The Bank of Japan’s Financial Statements’ Peculiarity

Nobuko Takahashi*

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ABSTRACT:

This study considers the influence and meaning of financial accounting after the Bank of Japan (BOJ) implemented a monetary easing policy. It argues that the policy changed the meaning of the BOJ’s balance sheet, intentionally allowing items on the debit and/or credit side to be devalued, while allowing the balance sheet itself to expand.

The study examines three points:

1. Possible conflicts between the accounting information and the BOJ’s purpose,
2. The BOJ’s operational accounting procedures and the role of capital, and
3. The financial statement’s meaning under either the conventional or unconventional policy.

From the above examination, two main features of the BOJ’s financial statements were identified:

1. Weigh up anchor from the balance sheet and
2. Release from the balance sheet.

Under the unconventional monetary easing policy, these features are apparent, thus posing the risk of excessive, if not perpetual, balance sheet expansion.

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1. INTRODUCTION

This paper examines if the meaning of the Bank of Japan’s (BOJ) financial statements has changed in the move of the BOJ monetary policy by focusing on their accounting treatment. The BOJ was changed into the unconventional policy to which monetary base is made to increase from the conventional policy which operates the interest rate for overnight loan. Many arguments have emerged both for and against the BOJ’s monetary easing policy since it was adopted in March 2001. The BOJ served as a pioneer central bank in its use of an unconventional monetary policy, which BOJ intended to use to overcome persistent deflation.

This policy was maintained from March 2001 to March 2006. According to the BOJ’s press release on March 19, 2001, the policy entailed shifting the bank’s focus from the un-collateralized overnight call rate to the outstanding balance of the BOJ’s current account, the goal of which would be to reach approximately five trillion yen (BOJ, 2001).

Several studies have suggested that the policy had restrictive consequences during its term (Harada, 2004; Hattori, 2007; Shirakawa, 2008; Ukai, 2006). Former BOJ governor Shirakawa (2008) summarized the newspaper editorials’ main points, representing their negative assessment of the policy’s ability to stimulate the economy.

After the Lehman shock, the BOJ revived its monetary easing policy. This time, the policy entailed qualitative as well as quantitative easing. However, critical studies have indicated that this monetary easing policy cannot overcome deflation (Hayashibara, 2010; Miwa, 2011; Yumoto, 2010).

Many of these critical studies conducted examinations by economic category. However, the author’s investigation of the literature found few examinations by accounting category. Few papers examined the BOJ balance sheet and determined the significance of its size and composition (Furuichi and Mori, 2005; Shiratsuka, 2009). However, a certain index, of being tolerance level if a capital–adequacy ratio is how much, on financial statements is not shown. Does the financial accounting clarify the financial condition of the organization concerned or does the activity provide clarity, as in the case of the BOJ?

Article 3 of the BOJ’s accounting rules explains that “accounting practices of the Bank shall be conducted taking into consideration the generally accepted principles of corporate accounting and the Bank’s financial soundness.” Shirakawa (2008: 16) stated, “Central banks practice policy by manipulating the dimension and structure of their balance sheets.” This comment leads us to consider the correlation between policy and the function of accounting. When the scale of a balance sheet can be expanded freely, what do ac-
counts mean?

Accordingly, this study examines the meaning of the BOJ’s financial accounting and its influence on the BOJ monetary easing policy, considering the correlation between the policy and the related accounting procedure. It examines the issue of a central bank operating without balance sheet limitations and discusses the implications of such a change.

2. THE BOJ’S ACCOUNTING PRACTICES

2.1 THE BOJ’S FINANCIAL STATEMENTS

Accounting information helps assessment and decision making by providing shared, accurate financial status information. Private corporations operate for a common purpose—earning profits. Their financial statements represent the operation’s results, i.e., whether the purpose was attained. Thus, the accounting system provides a lens (profits) to rationally comprehend both the operation’s process and result. The central bank has a different specific purpose, which its accounting information should be in accordance with. The purpose of the BOJ and its accounting practices are as follows:

Bank of Japan Act:

Article 1 The purpose of the Bank of Japan, or the central bank of Japan, is to issue banknotes and to carry out currency and monetary control.

