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BOE's "Monetary Easing in Three Dimensions": Common Points and Differences with BOJ and their Implications

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On August 4, 2016, the Bank of England (BOE) decided a monetary easing in three dimensions of quantity, quality and interest rate. The decision of easing at the August policy meeting was already anticipated and incorporated in the market through the statement of the July meeting and its summary of minutes, but the magnitude of the decision exceeded the anticipation of the market and has been accepted as a positive surprise. To be more precise, the quantitative easing that was practically dormant was resumed, with the amount of purchase of government bonds increased by ￡60 billion from the current level of ￡375 billion to ￡435 billion (for the period of 6 months from August). At the same time, the easing in quality was expanded to newly include in the assets for purchase up to ￡10 billion of sterling denominated bonds of non-financial companies with investment grade (for the period of 18 months from August). Furthermore, the BOE cut the policy rate for the first time in 7 years and 5 months since March 2009 (from 0.50% to 0.25%) and strengthened its lending activities to financial institutions by introducing a new funding framework (Term Funding Scheme).

As is well known, the monetary easing known as "three dimension easing" accompanied by quantitative, qualitative easing and interest rate cut was originally initiated by the Bank of Japan (BOJ) in January this year and the BOJ strengthened the policy on July 29th by increasing the amount of purchase of ETF (from equivalent of 3.3 trillion yen to 6 trillion yen). On the other hand, though the BOE does not call its policy as three dimension easing, it seems that the BOE, by moving to take an additional easing of extraordinary all-round type, had shown its determination to exploit every measure available in the face of so to speak a national crisis brought by the Brexit voting. Also the European Central Bank (ECB) decided in March a comprehensive package of easing that exceeded expectations. Reviewing anew the movements of the BOE and the BOJ since the end of last month about their common points and differences, there seem to be self-evident but important implications from them.

＜Quantitative easing is no more than a finite step to "buy a time" ＞

First, the common implications between the BOJ and BOE actions are the following two points: that the monetary policy measures are not unlimited and that extraordinary and massive quantitative monetary easing is just a “measure to buy a time before the government policies bear the successful fruits” in addressing the structural reforms and response to the Brexit.

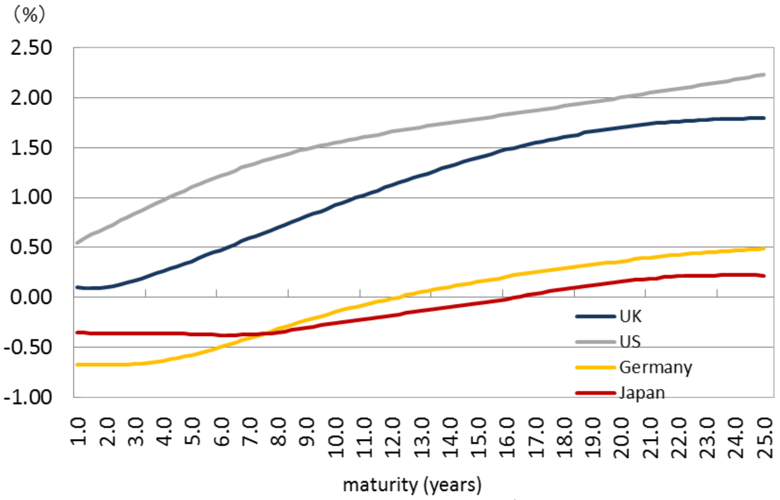
The technical limit was unintentionally exposed immediately after the resumption of gilt purchase by the BOE. The BOE reopened its government bond purchase on August 8 and implemented the purchase of super long-term bonds with maturity of more than 15 years, but it happened that the bank was not able to meet the planned amount of purchase. In the background there was a reluctance of investors to sell the government bonds as they had difficulty to manage the assets because of globally low interest rate. It seems that the BOE quickly ran into an obstacle of “lack of government bonds sellers” As for the purchase program of government bonds by the BOJ as well, it has already been pointed out by the IMF and others that the BOJ will be faced with the technical bound of scarcity of sellers by the middle of 2017. Apart from the “should-do arguments” over the weakening function of the market or a risk of monetization, it will be necessary to again acknowledge more widely and strongly that the massive purchase of assets by central banks, of all things, represents a policy that has technological limitation and soon or later it will run into the wall of sustainability (meaning it would not be an unlimitedly available tool).

