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Bank of Japan Provisions for Losses on ETFs Inadequate

Issues regarding BOJ exit strategy

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Summary

- The BOJ's FY2020 financial results were in the black, but there is a possibility that they will be in the red when it normalizes monetary policy, including shrinking the balance sheet and raising interest rates in the future. The biggest problems that can arise from the asset deficiency of central banks are the possibility that confidence in their currencies will be diminished and an increased burden on taxpayers. This paper focuses on the possibility that valuation losses on stocks, ETFs, and J-REIT may squeeze profits, and discusses preparations for losses.

- A transfer is made to provisions for losses on stocks, ETFs, and J-REIT, etc. after valuation losses are incurred. If valuation losses occur and distributions decrease, ordinary losses are expected if losses cannot be offset by other revenues. Estimating the market value of ETF, it is probable that a valuation loss of approximately ¥3 trillion occurred on March 16, 2020, when the stock price plunged due to the spread of COVID-19. At the end of March 2020, the market value barely exceeded book value. If the timing had been slightly different, it is highly likely that the bank would have posted a valuation loss, which would have put it in the red.

- Assuming that 50% of the distributions on ETFs at the end of each fiscal year were set aside as provisions for price changes from the end of FY2013, the outstanding balance of provisions as of the end of FY2020 would be 1.2 tril yen, which would alleviate the shock.

- The Bank of Japan's capital adequacy ratio relative to total assets has been on a downward trend since fiscal 1995. The capital adequacy ratio for accounting purposes is calculated relative to the outstanding balance of banknotes issued, but it may not be quite adequate, because the ratio of banknotes to the BOJ's balance sheet is declining.

- Despite an expanding balance sheet and increasing risks, the absence of changes in provision requirements and capital adequacy levels appears to imply inadequate provisions. It may be necessary to reexamine the allowance system and the capital adequacy ratio.

Attention
This report is a summary translation. The official document is only in Japanese.

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