Article 2 Currency and monetary control by the Bank of Japan shall be aimed at achieving price stability, thereby contributing to the sound development of the national economy.

Accounting Rules of the Bank of Japan:

Article 3 The accounting practices of the Bank shall be conducted taking into consideration the generally accepted principles of corporate accounting and the Bank’s financial soundness.

Although the BOJ’s accounting practices are similar to those used in corporate accounting, the institutions’ purposes differ. Private corporations aim to multiply their capital, whereas the BOJ aims to stabilize prices. Even if the BOJ’s accounting practices mimicked those of corporate accounting, their roles—and therefore the associated decisions and assessments—will still differ. An official BOJ publication explains the significance and objective of its accounting information as follows:

In the Bank’s statement of income, operating income consisted mostly of interest on JGSs purchased through open market operations and gains on sales of JGSs [Japanese

The Bank of Japan conducts its policies and business operations to achieve the objectives stipulated in the Bank of Japan Act. These policies and business operations are reflected in the Bank’s balance sheet. In that sense, its balance sheet changes in accordance with economic and financial developments and the Bank’s policies and business operations in response to such developments (ibid.: 49).

After a certain amount of the Bank’s net income is transferred to legal reserves and dividends are paid, the rest of the net income is paid to the Japanese government (ibid.: 50).

The appropriation of surplus prescribed in the Bank of Japan Act is given as follows:

Article 53 The Bank of Japan shall reserve, as a reserve fund, five-hundredths of the surplus resulting from the settlement of profits and losses for each business year.

(4) The Bank of Japan may, upon authorization from the Minister of Finance, pay dividends to contributories out of the surplus resulting from the settlement of profits and losses for each business year; provided, however, that the rate of dividend payments against paid-up capital may not exceed five-hundredths per annum.

The total portion of legal reserves and dividends is slight, so the majority of the profit is paid to the Japanese government. Obviously refunding the JGBS’ interest to the Japanese government is not the expected role of the BOJ.

The meaning of a central bank’s financial reporting was discussed in an article by the Institute for Monetary and Economic Studies (Furuichi and Mori, 2005). According to the article, a financial report provides useful information

(1) when foreseeing ex post verification of a policy and examining the range of executable actions in the future, and

(2) when evaluating whether management of assets or seigniorage is suitable.

In these contexts, earning profits does not have the same positive significance it has in corporate accounting. The BOJ places far more significance on the balance sheet than on income statements. Yet, the balance sheet does not lead to a positive action; on the contrary, the balance sheet only reflects a policy’s execution. Unlike in corporate accounting, figures in the financial statements do not necessarily indicate some specific action. Therefore, we conclude that the BOJ’s financial statements are passive. In essence, the BOJ’s financial statements serve as a memorandum of the operation.

2.2 OPERATION AND ACCOUNTING RECORD

The BOJ executes its operation according to its aims. One of these is to issue banknotes,
while another is to implement currency and monetary controls. Here, we use the BOJ’s financial statements to investigate if the BOJ’s actual operations align with its stated aims.

The cash outstanding balance is controlled through funds-supplying operations. The BOJ creates the electronic money that banks use to make payments to other banks. When the BOJ buys financial assets (mainly government bonds) on the market, it intakes an item and outputs money into the market through the current accounts that each financial institution (FI) owns as reserves. When it sells financial assets, it outputs an item and intakes money from the market through the same account. Therefore, buying financial assets increases the money supply, whereas selling financial assets reduces it.