A detailed explanation would not be necessary to the second point that it is a “measure to buy a time before the government policy measures would be successfully implemented”. The recent decision by the BOE represents only an initial emergency response to the national referendum that ended in the victory of the “Leave the EU” campaigners and it is nothing more than a measure to buy a time before the policies of the government, which was regarded as lacking in policies and irresponsible immediately after the result of the referendum became clear, getting on the right track. It is hoped that the government responses like the drawing of a roadmap to the Brexit and fiscal supports will make a good progress while a temporary lull is kept in the economy and financial market owing to the policy responses of the central bank. In this sense, the UK can be said to be in the same situation as Japan where structural reforms including restoring sound public finance are strongly desired while the untraditional monetary easing of the BOJ is producing the effect.

＜BOE says ”NO” to NIRP with its room for lowering the rate＞

On the other hand, the decisive difference has raised another implication. Although both central banks are similarly conducting their policy management with all their might, their attitudes toward the “lower end of policy rate” largely differ, at least officially. Asked about the lower end of the policy rate at the press conference after the recent policy meeting, the governor of the BOE Mark Carney commented that “the MPC has made it very clear that the virtual low end of the policy rate is within the positive range. That means close to zero, but a positive number.” He also said that “he himself would not agree to a negative interest rate”. He gave the reasons for it, saying that "if the negative interest rate is introduced in the environment of prolonged low interest rates, the lending rate will decline more rapidly while the cut of deposit rate has been constrained. Because of the shrinking margins that follow, the financial institutions will move to take such actions as raising bank fees, and as a result it will easily make the practical borrowing conditions on the side of customers tighter."

＜Yield Curves of Government Bonds in Major Countries＞



（Source BOE / 15days- average to July 26 2016）

It would be safe to say this is somewhat a bold statement. If he had made a positive statement to the negative interest rate even if in general terms, the market would have instantly moved to incorporate it, possibly causing a turmoil in the market. So the governor's statement might have contained careful attention to that possibility. However, not a few countries in Europe as well as Japan have already introduced negative interest rates, and the Chairwoman Janet Yellen of the US Federal Reserve Board (Fed) also showed in May a certain understanding to a negative interest rate, saying that "although we need much deeper analysis, I would not completely rule out the use of negative interest rates as a policy alternative" So one can say that Mr. Carney's statement belongs to a minority group among the major central banks.

＜All the more important communications for highly complicated monetary policy＞

Yet, governor Carney's point to the possible adverse implications of the negative interest rates is right even if he belongs to the minority group. His statement highlights all the more difficult situations (strong domestic criticisms) that the BOJ and the ECB are facing. What is important here will be that these central banks have their own circumstance that forces them to choose or maintain the negative interest rates while acknowledging the damages from them, and that it is their current stance that they will not hesitate to choose the negative interest rates despite their short-term and partial adverse effects if they can ultimately expect a win-win effect in the macroeconomic perspective.

It may be a well-worn conclusion, but if that is the case, the important thing is a good communication. Since they are conducting very challenging policies, it will be all the more necessary for them to disclose frequently enough the relevant information on their policy intentions, transmission mechanisms and required time spans in the way that is easy to be understood by both pros and cons. The receivers of the information, on the other hand, should not only criticize the central banks from their own standpoint but also present alternative proposals based on a macroeconomic viewpoint. In that sense, it is not surprising that the "comprehensive policy review" to be made at the next policy meeting of the BOJ (to be held on September 20 and 21) draws much attention and expectation.

Even in the Fed, which seems to be suffering least from the woes of managing monetary policies among the four central banks of Japan, the UK, the US and Europe, this fundamental argument has been thrown to the table of policy makers. On August 15th, the president of the Fed of San Francisco John Williams, who is believed to be a theorist with a closer thinking to the Board Chair Janet Yellen, published a letter urging that given the low level of natural interest rates in the US, the Fed has to reconsider their policy tools. Even in the US we find a question of whether the currently used policy tools are appropriate at all or not in meeting reality has been raised from inside of the institution. For good or bad, we may have to expect this situation to continue for some time in the future where attention is focused on every move of the major central banks, which will happen to induce higher volatilities in the market.