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TD Economics

Data Release: Bank of Japan announces negative interest rates

- In a surprise decision, the Bank of Japan announced a move into negative interest rate territory, cutting the interest rate "current accounts that financial institutions hold at the Bank" to -0.1%. Markets have reacted to this decision by selling off the Yen.

- Interest rates on reserves will be set on a three tiered system. Negative rates will apply to new reserves created by the Bank's quantitative easing program above a certain threshold. Macro add-on reserves – related to the Bank of Japan's various lending support programs – will maintain a zero interest rate, while current reserves will maintain a modestly positive interest rate of +0.1%.

- There were no changes made to the Bank of Japans quantitative easing program. The Bank will continue to purchase assets in order to increase the monetary base "at an annual pace of about 80 trillion yen."

- The Bank of Japan also communicated that it will cut the rate further into negative territory if judged as necessary.

Key Implications

- Japan joins the European Central Bank and the central banks of Sweden, Switzerland and Denmark in pushing interest rates below zero. In yesterday's decision, the Bank of Japan highlighted the desire to use negative interest rates in combination with its quantitative and qualitative (QQE) easing program in order to help achieve its inflation target of 2% at the earliest possible time. Essentially, the goal is to put further downward pressure on short-term yields with negative interest rates on excess reserves, while using QQE to keep downward pressure on long-term yields.

- In our view the additional monetary stimulus announced today should help the Bank of Japan achieve its inflation target, particularly since temporary factors such as falling energy prices, the VAT tax increase and exchange rate movements have made it difficult to gauge underlying trend inflation. However, a large part of the success of the "Three Arrows" economic policies require a kickstart in consumer spending that should enable stronger business confidence and thus investment, leading to a virtuous economic cycle. Household spending growth has been anemic at best since Prime Minister Shinzo Abe's government engaged in its "Three Arrows" policies back in 2013. The weakness in household consumption can be attributed to the failure of robust nominal wage growth to materialize despite tightening labour market conditions.

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