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Bank of Japan

One Month after the Great East Japan Earthquake: Critical Role of Financial Infrastructure

Opening Remarks at a Meeting Hosted by the Institute of Regulation & Risk, North Asia

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I. Introduction

I am honored to have been invited today to this meeting hosted by the Institute of Regulation & Risk, North Asia.

It is now exactly one month since the March 11 earthquake. I would like to express my sincere condolences to the victims of the disaster and offer my heartfelt sympathies to those who are suffering. I am pleased to see many friends in attendance today, and my gratitude especially goes to Bill Dudley, president of the Federal Reserve Bank of New York, who is here despite these difficult times after the disaster triggered by the earthquake.

I am told that the meeting focuses on financial regulation and supervision. The earthquake, which had a magnitude of 9.0 and was the largest on record in Japan, the tsunami, and the nuclear plant problems were a series of events that have raised many risk issues that go beyond the level of risk management by financial institutions. For that reason, it is critical to reconsider how society as a whole copes with such issues. Of course, it would be premature to attempt to provide comprehensive answers at this juncture, but one of the important aspects in this regard is the robustness of social infrastructures. In what follows, from such a perspective, I would like to make a modest contribution by sharing with you what has happened in terms of financial infrastructure, which is one of the critical social infrastructures, in the past month and my impressions over this period.

II. Impact on Financial Infrastructure

Let me first talk about how the disaster affected Japan's financial infrastructure.

The physical damage to financial institutions in the areas hit by the earthquake was enormous, including the destruction and flooding of some branches. Thanks to the dedicated efforts of those involved, financial institutions have been gradually starting to get their branches and offices in those areas back on their feet. There are 72 financial institutions with headquarters in one of the six prefectures of the Tohoku region or Ibaraki Prefecture. Of the 2,700 branches and offices of these financial institutions, those closed as of March 16 were about 310, or about 10 percent of the total, but as of today this has declined to about 150, or about 6 percent of the total. The other 94 percent are open for business as usual, providing various financial services.

Looking at the impact on a nationwide level, Japan's core payment and settlement systems, including the Bank of Japan Financial Network System, or BOJ-NET, have been consistently functioning as normal since the earthquake struck. In financial markets, the Tokyo Stock Exchange has been open for business as usual.

Like electricity, water, gas, railways, and roads, the financial and settlement systems are critical infrastructure that supports people's lives and economic activity. If the financial and settlement systems as a whole had ceased to function normally, the adverse effects on people's lives and economic activity probably would have been even greater. The robustness of the financial system that we have seen this time was attributable to the hard work and solidarity of the people involved after the earthquake struck. I would also like to point out that the steady efforts of those involved in normal times, such as in developing business continuity plans and carrying out street-wide disaster exercises, greatly contributed to this robustness.

III. Bank of Japan's Responses

Next, I would like to explain how the Bank of Japan reacted to the disaster.

Continued Provision of Financial Services

What the Bank of Japan did first was to continue providing financial services as usual.

In that regard, it was vitally important to maintain the financial functions that serve as a lifeline in the affected areas. On the financial front, the first urgent need faced by people in the affected areas is to secure cash to purchase the necessities. The day the earthquake occurred, I promptly asked, jointly with the Minister for Financial Services, financial institutions to take appropriate measures to accommodate the needs of those affected by the disaster, such as permitting the withdrawal of deposits even in cases where depositors had lost certificates of deposits or passbooks. Moreover, the Bank of Japan strived to provide cash to the disaster areas in a prompt and sufficient manner day after day, including holidays, to meet the cash needs of people in those areas. In fact, the amount of cash provided to the affected areas was three times larger than in normal times. The Bank of

Japan has also been taking all possible measures as the central bank to support affected areas by responding to various related financial needs such as exchanging banknotes and coins that were damaged by the earthquake and tsunami. The Bank of Japan's operations in the Tohoku region, including our branches in Sendai and Fukushima and our office in Morioka, have been providing uninterrupted central banking services as usual, thanks to the efforts of the employees of these operations and the support provided by the Bank of Japan's head office and other branches.

In addition to maintaining retail payment functions, it is also vital to ensure that the wholesale payment systems for funds and securities continue to function in a stable manner. In this regard, as I mentioned earlier, the BOJ-NET continued to operate without interruption after the earthquake.

Ensuring the Stability of Financial Markets

The Bank of Japan's second response was to ensure financial market stability.

When a huge risk manifests itself, such as a disaster triggered by an earthquake, and there is increased uncertainty over the future, market participants try to retain a large amount of funds at hand to prepare for the worst. If such an increase in precautionary demand for liquidity is left unaddressed, it could destabilize financial markets and eventually adversely affect economic activity. To prevent such a situation, the Bank of Japan has been providing ample liquidity since immediately after the earthquake, and has been striving to ensure financial market stability by maintaining a sense of security on the funding front. On March 14, the first business day after the disaster, the Bank of Japan provided a total of 21.8 trillion yen in liquidity. This was a daily record and nearly three times larger than the largest daily liquidity provision after the Lehman crisis. The Bank of Japan has continued to provide ample liquidity every day and its outstanding current account balance also reached a record high of 42.6 trillion yen on March 24.

