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BOJ stuns markets with surprise move to negative interest rates

TOKYO | BY LEIKA KIHARA



The Bank of Japan unexpectedly cut a benchmark interest rate below zero on Friday, stunning investors with another bold move to stimulate the economy as volatile markets and slowing global growth threaten its efforts to overcome deflation.

Global equities jumped, the yen tumbled and sovereign bonds rallied after the BOJ said it would charge for a portion of bank reserves parked with the institution, an aggressive policy pioneered by the European Central Bank (ECB).

"What's important is to show people that the BOJ is strongly committed to achieving 2 percent inflation and that it will do whatever it takes to achieve it," BOJ Governor Haruhiko Kuroda told a news conference after the decision.

In adopting negative interest rates Japan is reaching for a new weapon in its long battle against deflation, which since the 1990s have discouraged consumers from buying big because they expect prices to fall further. Deflation is seen as the root of two decades of economic malaise.

Kuroda said the world's third-biggest economy was recovering moderately and the underlying price trend was rising steadily.

"But there's a risk recent further falls in oil prices, uncertainty over emerging economies, including China, and global market instability could hurt business confidence and delay the eradication of people's deflationary mindset," he said.

"The BOJ decided to adopt negative interest rates ... to forestall such risks from materializing."

Kuroda said as recently as last week he was not thinking of adopting a negative interest rate policy for now, telling parliament that further easing would likely take the form of an expansion of its massive asset-buying program.

But, with consumer inflation just 0.1 percent in the year to December despite three years of aggressive money-printing, the BOJ's policy board decided in a narrow 5-4 vote to charge a 0.1 percent interest on a portion of current account deposits that financial institutions hold with it.

The central bank said in a statement announcing the decision it would cut interest rates further into negative territory if necessary, in its battle against deflation.

"Kuroda had been saying that he didn't think something like this would help so it is a bit surprising and it's clear the market has been surprised by it," said Nicholas Smith, a strategist at CLSA based in Tokyo.

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Some economists doubted the BOJ move would prove effective.

"It has gone on the defensive," said Hideo Kumano, chief economist at Dai-ichi Life Research Institute. "It made this decision not because it's effective, but because markets are collapsing and it feels it has no other option."

GOING NEGATIVE

Several European central banks have cut key rates below zero, and the ECB became the first major central bank to do so in June 2014.

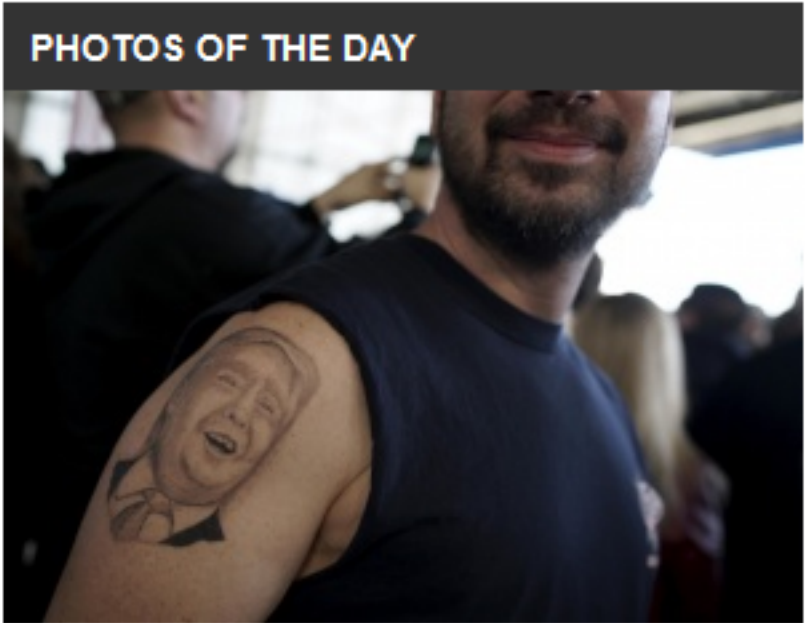
In pursuing the same path, the BOJ is hoping banks will step up lending to support activity in the real economy, rather than pay a penalty to deposit excess cash at the central bank.

There is little sign of any pent-up demand from Japanese banks or cash-rich companies for fresh funds, however, and any money released into the system may merely be hoarded or steered into speculative activity.

"This is an aggressive all-stick-no-carrot approach to spurring investment," said Martin King, co-managing director at Tyton Capital Advisors in Tokyo.

The BOJ maintained its pledge to expand base money at an annual pace of 80 trillion yen (\$675 billion) via aggressive purchases of Japanese government bonds (JGBs) and risky assets conducted under its quantitative and qualitative easing (QQE) program.

The BOJ's move - boosting the dollar by 1.7 percent against the yen - could make it even harder for the U.S. Federal Reserve to raise interest rates four times this year, as originally envisaged by its policy board.



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"REGIME CHANGE"

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This is the fourth time the BOJ has pushed back its time frame for hitting its inflation target - from an initial goal of around March 2015.

Friday's surprise interest rate decision came in the wake of data that showed household spending and output slumped in December, underscoring the fragile nature of Japan's recovery.

Many analysts had already been suggesting that the BOJ had little scope left to expand its asset-buying program.

"I think this is a regime change and the BOJ's main policy tool is now negative interest rates," said Daiju Aoki, an economist at UBS Securities in Tokyo. "This shows that the ability to buy more JGBs is limited."

Kuroda said the BOJ was not running out of policy ammunition.

"Today's steps don't mean that we've reached limits to our JGB buying," he said. "We added interest rates as a new easing tool to our existing QQE framework."

(Additional reporting by Stanley White, Tetsushi Kajimoto, Kaori Kaneko and Joshua Hunt; Writing by Alex Richardson; Editing by Eric Meijer and Jacqueline Wong)



A line of waiting customers are reflected in a window as an employee counts money at the Bank of Tokyo-Mitsubishi UFJ foreign currency exchange in Tokyo October 10, 2008.
REUTERS/YURIKO NAKAO



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