

Bank of Japan decision sends “shock” through global markets

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The Bank of Japan (BoJ) has delivered what was almost universally described in the financial press as a “shock” to global markets with its decision on Tuesday to relax its so-called yield curve control (YCC) policy.

Under the policy, implemented almost a decade ago, the central bank has intervened in the market, buying up government bonds, to ensure that the yield or interest rate on 10-year government debt hovers around zero.

The loosening move was a decision to expand the band within which the yield can fluctuate from minus 0.25 percent to plus 0.25 percent to minus 0.5 percent to plus 0.5 percent.

Bond prices fell in response to the decision, sending the yield to as high as 0.47 percent before easing back to 0.41 percent, the highest level in almost two decades. Bond prices and their yields move in opposite directions.

While the numbers involved are small, the implications are large because of the trillions of dollars that surge through the global financial system every day. Thus, a small movement in interest rates can result in sizeable gains or losses on any deal depending on the calculations made when it was struck.

A number of financial trading houses had been making the bet there would be some move on the YCC policy, if not its total abandonment. This was because of the pressure on the Japanese currency and financial system resulting from the interest rate rises spearheaded by the US Federal Reserve and being followed by central banks around the world.

The interest rate disparity between Japan and the rest of the world led to a sharp drop in the yen as it fell to a low of 150 to the dollar in October. It rose subsequently and, as a result of the loosening announcement, the exchange rate was 133, an upward movement of 2.9

percent on the day.

Outlining the decision, BoJ governor Haruhiko Kuroda denied it was monetary tightening or the abandonment of YCC. He said it was aimed at addressing volatility in global financial markets and improving the functioning of bond markets to “enhance the sustainability of monetary easing.”

“This measure is not a rate hike,” he said. “Adjusting the YCC does not signal the end of YCC or an exit strategy.”

Despite these claims, the move was seen in markets as at least a significant “crack” in the operation of the YCC, possibly opening the way for its eventual scrapping.

Some movement had been expected but not until the retirement of Kuroda, the architect of the policy, in April next year.

“We view this decision as a major surprise, as we had expected any widening of the tolerable bands to be made under the new BoJ leadership from spring next year, similar to the market,” Naohiko Baba, chief Japan economist at Goldman Sachs told the *Financial Times* (FT).

In a situation of rising interest rates worldwide, the BoJ’s YCC policy has been described by some analysts as a “dysfunction.” The BoJ now holds more than half of all outstanding government bonds compared to 11.5 percent when Kuroda became governor in 2013.

For past decade, the BoJ has carried out one of the most extreme versions of the program of “quantitative easing” adopted by all major central banks in response to the global financial crisis of 2008. Under the YCC policy initiated in 2015, virtually all new debt of the government, one arm of the state, was bought up in the bond market by its financial arm, the BoJ.

As a result total Japanese public debt has risen to the

equivalent of more than 260 percent of GDP.

The BoJ's move did not produce major movements in financial markets apart from some marginal tightening of interest rates. But further steps in the same direction could have more significant consequences.

In comments reported by the FT, Mansoor Mohi-uddin, chief economist at the Bank of Singapore, said the decision was significant because it indicated the central bank was considering an exit from YCC, as he recalled a major turning point in Japanese financial history.

"The BoJ decision to raise interest rates in December 1989 led to a major sea change in Japanese markets," he said. "Today's officials will be keenly aware of that history. It amplifies the significance of their signal to markets today."

The 1989 decision led to the collapse of a financial bubble during which the value of the imperial palace in Tokyo was "worth" more than all the land in California. The puncturing of the bubble led to a sustained fall in the value of stocks on the Tokyo market from levels to which it has never returned.

A series of comments from financial analysts, reported by Bloomberg, pointed to the potential global consequences of the BoJ's move.

According to Vishnu Varathan, a leading official at the Mizuho Bank in Singapore: "The BoJ has created so much tension in the markets this year with its policy stance—the spring has been so tightly wound—the impact could be massive when they finally decide to let it go. It will rip through every aspect of markets."

Masamichi Adachi, a former BoJ official, now chief Japan economist at UBS Securities, said the decision was a "step toward an exit, whatever the BoJ calls it" and opened the door for a rate hike next year.

In a note to clients, Jim Reid global head of macro research at Deutsche Bank wrote: "It's important not to underestimate the impact this could have, because tighter BoJ policy would remove one of the last global anchors that's helped to keep borrowing costs at low levels more broadly."

Japanese financial interests have more than \$3 trillion invested in stocks and bonds globally with more than half of that in the US, chiefly in US Treasury bonds.

According to financial analyst Amir Anvarzadeh, an observer of Japanese markets for more than three

decades, a decision to allow rates to rise, "could see a tsunami of offshore Japan money flooding back home. That is the big 'reset' move."

Naka Matsuzawa, chief strategist at the Japanese financial giant Nomura, said: "Yield curve control is approaching an effective end if a wider trading band is the BoJ's way of normalising policy. Market volatility will only rise further."

Such comments illustrate the fact that central banks, which have pumped out trillions of dollars over at least the past 15 years to prevent a financial crisis, have only created the conditions for even greater financial turmoil as they attempt to "normalise" policy.



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