The journal entry for this transaction is as follows. When the BOJ retires the outstanding balance, the journal entry is reversed.

\[
\begin{array}{c|c}
\text{The BOJ journal entries Funds-supplying operations} \\
\hline
\text{(Assets)} & \text{(Liabilities)} \\
\text{Financial assets} & \text{FIs current account} \\
+ & + \\
\end{array}
\]

Operations are conducted via a market in which a financial institution always participates, so the financial institution’s balance sheet confirms the operation’s consequences. The behavior of a financial institution’s balance sheet is as follows:

\[
\begin{array}{c|c}
\text{FIs journal entries Funds-supplying operations} \\
\hline
\text{(Assets)} & \text{(Assets)} \\
\text{BOJ current account} & \text{Financial assets} \\
+ & - \\
\end{array}
\]

When FIs withdraw cash from the BOJ account, the journal entry for the transaction is as follows:

\[
\begin{array}{c|c}
\text{The BOJ journal entries Issuance of banknote operations} \\
\hline
\text{(Liabilities)} & \text{(Liabilities)} \\
\text{BOJ current account} & \text{Cash outstanding} \\
- & + \\
\end{array}
\]

The financial institution’s balance sheet behaves as follows:

\[
\begin{array}{c|c}
\text{FIs journal entries Funds-supplying operations} \\
\hline
\text{(Assets)} & \text{(Assets)} \\
\text{Cash} & \text{BOJ current account} \\
+ & - \\
\end{array}
\]

The BOJ’s first journal entry seems reasonable. They buy financial assets from the financial institution on credit. Their balance sheet expands from this transaction by elec-
tronic money. However, the next journal entry’s category classification is disputable. The cash outstanding is journalized as a liability when a financial institution draws out cash from the BOJ’s account. The BOJ issues the cash as a banknote. What does it mean for economies—and banks—everywhere if banknotes adopt the nature of a liability? The IASB framework defines a liability as follows:

*A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.*

Let us clarify the nature of these journal entries considering the definition of liability. The FIs current account is settled by cash when a financial institution draws out from the BOJ account. Cash is usually an asset; in that sense, the FI’s account reserves are a liability. However, the BOJ issues the cash as a banknote as per request. Banknote issuance is not a present obligation of the BOJ. The BOJ’s banknote itself is not necessary to settle by an outflow of resources embodying economic benefits because it is cash itself. Therefore, we must ask if the FI’s current account is actually a liability.

Journalizing a banknote as a liability is explained on the BOJ’s website as follows:

*When seen historically, a banknote’s exchange for gold or silver was guaranteed since the BOJ’s founding.* (omission) *It can be said that the banknotes that have such character are debt security.* (omission) *Even now, there is no change in character: a BOJ banknote is a “bill of debt” that must secure approval, and it is still appropriated as a liability.*

(https://www.boj.or.jp/announcements/education/oshiete/outline/a23.htm/)

The above-mentioned article from the Institute for Monetary and Economic Studies also explained the journal entry as follows:

*Although it is concluded that the debt’s nature as a requirement for debt appropriation in business accounting was filled under the standard monetary system on the condition of conversion to gold or silver, this point does not necessarily hold following a shift to a managed currency system. Instead, it seems that the central bank’s capital account consists of capital that can be classified as contributed capital, a legal reserve saved in the process of appropriating a fundamental profit, and is recognized as such because only that which can be lost through lack of developmental time can be appropriated. If this is accurate, it will be considered easy to appropriate a banknote to be issued for a debt succeeding as classification on accounts (Furuichi and Mori, 2005: 137).*

According to this description, a banknote is mainly recognized as a liability because of historical precedent. Recognizing banknotes as a liability is reasonable under the convert-
ible currency system. A central bank must exchange banknotes for gold or silver on request from the banknote's holder. However, under the managed currency system, the accounting procedure for banknote issuance does not have a positive logic, leading to the following arguments against the BOJ's accounting procedure:

There is also a view that makes the issuance of currency the national government's debt. When considered as a debt, currency has no term of payment and no interest. So, comprehending this issuance poses a significant issue. Should it be classified and indicated separately from other profits or classified as a debt? (Fudeya et al., 2004: 238).

The form of the money in a managed currency system is the same as that of the central bank's non-voting stock, wherein the substance's authorization by law was carried out in non-dividend also with a debt (Iwamura and Watanabe, 2004: 34).

Thus, Fudeya, Iwamura and Watanabe alluded that classifying banknotes as a liability is unreasonable. When a private corporation raises money, it is journalized as either a liability or capital, and the corporation faces regulations regarding correct journalizing of its transactions. And judgment of the safety of the private corporation is about whether it is journalized as a liability whether it journalizes as a capital, and changes.

