Asia's Developing Future

ADBInstitute

ASIAN DEVELOPMENT BANK INSTITUTE

Bank of Japan stock buying will be hard to unravel

The Bank of Japan's ongoing purchases of Japanese stocks has warped the country's equity markets. Every day it continues will make the eventual unwinding of those holdings harder, both for the central bank and for the markets themselves.

In January 2013, the BOJ introduced a 2% price stability target in an effort to extract the country from more than a decade of stagnant or falling prices. That in itself was a rare move by a central bank.

A few months later, the bank stepped up its efforts under a program it called Quantitative and Qualitative Monetary Easing, or QQE. The main pillars of the BOJ's monetary easing were large-scale purchases of Japanese government bonds, a negative interest rate, and a target for the yield (or return) on the country's 10-year government bond.

Sayuri Shirai, who was a member of the BOJ's policy board at the time, explains what happened next:

> As part of QQE, the BOJ has been purchasing Japanese stocks—not directly but indirectly through the purchases of exchange-traded funds. There are very few central banks in the world that have purchased stocks on this scale and for such a long time as part of the conduct of monetary policy.
>
> When the BOJ embarked on its course of action, it had no reference to the experiences of other central banks. Similarly, the BOJ's extremely challenging task of normalizing the policy and ultimately disposing of the stocks purchased is without precedent.

Exchange-traded funds, or ETFs, lump together stock purchases to track the indexes used to monitor market activity. In this case, the BOJ was buying ETFs that tracked two of the country's main stock indexes, the Nikkei 225 and the TOPIX. It hoped that its purchases would trigger buying by Japanese individuals, who are much less likely to own stocks than their counterparts in most other developed countries.

> The BOJ hoped to generate "healthy" risk-taking behavior among individuals, not just among firms and financial institutions, as risk money (such as investment in stocks and real estate and foreign investment) could energize the Japanese economy and encourage individual investors to diversify their financial assets. Traditionally, individuals have held over a half of their financial assets in the form of cash and deposits in Japan. They are highly risk-averse, as only 10% has been invested in stocks, compared with 36% in the United States and 18% in the Eurozone, according to the BOJ.

The BOJ was already buying ETFs under previous programs when QQE began, but on a much smaller scale. It held 1.5 trillion yen in ETFs at the time QQE started. That's about $14 billion at current exchange rates.

QQE kicked those purchases into a higher gear and when the various measures taken by the BOJ failed to prime the pump of Japanese inflation, the bank kept increasing its efforts. The BOJ is currently adding 6 trillion yen a year worth of ETFs to its holdings. By August 2018 it had accumulated about 21 trillion yen worth.

The result is that the BOJ has become the third-largest holder of Japanese stocks, after Japan's Government Pension Investment Funds, known as GPIF, and the investment fund Blackrock. Its actions now shape the markets. GPIF, one of the world's largest government funds, started buying more domestic stocks in 2014 and now holds about 41 trillion yen worth. The buying by the BOJ and GPIF has helped keep Japanese stock prices buoyant. By September 2018, the Nikkei 225 had more than doubled in value from the time of QQE's introduction.

But propping up the stock market was not the main goal of the BOJ's actions. The intended result, to shake Japanese individuals out of their conservative investment habits, hasn't materialized.

> **Individuals remained largely risk-averse and did not actively rebalance their portfolios in favor of risk assets. This was despite the BOJ's policy, GPIF reform that increased stockholdings, and a series of government tax incentives to promote stock investment for individuals.**

There were also unintended consequences.

The BOJ is a silent holder of stocks. It doesn't vote. Its presence as such as large stock holder that does not exercise voting rights may delay much-needed corporate governance reforms. Until recently, the BOJ was splitting its ETF purchases between the Nikkei 225 and TOPIX. That became a problem because there are 225 companies on the Nikkei versus more than 2,000 on TOPIX and many on the Nikkei are smaller firms. That led to criticism as BOJ buying was seen to be disproportionately going to the stocks of some companies on the Nikkei, benefitting them more than others.

There are also worries that investors may now be reluctant to buy Japanese stocks, knowing that at some point the BOJ will need to slow and eventually reverse its stock buying, which could send prices down.

> **The longer the BOJ continues with the ETF purchases, the more turbulence the stock market is likely to experience when the BOJ makes a major step toward normalization. This might make it much harder for the BOJ to adopt a smooth exit strategy. The dilemma between achieving the 2% price stability target and coping with various side effects may become amplified.**

This podcast was based on *Bank of Japan's Exchange-Traded Fund Purchases as an Unprecedented Monetary Easing Policy*, a working paper for the Asian Development Bank Institute by Sayuri Shirai. She is a professor at Japan's Keio University and a visiting scholar at the Asian Development Bank Institute and served on the Bank of Japan's monetary policy board from 2011 to 2016.

Listen to podcast

- https://soundcloud.com/adbinstitute/bank-of-japan-stock-buying-will-be-hard-to-unravel/

Read the working paper

- https://www.adb.org/publications/boj-exchange-traded-fund-purchases-unprecedented-monetary-easing-policy

Know more about ADBI's work

- https://bit.ly/2GsYx