROVIDES A REAL BENEFIT.

ADDITIONALLY, ALL SECONDARY MARKET TRANSACTIONS IMPOSE REAL COSTS ON THE MACRO ECONOMY.

Second, the Bank has been enhancing the settlement infrastructure for financial markets. The Bank started online operation of its funds transfer system in 1988, and of the transfer system for Japanese government securities (JGS) in 1990. As for CP, corporate bonds, and stocks, the Bank has cooperated with private-sector settlement systems to introduce online settlements as well as simultaneous settlements of securities and funds, the delivery versus payment (DVP) system. The Bank will continue its proactive support for ongoing projects, including the complete online settlement of corporate bonds and stocks.

Third, the Bank has continuously reviewed the effects of its various policy measures and operations, adjusting these in light of prospective changes in financial markets and at financial services providers. In 1999, the Bank began to accept ABSs as collateral for its market operations to provide liquidity, and since then it has expanded the scope of ABSs as eligible collateral.

I'M NOT SURE WHY THIS MATTERS. THERE IS NO SHORTAGE OF JGB'S. PERHAPS IT LOWERS FUNDING COSTS OF ABS HOLDERS A FEW BASIS POINTS.

Currently, the Bank is also working on detailed ways of using syndicated loans as collateral, a project for which it has sought the opinions of market participants.

AGAIN, TO WHAT PURPOSE? THE BOJ ALREADY SUPPORTS MEMBER BANK FUNDING IN GENERAL. THAT ALREADY COVERS COMMERCIAL LOAN PORTFOLIOS.

In the summer of 2003, the Bank launched operations to purchase ABSs. This represents an unconventional policy measure for a central bank.

YES. BUT AGAIN, WHETHER THEY PURCHASE ABS OR SUPPORT MEMBER BANK FUNDING THAT IS USED IN THE PURCHASE OF ABS MAKES LITTLE DIFFERENCE TO THE MACRO ECONOMY.

However, since the market for ABSs is still in an embryonic stage, with relatively few market participants willing to assume the associated risks and with difficulties in arranging the securities, the Bank decided to shoulder the credit risk of holding ABSs itself.

LIKEWISE IT SHOULDERS SOME OF THE RISK OF ALL BANK LENDING VIA DEPOSIT INSURANCE AND THE OWNERSHIP OF PREFERRED STOCK, ETC.

Although it is conceivable that this intervention by the Bank may distort the price discovery function of the market and thereby jeopardize its sound development, the Bank's design and management of the purchase scheme makes careful allowances for this risk.

AND THIS IS THE CASE WITH MOST ALL BANK LENDING, AS ABOVE.

The Bank wishes to make every effort to cooperate with market participants in the revitalization of credit markets. To this end, the Bank has inaugurated a "Workshop on Securitization." I hope that various market participants, including both originators and investors, will take part in the workshop and suggest further ways to nurture and improve these credit markets. I expect this workshop to provide valuable insights in these areas.

ISN'T THE MAIN BENEFIT TO THE BROKERS AND DEALERS IN THESE SECURITIES?