Now we address the question of whether the meaning of the BOJ’s balance sheets would differ by the banknotes category, whether it is a liability or a capital. The BOJ’s view is as follows:

The Bank holds its capital base, such as capital, legal reserves, and provisions, to be prepared for potential losses. The Bank measures its capital adequacy ratio by dividing the amount of its capital base by the annual average of banknotes issued, and accumulates provisions and legal reserves to maintain its financial soundness (Institute for Monetary and Economic Studies, 2012: 50).

The above cases of actual behavior of some central banks indicate that central banks' concern with the soundness of their capital base might not be grounded purely in economic theory but may be motivated rather by the political economic instincts of central bankers. In other words, once the restriction that “the central bank should only take risks consistent with the level of its self-imposed capital base” is violated, the boundary between the functions of the central bank and those of the government may become difficult to discern (Fukui, 2003).

The BOJ seems to make a point regarding capital adequacy ratio. A private corporation calculates its capital adequacy ratio by dividing the amount of its capital (stockholders’ equity) by the annual average of the gross capital (liabilities + capital). Calculation of the BOJ’s capital adequacy ratio excludes other liabilities from the denominator. Other liabili-
ties primarily consist of commercial banks’ account reserves and the government deposits. The fact that these liabilities could be financed by the banknotes might explain this exclusion. The BOJ seems to consider the final settlement instrument as a liability. The BOJ is showing this criterion in the table of “The Bank’s Capital Base and Capital Adequacy Ratio” on their Annual Review (BOJ 2013:61). The fact of showing on their annual review reveals that they put significance on this criterion. And this ratio is directly fluctuated by the amount of outstanding banknotes.

These indications contradict the Bank of Japan Act’s restriction on the appropriation of surplus. If capital is so important, why does the act not restrict payments to the Japanese government so that they come only from profit? This question was addressed in the speech “The Role of Capital for Central Banks” by former BOJ policy board member Kazuo Ueda at the Japan Society of Monetary Economics on October 25, 2003 (Ueda, 2003). After discussing other central banks, he stated, “Summing up the experiences of insolvent central banks, my conclusion is that the maintenance of a sound balance sheet is, in general, neither a necessary nor a sufficient condition for fulfilling a central bank's responsibility, but there have been cases where an unhealthy balance sheet became a major obstacle to price stability.” The conclusion of the speech was ambiguous, pointing out that the BOJ’s financial strength would deteriorate under certain economic conditions. However, this concern is not directly connected with the obstacles to achieving their goal of maintaining price stability, as these obstacles remain merely a “probability.” Furthermore, even though the title of the speech included “The Role of Capital,” Ueda did not clarify the function of capital.

A balance sheet expresses an organization’s financial condition, and aggravation of a balance sheet inevitably has a decisive meaning in an organization’s operations. Therefore, the question of whether the aggravation of the BOJ’s finances reflects a malfunction within the organization is highly significant. Their financial statement’s meaning can be identified by examining the connection between accounting practices and their actual operations as indicated by their financial policy.

3. MEANING OF FINANCIAL STATEMENTS IN FINANCIAL POLICY

In this section, we examine the meaning of the BOJ’s financial statements under two policy types: conventional and unconventional policy.

Under a conventional policy, the overnight interbank rate serves as an operational tar-
get. The BOJ influences supply and demand for both funds and interest-rate formation in money markets by adjusting financial institutions’ current account balances at the BOJ through market operations as detailed in the Table 1 and Table 2.

Money circulating in a market remains in prosperity, and it is assimilated by a funds-absorbing operation during inflation. A funds-absorbing operation functions as a tight-money policy.

