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On the June BOJ Policy Meeting

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Donald Luskin

The BOJ wisely sticks to its strategy -- higher JGB yields mean that it's working.

The Bank of Japan supposedly disappointed markets at today's monthly policy meeting by not introducing new programs aimed at capping government bond yields, or at least controlling their volatility. The Policy Board's statement today didn't even mention those concerns, instead simply reaffirming the bold "quantitative and qualitative easing" program introduced at the April meeting (see "On the April BOJ Policy Meeting" April 4, 2013).

- There had been rumors that the BOJ would institute a program similar to the European Central Bank's Longer-Term Refinancing Operations (LTRO) to ease bond market volatility. In today's press conference, BOJ Governor Haruhiko Kuroda said simply that is was "not needed for now."
- Such a thing may indeed have calmed bond volatility. But it would be additional easing, and by increasing growth and inflation expectations it should have pushed long-term yields higher.
- But for the BOJ to have done it would have been to bow to pressure to "do something," which would have risked its institutional credibility. Once the BOJ started down the slippery slope of catering to every outcry, the risk is that it would pull back on its asset-purchase program if bond yields were to rise further.
- The cult of Abenomics has to some extent led markets to expect the impossible -- benefits without costs. For JGB yields to rise from their unusual and pathological recent lows is a small price to pay for pulling Japan out of 15 years of deflation.
- If the BOJ is successful at raising inflation and growth expectations, then JGB yields *will* rise further and *should* rise further. When they do so it will be welcome proof that the BOJ's program is working (see "Japan: At Long Last a Correction" May 31, 2013).

Bottom line

The BOJ stood strong, neither adding to nor pulling back from its bold easing initiative. While a short-term disappointment to markets under the spell of the Abenomics, this kind of policy stability is exactly what the BOJ needs to convince markets that it will follow through on reflation. We expect JGB yields to gradually move higher, and stocks to recover from their sharp correction.

Update to strategic view

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