Although the disaster had no impact on Japanese financial institutions' foreign currency funding, in its U.S. dollar-funds supplying operation that has been in place since before the earthquake, the Bank of Japan started to offer one-week funds, as a safety valve, in addition to the existing three-month funds. Since Bill is here, I should not forget to mention that this operation is based on swap arrangements between major central banks and the Federal Reserve Bank of New York. I would also note that coordinated foreign exchange market intervention by G-7 countries played a critical role in not only stabilizing the foreign exchange market, but also helping to prevent negative spillovers into other markets, for example Japan's stock market.

With such ample liquidity provision and backup support, calm has been restored in Japan's money markets and they are currently quite stable.

Enhancement of Monetary Easing

The third response was to take policy measures on the monetary policy front, by enhancing monetary easing.

It so happened that the Monetary Policy Meeting was scheduled to be held over two days starting from the next business day after the earthquake. As the Bank of Japan deemed it desirable to examine the possible effects of the disaster on Japan's economy and finances and promptly announce a guideline for money market operations, thereby ensuring stability in public sentiment and in the financial markets, it shortened the duration of the meeting to one day and decided on enhancement of monetary easing on March 14.

What we feared most immediately after the disaster was a situation in which a deterioration in business sentiment or an increase in investors' aversion to risk would lead to an increase in various risk premiums, thereby adversely affecting economic activity. Since the autumn of 2010, the Bank of Japan has started to purchase various assets, including risk assets such as CP, corporate bonds, exchange traded funds (ETFs), and Japan real estate investment trusts (J-REITs), under the comprehensive monetary easing framework. This time, the Bank of Japan decided to increase the amount of the Asset Purchase Program, by doubling the purchases of assets from about 5 to about 10 trillion yen. This measure appears to have helped to reassure financial markets.

IV. Confidence in Financial Infrastructure

That concludes my explanation of what we did in the month following the earthquake. As the situation is still evolving and we do not yet have sufficient information, it is too early to draw any lessons at this juncture. Nevertheless, it does seem worthwhile to share our impressions with one another while our memories are fresh, ahead of full-scale examination of the issue in the future. I myself have thought many things, but if I were to choose one, it would be the importance of ensuring that people retain confidence and trust that financial infrastructure will function normally.

In the week following the earthquake, rumors spread mainly among some foreign financial institutions that Tokyo financial markets would close. While hard to believe, there was also a groundless rumor that the Bank of Japan would move its computer center to Osaka. Extreme anxiety can in itself induce self-propagating market reactions. Fortunately, such rumors gradually dissipated. Several factors contributed. The first of these was the strong commitment shown by those involved. For my part, I explained to overseas authorities, through an impromptu conference call with G-7 finance ministers and central bank governors and on other occasions, that the Bank of Japan had been taking all possible steps to maintain Japan's financial intermediation function and ensure smooth fund settlement. Moreover, the International Bankers Association, which is a group of foreign financial institutions active in Japan, issued a press release on March 15, soon after the earthquake, stating that major foreign financial institutions in Japan were continuing to operate business as usual. Subsequently, senior executives of such institutions visited Japan one after another and expressed their commitment to continue to do business in Japan. Along with such communication, it is, as I mentioned earlier, of utmost importance that settlement systems and the financial markets physically continue to function as normal. Once financial infrastructure continues to function normally, unfounded rumors will disappear in due course. If, on the contrary, financial infrastructure does not function normally, the situation will deteriorate further. For that reason, even in times of disaster, it is important to make the necessary preparations to enable the normal functioning of financial infrastructure. In this regard, it has driven home to me the importance of the "logistics" of providing human and physical resources, and within this the importance of the location of backup centers.

The foremost challenge for Japan today is responding to the acute emergency after the disaster. Financial infrastructure is vital not only in this emergency phase immediately after the disaster, but also in the process of economic rebuilding that will gradually become more and more center-stage. The financial markets have the most important role as the infrastructure for providing the financing necessary for this rebuilding. After the Great Kanto Earthquake of 1923, foreign currency-denominated government securities were issued to cover the rebuilding costs. At that time, the government was forced to issue securities at high interest rates. Since the recent earthquake, there have been 12 auctions for 35.0 trillion yen worth of newly-issued government securities including treasury discount bills. Despite the unprecedented major earthquake and subsequent disasters and despite the fact that Japan's fiscal conditions remain severe, it was still possible to issue securities at low interest rates in a stable manner. This was possible partly because the markets have confidence that the aim of Japan's monetary policy is to achieve sustainable growth with price stability and not to facilitate government financing. It is not easy to get a sense of the importance of the infrastructure at the heart of society, such as electricity supply and the road network, when it is functioning as normal. The recent disaster has made us recognize that, once such infrastructure is damaged and impaired, repairing it is not easy and the damage has a very large impact on people's lives and economic activity. The same thing can be said of confidence in the nation's currency. The Bank of Japan will continue, as the central bank, to steadfastly work to ensure that trust in Japan's currency is maintained as well as to carefully examine the outlook for economic activity and prices, and take appropriate policy actions as necessary.

Thank you for your attention.