On the other hand, when the money circulating in a market is insufficient, additional

<table>
<thead>
<tr>
<th>Type of Operations</th>
<th>Year of introduction</th>
<th>Start day*</th>
<th>Duration</th>
<th>Maturity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funds-supplying operation against pooled collateral</td>
<td>2006</td>
<td>From T + 0</td>
<td>Short-term</td>
<td>Within one year</td>
</tr>
<tr>
<td>(at the Head Office)</td>
<td></td>
<td>through T + 4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Funds-supplying operation against pooled collateral</td>
<td>2006</td>
<td>From T + 0</td>
<td>Short-term</td>
<td>Within one year</td>
</tr>
<tr>
<td>(at all offices)</td>
<td></td>
<td>through T + 2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase of CP with repurchase agreements</td>
<td>1989</td>
<td>T + 2</td>
<td>Short-term</td>
<td>Within three months</td>
</tr>
<tr>
<td>Purchase of Japanese government securities with</td>
<td>2002</td>
<td>From T + 0</td>
<td>Short-term</td>
<td>Within one year</td>
</tr>
<tr>
<td>repurchase agreements</td>
<td></td>
<td>through T + 2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outright purchase of treasury discount bills</td>
<td>1999</td>
<td>From T + 2</td>
<td>Short-term</td>
<td>—</td>
</tr>
<tr>
<td>(at the Head Office)</td>
<td></td>
<td>through T + 3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outright purchase of Japanese government bonds</td>
<td>1966</td>
<td>T + 3</td>
<td>Long-term</td>
<td>—</td>
</tr>
</tbody>
</table>

*The start day is the day on which funds and securities are settled after an operation and that marks the beginning of the term of the operation. “T” in “T + α” stands for the day of trade, which here indicates the day of offering, on which the Bank issues notice to the eligible counterparty to the operation regarding the type of operation, the amount of funds, and the start day. “α” indicates the number of business days from the day of offering to the start day. Depending on financial market conditions, however, start days other than those indicated above may be used.

<table>
<thead>
<tr>
<th>Type of Operations</th>
<th>Year of introduction</th>
<th>Start day*</th>
<th>Duration</th>
<th>Maturity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales of bills</td>
<td>1971</td>
<td>From T + 0</td>
<td>Short-term</td>
<td>Within three months</td>
</tr>
<tr>
<td>through T + 4</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sale of Japanese government securities with repurchase</td>
<td>2002</td>
<td>From T + 0</td>
<td>Short-term</td>
<td>Within six months</td>
</tr>
<tr>
<td>agreements</td>
<td></td>
<td>through T + 2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outright sale of treasury discount bills</td>
<td>1999</td>
<td>From T+0</td>
<td>Short-term</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td>through T + 3</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Institute for Monetary and Economic Studies, Bank of Japan (2012) : 121-22 Figure 5-3
money is injected by a funds-supplying operation during deflation. Funds-supplying operations serve as a monetary easing policy. These conventional policies do not generally require financial restraint. Conversely, a corporation almost always operates under conditions of financial restraint. It raises money for its operations and invests in specific assets, and both the type and amount of assets that a corporation can own are restricted by the amount of money raised and the corporation's capacity. The corporation's balance sheet indicates its financial condition as well as factors such as its safety degree and capability. However, the BOJ does not face the same financial restraints. In an inflationary market, the BOJ absorbs money by selling gilts until the overnight interbank rate's level of necessity is achieved. Conversely, in a deflationary market, the BOJ supplies money by purchasing gilts until the overnight interbank rate's level of necessity is achieved. No ceiling exists, especially for purchasing gilts. The BOJ turns the balance in financial institutions' current account into a liability through such purchasing operations—a conversion that might lead to a potentially limitless expansion of the balance sheet's scale. The BOJ's unconditional finance is disputable, although it did not escalate into a major problem as long as it remained within predictable market fluctuations. However, as part of the BOJ's unconventional policy, the problem can no longer be ignored.

The BOJ first moved toward an unconventional monetary easing policy in March 2001 to conquer persistent deflation. Under a monetary easing policy, the BOJ targeted its current account's outstanding balance. However, the target changed from the overnight interbank rate to the balance of the items in the balance sheet—a swap in operational target that allows the balance sheet to easily expand.

