

CAN BOJ POLICY STIMULATE JAPAN'S EQUITY MARKET?

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This week's Bank of Japan (BOJ) actions lay a strong foundation for a successful counter to the rising COVID-19 depression risks. To become credible and successful, its focus now shifts to three major areas: two at home and one abroad.

- First of all, we need to see Japanese fiscal policy quickly be coordinated and compound the new monetary steps. Here, we expect a special package to be compiled before month-end, worth as much as 1.5%–2% of [gross domestic product \(GDP\)](#), primarily focused on added zero-rate loan facilities and wage-bill support. This will add concrete transmission channels to the new credit facility announced by the BOJ this week.
- Second, we'll need to see domestic institutional investors follow the BOJ's lead and raise their allocation to yen equities. As of March 16, the BOJ is set to buy approximately 4.1% of the market. However, if the BOJ (and corporate [buybacks](#)) remains the only source of net equity buying power—and private domestic savers continue to sell—Japan's monetary policy will become nothing but the biggest experiment in financial socialism ever seen in a free-market economy.

In my view, corporate leaders will do their share to attract domestic savers by not cutting [dividends](#) and *not* significantly reducing their share buyback plans. The record cash balances of listed companies—almost 130% of GDP—certainly allow for this, despite the coming [cash flow](#) squeeze. Japan's new and improved capital stewardship and corporate governance priorities have raised hopes that corporate leaders will now have enough capitalists' focus to pass this simple test in coming months.

Clearly speaking, if, as I suspect, dividends are maintained, domestic investors now have no excuse to not follow the BOJ and raise domestic equity portfolio allocations. With the new fiscal year starting April 1, chances are good that we'll start seeing more positive private investor flow activity before long.

- Finally, we'll need to see energized resolve for international policy coordination in general, and well-coordinated currency policy in particular. Governor Kuroda made it very clear that a currency war and devaluation temptations must be avoided at all costs. A sustained surge in the yen toward, say, ¥95/\$ would almost certainly overpower the positive counteroffensive in the fight against a COVID-19 depression launched this week by the BOJ.

What Did the BOJ Resolve?

Specifically, the BOJ decided to:

1. Raise the upper limit of annual ETF buying from ¥6 trillion to ¥12 trillion. This brings total BOJ buying power to approximately 4.1% of the Japanese market (at current [TOPIX](#) market cap of ¥286 trillion).

Importantly, Governor Kuroda went out of his way in the press conference to clarify that, yes, the ETF buying program will indeed be doubled, thereby explicitly dispelling market concerns that the annual purchase guideline may still be unchanged at ¥6 trillion, despite the new ¥12 trillion budget. (This misconstrued interpretation of this week's policy decision may have contributed to the market sell-off following the BOJ announcement, which was during the trading day, while the governor's press conference was after the close.)

All said, the governor's credibility is on the line, and we must see a credible path toward the doubling of daily BOJ ETF buying in coming days. If, as we suspect, concrete actions do follow this week's words, investor confidence in the BOJ support for the domestic equity market should grow.

Indeed, the flow-of-fund story for Japanese equities is starting to look quite compelling: The BOJ is set to buy 4%

of the market, share buybacks are set to run about 2% of [market cap](#) and there's a [dividend yield](#) of around 3%. Meanwhile, the risks of an accelerating exit by global investors would appear to be low, given they already cut positions to record low levels by the end of December, at approximately 7%–8% below global benchmarks.

2. Pledged to just about double its purchasing plan (to ¥180bn for REITS, ¥4.2trn for corporate bonds and ¥3.2trn for commercial paper) for REITS, corporate bonds and commercial paper.

3. Create a new special funds supply operation to support COVID-19-affected corporate liquidity, which will provide companies with zero-interest loans with a maturity of up to one year.

4. Provide U.S. dollar liquidity by cutting USD [swap](#) loan rates and offering USD weekly with 84-day maturity, in addition to the one-week maturity previously offered. This new JPY/USD swap agreement is coordinated with the [Federal Reserve \(Fed\)](#), European Central Bank (ECB), Bank of Canada (BOC), Bank of England (BOE) and Swiss National Bank.

5. *Not* change interest rate policy. This is a very positive development, in our view. Adding further negativity to bank profit margins, which is what negative rates would do, would not only be counterproductive to the ETF-buying impact on stocks (by fueling further earnings revisions down from the banks), but it would also raise the possibility of potential systemic risks creeping into the banking system, with regional lenders and credit unions in focus.

All said and done, at this week's emergency BOJ policy meeting, the central bank added significant firepower to its war chest of potential asset purchases and liquidity provision. If, as we suspect, the coming days do confirm a de facto doubling of BOJ ETF buying, and Prime Minister Abe follows up with a quickly compiled emergency fiscal package in a week or so, the path toward recovery in Japanese markets should become clearer and more credible. A new Japan [bull](#) market would start if we get evidence that private domestic investors are indeed following the BOJ lead and raising their domestic equity portfolio allocations.

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DEFINITIONS

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Buyback : When a company uses its own cash to purchase its own outstanding shares; may positively impact the share price.

Dividend : A portion of corporate profits paid out to shareholders.

Cash flows : a measure of how much cash a business generates after taking into account all the necessary expenses, including net capital expenditures.

TOPIX 500 Index : A capitalization-weighted index designed to measure the performance of the 500 most liquid stocks with the largest market capitalization that are members of the TOPIX.

Market Capitalization : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

Dividend yield : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Swap : A swap is an agreement between two parties to exchange payments based on a reference asset, which may be a currency or interest rate but also may be a single asset, a pool of assets or an index of assets.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Bullish : a position that benefits when asset prices rise.