Size of Central Bank Balance Sheets: Bank of Japan Is on Track to Cross the 100% GDP Mark

Some central banks have yet to begin their monetary tightening. The Bank of Japan (BoJ) is one of them. As inflation still struggles to gain momentum in Japan, the BoJ is forced to maintain its key interest rate at the historic low of -0.1%, in addition to continuing its massive asset purchases. The cumulative purchases are nearing an amount equal to 100% of Japan’s GDP. This symbolic mark might be achieved at the end of the third quarter, if not the next one.

The size of the BoJ balance sheet would be even higher had the Bank not eased the pace of its purchases in 2017 and 2018. Officially, it plans to purchase approximately ¥80,000B worth of assets per year, with Japanese government bonds accounting for about 80% of these assets. However, the actual pace of purchases depends on the achievement of a target for the 10-year bond yield. The BoJ is aiming for a rate of roughly 0%, which it was able to reach with fewer asset purchases in 2017 and since the start of 2018. This may change, however, as Japanese bond yields appear to want to resume an upward trend like in the rest of the world.

The size of the BoJ balance sheet is much higher than the Federal Reserve’s (Fed) peak in 2014 or the European Central Bank’s (ECB) current level. At its highest, the size of the Fed’s balance sheet was slightly above 25% of U.S. GDP. It is now shrinking due not only to the increase in GDP, but also to the gradual asset off-loading initiated in October 2017. The size of the ECB’s balance sheet should level off at around 40%. The ECB’s asset purchases are expected to decline to just €15B as of next month and stop altogether by the end of the year. The size of the balance sheet should then slowly deflate as GDP grows.

**IMPLICATIONS**

While this is mostly a symbolic threshold, the fact that the BoJ has managed to purchase so many assets is nonetheless food for thought. One question is whether there is truly a limit on how far central bank balance sheets can expand. This limit is likely guided by the quantity of assets available on the market. The Japanese government has taken on significant debt at more than 200% of GDP, a much heavier load than the United States or the eurozone. If there is another recession and the Fed and ECB resume asset purchases, they would hardly reach a balance sheet as high as Japan’s, unless they were to rely heavily on the purchase of other assets like corporate bonds or equities. This could, however, seriously distort the markets.

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