As shown in Figure 1, in the conventional policy, the BOJ conducted indirect business adjustments by manipulating interest within the limits of supply and demand in the indirect-financing mainstream financial market. In the unconventional policy as shown in Figure 2, the BOJ is urged to engage in direct business adjustment exceeding demand in the direct-financing mainstream financial market. Expansion of the BOJ's balance sheet is accordingly enhanced.
Therefore, the BOJ established the “banknote principle” as an avoidance measure. Its principle was explained during the March 19, 2001 announcement concerning new procedures for money market operations and monetary easing:

*The Bank will increase the amount of its outright purchase of long-term government bonds from the current 400 billion yen per month, in case it considers that increase to be necessary for providing liquidity smoothly. The outright purchase is, on the other hand, subject to the limitation that the outstanding amount of long-term government bonds effectively held by the Bank, i.e., after taking account of the government bond sales under gensaki repurchase agreements, be kept below the outstanding balance of banknotes issued (BOJ, 2001)*.

Ultimately, this principle asserts that the amount of banknotes in circulation comprises the BOJ’s long-term liabilities, whereas the balance of purchased government bonds is considered as long-term assets. Accordingly, the outstanding balance of banknotes should be backed by purchased government bonds (Miyao, 2013). As the accounts largest asset balance is restricted to matching its largest liability balance, expansion of the balance sheet is prevented. This seems to be a sensible policy in response to a legitimate concern over the unconventional policy’s implications.

However, the BOJ actually enacted this principle to dispel public concerns over fiscal dominance and maintain the credit to the banknote referred to the adequate money supply. In reality, the unconventional monetary easing policy serves as direct financing to the government. A central bank providing direct financing to a government is worrying in terms of both future policy implications and economic consequences.
4. BANKNOTE CREDIBILITY

To clarify the banknote problem, we determine the implications of the above policy’s financial effects by examining the government’s and central bank’s procedures.

Nobel Prize–winning economist Joseph Stiglitz spoke on “Deflation, Globalization and the New Paradigm of Monetary Economics” at Japan’s Ministry of Finance on April 16, 2003 (Stiglitz, 2003). His speech referred to the issuance of government notes, setting off a wider debate. In response to Stiglitz’s argument, Professor Oguri, the BOJ’s ex management, published research referencing preceding studies and describing the difference between government notes and central banknotes (Oguri, 2011). His argument comprised the following points:

(1) Is the issuance based on the credit relationship?

A central bank usually acquires collateral assets when issuing banknotes; this transaction forms the relationship of debit and credit. Banknotes, including central banknotes, are issued only through financial transactions. The government bears no liability when issuing notes.

(2) Is the issuance endogenous or exogenous?

Credit money, including banknotes, is essentially a bill of debt, primarily based on the commodity’s value. However, government notes are isolated from their commodity value and injected from outside the economy.

(3) Is the issuance an administrative or business act?

A central banknote is both a bill of debt and credit money, whereas the issuance of a government note is an administrative act. The government takes forcible measures to issue government notes. Although a government note is a debt, it has no due date and carries no interest.

Oguri emphasized that a central bank issues notes within the financial market. Because a central banknote is a debt, it returns to the bank at the end of the credit relationship.

On examining the procedure of issuing government notes, in particular the accounting treatment, we identify similarities with that of issuing central banknotes. The two procedures can be compared as follows.

(1) The government issues government notes to the central bank, which puts them into circulation. The same treatment is given to coins currently issued by the government. The journal entry of the central bank would therefore be as follows:
The central bank issues government notes through acquisition and/or expenditure. Their journal entry would therefore be as follows:

\[
\begin{array}{c|c}
\text{(Assets or Expenses)} & \text{(Liabilities)} \\
\hline
\text{An item of assets/expense} & \text{Government deposits} \\
+ & + \\
\end{array}
\]

When the note returns to the bank, the corresponding journal entry would be the reverse of the above.

(2) The government issues government bonds to the central bank, and the central bank possesses them as assets. This treatment increases the balance of the government deposit, and the central bank continues to hold these assets. When the government withdraws some amounts from the account, the central bank issue the banknote. If we compare this treatment with the above (1) case, the balance of the items of an account are different but the actual financial condition is the same.

