

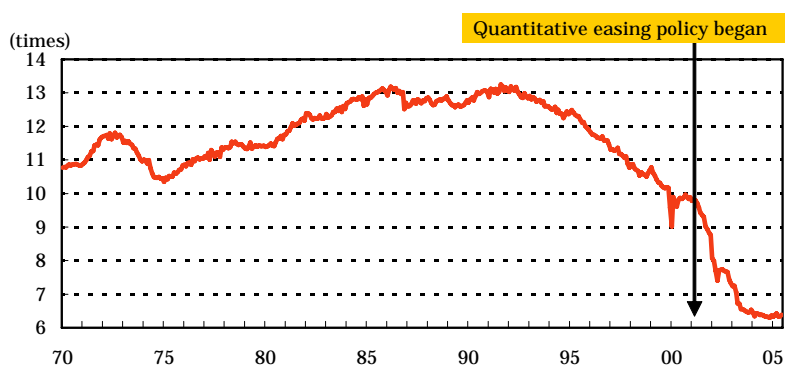
The effects of quantitative easing policy and the next monetary policy *

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More than four years have passed since the Bank of Japan adopted a quantitative easing policy in March 2001. This policy has two targets: to maintain orderly credit conditions and to fuel economic growth with price stability. The risks of instability in the financial system have been reduced significantly as the Bank of Japan continues to provide ample liquidity. At the same time, Japanese banks have succeeded in suppressing their bad loans, and the deposit payoff system has finally been introduced. As a result, the necessity of retaining a quantitative easing policy in order to ensure stability in the financial system has diminished.

This easing policy, however, has little direct effect on the economy and prices. The monetary base has expanded through an increase in the current account balance at the Bank of Japan, but the growth rate of the money supply has remained almost unchanged without a certain level of demand for funds, causing a further decline in the credit creation multiplier.

Credit multiplier continues to decline without certain demand for funds



Note: Credit multiplier equals Money supply (M2+CD) divided by Monetary base. Figures are seasonally adjusted and taking changes in reserve ratio into account.

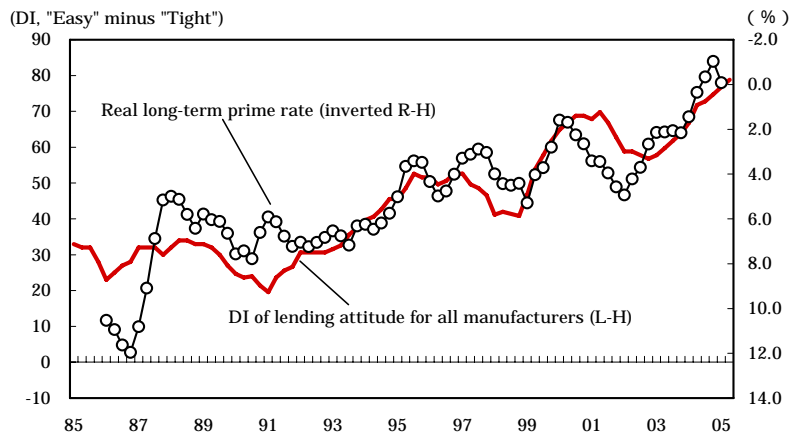
Source: Bank of Japan

* This is an English summary of a report originally published on August 11, 2005. The full report is available only in Japanese, but the author will answer questions regarding the topic by e-mail.

Yet, it is true that a fall in real interest rates caused by a decline in nominal interest rates due to ample liquidity has made borrowing easier. In fact, according to the Bank of Japan's Tankan survey, the DIs for lending attitudes of financial institutions ("easy" minus "tight") rise as real interest rates fall. Moreover, with some time lag, companies tend to increase their borrowing as they find it easier to borrow. In short, a decline in real interest rates encourages an intention to borrow, resulting in an increase in actual borrowing, and a positive sign for the economy.

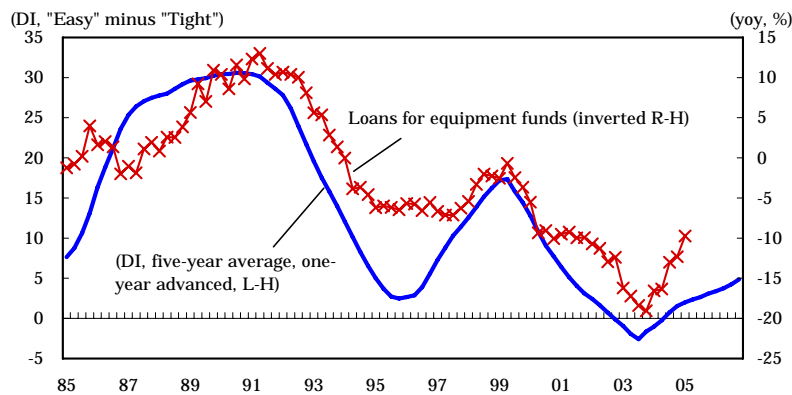
If a growth-supportive effect derives from lower interest rates, not from a funds-supplying operation, it may be time for the Bank of Japan to consider a return to a zero-interest-rate policy and return its operating target to an uncollateralized overnight call rate from the outstanding balance of the current accounts at the Bank.

Lower real interest rates, easier lending attitude for companies



Note: Changes in DI due to special factors are excluded to a large extent.
Source: Bank of Japan, Ministry of Internal Affairs and Communication

Easier lending attitude encourages more borrowing



Note: Figures are those of the manufacturing sector. Source: Bank of Japan

*The information and the views contained herein are subject to change without notice.

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