Musha Research

22 December 2022

Musha Research Commentary

Strategy Bulletin Vol. 321

# Bank of Japan on the offensive, risk averters in a tight spot

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**Purpose of YCC change, progress towards inspiring animal spirits**
The 20 December YCC (yield curve control) change, widening the range of long-term interest rate volatility from 0.25% to 0.5%, came as a surprise. The fact that no one expected it is a sign that the BoJ is on the offensive, which is positive for stock prices and risk-takers. We believe that it is a factor for stock market strength, but not linked to stock market weakness.

**Surprise awe-struck the market**
The following three factors can be pointed out as the significance of the YCC change.

i. It showed that the BOJ has a free hand, awe-inspiring the market.

ii. It suggested a long-term trend of rising interest rates and encouraged investors to change their actions = risk-taking.

iii. It showed room for adjustment within the YCC framework and a smooth path to normalization (=exit).The BOJ made ample allowances for market turbulence and distortions: it notified that it would conduct 'indicative price operations' for unlimited purchases of newly issued 2-, 5- and 20-year bonds at specified yields, making clear its stance of controlling the entire yield curve, not just the 10-year one. QE was also increased (from 7.3 trillion yen to 9 trillion yen per month).

This is positive for the management of financial institutions due to the widening of the long/short interest rate differential. The housing loan, which had been a concern, will remain the same for variable loans linked to short-term interest rates, but fixed loans, which are influenced by long-term interest rates, will rise. This rise in interest rates will not reduce banks' demand for lending, but rather increase their willingness to 'borrow while interest rates are low', which will increase lending.

**The BOJ is trying to drum up JGB shorts (= more borrowing)**
The Nikkei Shimbun reported "BOJ backed into a corner by speculators, JGB selling by Blue Bay Asset playing out" (22 Dec.) and portrays the BOJ as having lost out, which is not the case at all. The BOJ wants investors and companies to act like blue bays; JGB shorting is synonymous with 'borrow while rates are low' (= more debt).

W. Buffett raised JPY 600 billion at 0.4% interest rates in 2019 to buy stocks of five major trading companies with dividend rates of 4-5%, and raised another JPY 115 billion this November through a yen-denominated bond issue, bringing the total amount raised so far to over JPY 1 trillion. The BOJ wants to inspire this kind of animal spirit. It wants to help build a position (i.e., increase debt) that will benefit from future interest rate rises while interest rates are at their current abnormally low level. Both financiers of companies and investors are being asked to lighten their ding.

**Free from the yoke of exchange rates, the BOJ has a free hand**
The reason why the BOJ has a free hand is that it does not have to take the foreign exchange market into account at all. There is no need to worry about a collapse in the yen. There is also a sufficient buffer against a strong yen. This is not like the Bank of England (BOE) in 1992, when it was defeated by George Soros' selling of the pound.

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**YCC critics, who make investors and businesses feel powerless, are the BOE's enemies**

Media commentary has been mixed and the stock market has been misled and distracted. The measures cannot be assessed on tactical grounds. We need a measure of what the BOJ is fighting against, what a victory for the BOJ would look like, and whether or not the BOJ is getting closer to it. The BOJ is fighting deflation, and it is fighting critics of unprecedented monetary easing who downplay (or ignore) the risks of deflation. The media and majority economists who have been saying that YCC will fail to establish 2% inflation and investors and businesses should not take risks. Those people have continued to suppress animal spirits.

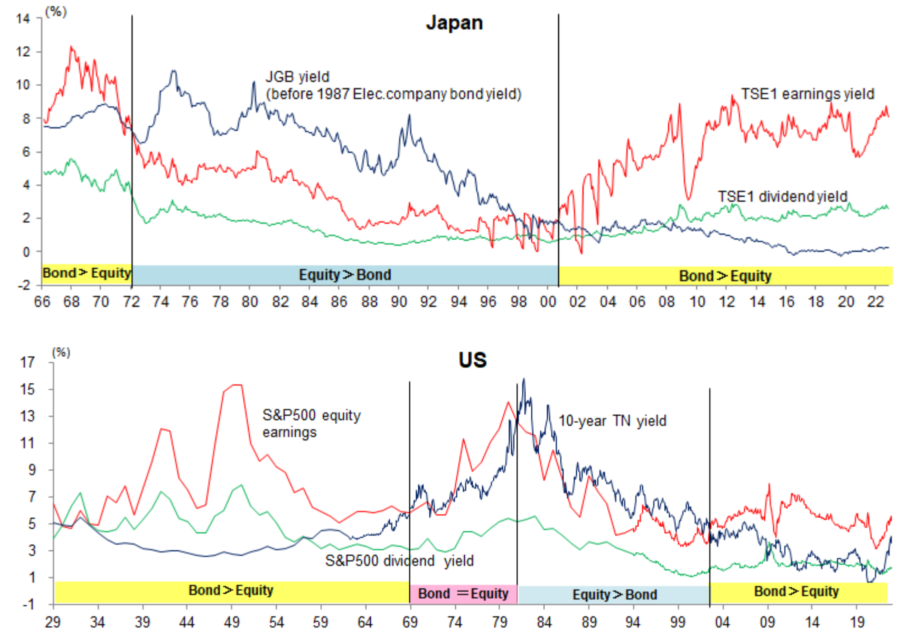
Nikkei Shimbun Monetary Policy and Markets Editor Setsuo Otsuka has commented that "YCC is a defeat for unprecedented monetary easing, and this change is the beginning of the 'dismantling' of unprecedented easing" (21 December), calling on people to be wary, which is a totally wrong assumption. YCC is a deepening of the unprecedented monetary easing scheme and It is a legitimate monetary policy.

Unprecedented Monetary Easing is a strengthening of market control by the BOJ, which on the surface appears to impede market functioning. Critics of unprecedented monetary easing point out that YCC is the ultimate market control by the BOJ, a moral hazard and undesirable based upon textbook. It is the correct however since market dose not functioning for raising risk capital the only path for the BOJ's is to adopt dangerous drug to achieve ultimate goal of a complete break from deflation.

We would like to emphasize that criticism of BOJ policy without such a strategic theory is nothing more than misleading the public.

YCC/long-term interest rate fixing was once implemented in the US at the end of the 1940s, when US equities were at historic lows in terms of valuations. In other words, the animal spirits of investors were broken in the context of the Great Depression and war. However, as shown in Figure 1 below, after the end of the YCC in1951 , US stocks began to soar . These historical lessons should be recalled.

**Figure 1: Japan & US – government bond yields, equity earnings yields and dividend yields**




Source: Bloomberg, Wright Investors' Service, Musha Research