Oguri further stated that the sequence of a government note’s issuance means that the central bank retains it with neither due date nor interest. Such behavior is as if the government forced the central bank to accept government bonds without due dates and interest. He opposes issuing government notes because they ignore the market principle, instead preferring the issuance of central banknotes, as they are based on a debit/credit relationship and are therefore reliable.

Banknote issuance is executed as market transactions, which is as per Oguri’s statements. However, under the monetary easing policy, financial institutions purchase government bonds in the market on the basis of a prediction that the BOJ would purchase these bonds. Such an assumption renders the market transaction a mere formality. Moreover, the accounting procedure and its consequence on the BOJ’s balance sheet is nearly identical for banknote and government note issuance.

5. MEANING OF THE BOJ’S FINANCIAL STATEMENT

Despite its consequences thus far, the BOJ has promoted the monetary easing policy, announcing the introduction of “quantitative and qualitative monetary easing.” The BOJ
intends to double in two years not only the monetary base and the outstanding amounts of Japanese government bonds but also exchange-traded funds, as well as more than doubling the average remaining maturity of Japanese government bond purchases. Moreover, the BOJ enacted a temporary suspension of the banknote principle (BOJ, 2013). Although only enacted in 2001, its suspension is significant as it enables the BOJ to expand their balance sheet without limit, subject only to decisions concerning the “necessity” of government bond purchases. Fundamentally, suspension releases the BOJ from the limitation imposed by the balance sheet. As previously discussed, while the corporate operations are limited by their raised funds, BOJ operations are not. Even prior to the banknote principle, the BOJ had already sought to avoid the limitations imposed by the balance sheet. This financial property of the BOJ is inherent merely under the managed currency system. To find functional limitations on the BOJ’s operations, we must trace back to the convertible currency system.

In the convertible currency system, a banknote substituted for the commodity money (gold or silver). For example, a central bank was obliged to convert the issued banknote to gold bullion under the gold exchange standard. A central bank is therefore needed to maintain a certain amount of reserves to conduct such conversion transactions. The link

<table>
<thead>
<tr>
<th>Table 3</th>
<th>BOJ’s Balance Sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td>%</td>
</tr>
<tr>
<td>Gold</td>
<td>441,253,409</td>
</tr>
<tr>
<td>Cash</td>
<td>290,116,631</td>
</tr>
<tr>
<td>Japanese government securities</td>
<td>180,856,193,880</td>
</tr>
<tr>
<td>Commercial paper</td>
<td>2,024,206,093</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>3,291,860,220</td>
</tr>
<tr>
<td>Pecuniary trusts (stocks held as trust property)</td>
<td>1,360,510,447</td>
</tr>
<tr>
<td>Pecuniary trusts (index-linked exchange-traded funds held as trust property)</td>
<td>2,406,429,438</td>
</tr>
<tr>
<td>Pecuniary trusts (Japan real estate investment trusts held as trust property)</td>
<td>139,250,963</td>
</tr>
<tr>
<td>Loans (excluding those to the Deposit Insurance Corporation)</td>
<td>23,820,090,000</td>
</tr>
<tr>
<td>Foreign currency assets</td>
<td>5,207,978,768</td>
</tr>
<tr>
<td>Deposits with agents</td>
<td>23,240,807</td>
</tr>
<tr>
<td>Others</td>
<td>502,884,685</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>220,364,015,341</td>
</tr>
</tbody>
</table>

between currency and the value of actual commodity holdings limited banknote issuance to the asset balance of the item subject to conversion. In such a system, the balance sheet indicates if the central bank's financial condition is stable. In that sense, the balance sheet reflects real substantial capital. In the transition to the managed currency system, the central bank's financial obligations undergo a change. No intrinsic limitations on banknote issuance exist in the managed currency system. Instead, the BOJ focuses on an economic indicator that cannot be directly controlled. As this operational indicator is external, it has no connection with their financial figures. Therefore, the balance sheet reflects merely the consequences of the BOJ's operations, not the health of the wider economy or financial system.

Table 3 summarizes the BOJ balance sheet disclosure. The valuation measure of securities in assets is prescribed in the BOJ's Accounting Rules:

*Article 13* At the ends of the first half of every fiscal year and of the full fiscal year, securities shall be valued as follows. (1) Yen-denominated bonds and commercial paper shall be valued at amortized cost determined by the moving-average method.

Therefore, deterioration of “Japanese government securities,” which comprise 82% of the BOJ's total assets at this period, would not directly affect their capital. Even though deterioration of the asset would affect capital, it would not serve as a direct cause of financial disrepute as the meaning of the capital is ambiguous.

The meaning of the BOJ’s balance sheet has shifted in the transition process to the managed currency system. The change can be summarized as follows:

1. Weigh up anchor from the balance sheet.
   - The prescription of holding reserves of substantial assets prevented the BOJ from experiencing balance sheet expansion. The withdrawal of this prescription gave the BOJ free reign over their operations.

2. Release from the balance sheet.
   - Since the prescription's withdrawal, the BOJ is no longer bound by any item on a balance sheet. As a result, the balance sheet became merely a memorandum record.

The currency system's transition also changed the meaning of the BOJ’s balance sheet. This financial statements’ peculiarity, the BOJ balance sheet just shows the memorandum, has been increasingly evident under the monetary easing policy, especially given the eradication of the banknote principle.
6. CONSEQUENCES OF THE POLICY

The BOJ terminated its first introduction of the unconventional policy by March 2006. Former Governor of the BOJ Shirakawa summarized the effect of the monetary easing policy in his book, “Modern Monetary Policy in Theory and Practice” and emphasized the policy duration effect (2008: 344–70). If the BOJ upheld the monetary easing policy to maintain a zero rate “until deflationary concerns are dispelled,” the effect can be obtained.

Okina has highlighted the influence of the potential future inflation resulting from the unconventional policy differences between FRB and BOJ, despite both having followed the same policy. While Bernanke stated that “the size of the FRB balance sheet has no effect on the inflationary predictions,” the BOJ announced the monetary easing policy would maintain a zero rate until the attainment of the 2% inflation target. The BOJ aims to influence the general public’s price predictions (Okina, 2013: 243–50). Given the lack of limitations on the balance of item on the balance sheet, the BOJ can therefore operate freely and is limited only by its intentions. However, despite its intentions, the BOJ cannot directly influence the general public’s price predictions. Its balance sheet does not possess sufficient capital, although the same cannot be said of the fictitious capital expressed on its balance sheet.

The BOJ’s balance sheet has been reduced to a mere memorandum record, and the ultimate outcome of unfettered expansion remains undetermined. Given the unknown outcome but the very real, potent risks that can be surmised, one can argue that the BOJ has already expanded its balance sheet beyond a safe level. A governmental national bond is a liability for the government which must be repaid at some certain point of the future unlike banknote of BOJ. Originally it cannot be issued without the hope of future repayment. However, under the monetary easing policy, BOJ is continuing buying a government bond. The BOJ can continue performing it by the release of the financial fetters now. The amount issued of a government bond will exceed the capability of future repayment of the government someday. The balance sheet of a private corporation expresses the financial condition of an organization. However in fact, the balance sheet of BOJ has not expressed the substantial financial condition of its organization anymore. Although the independence of BOJ from the government is stressed, it can be said that especially the BOJ’s financial condition has been integrated with the government under unconventional monetary policy. It became impossible to say that the balance sheet of the BOJ expresses financial condition by becoming a mere memorandum. Therefore, it had not necessarily become a big problem directly to having removed banknote principle. The brake stopped however,
starting expansion of a balance sheet by having removed fetters completely. In fact, a capital–adequacy ratio will be scrutinized, as long as the rule of a private corporation is used, though the balance sheet expresses the mere fictitious capital. It is unknown how far a market permits decline in the capital–adequacy ratio of BOJ. It is unknown how far a market permits decline in the capital–adequacy ratio of BOJ. However, it is so clear to approach a risk of exceeding the tolerance level of a market that the balance sheet of BOJ expands. Hence, the monetary easing policy can damage the very currency stability that defines the BOJ’s purpose.

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