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BOJ's YCC shift parallels a Fed pattern

Confluence of factors caused the surprise shift

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In what was probably the best kept secret of many years, the BOJ unanimously agreed to shift its YCC policy well before virtually any economist or market watcher expected. The largest question people seem to have is "why now?". As with most major decisions, the answer was likely a confluence of several important items, with the major ones listed below:

1. The surprise is likely related to creating a smooth transition to new BOJ leadership. For instance, prior to Fed leadership changes, major policy changes are often established beforehand so that new leaders are not burdened with such. A new BOJ governor should be announced soon for the April transition, and while neither of the top candidates hold views greatly different that BOJ Governor Kuroda's, they will now have the flexibility to change policy further, if needed. The main difference with the Fed, however, is that the Fed did not surprise the market with its transitions.

2. The holiday season is a quiet period and the BOJ intends to use virtually unlimited resources to buy JGBs all along the curve, thus attempting to create a new framework for rates all along the curve.

3. The BOJ is adamant that this is not a shift in monetary policy, but rather intended to help market liquidity. No change in policy rates or YCC is deemed necessary at this time, a stance which should help prevent excessive market volatility.

4. One of the greatest reasons for consumer discontent, both politically, for the Japan's Prime Minister and LDP, and economically, is high inflation and a stronger yen will help tame such quite quickly.

5. Japan often looks to the ECB as an example, and although the economic situations now are much more different than normal, the fact that the ECB was so hawkish last week likely influenced the BOJ to start allowing more flexibility ahead.

6. The yen was already appreciating from its lows this autumn, mostly due to forex intervention fears, lower US bond yields, related expectations of "peak Fed" and inbound tourist revenues rapidly streaming in. Inflation would, thus, have fallen ahead, especially if global economic growth was likely to slow further, but there was likely some fear that China's shocking re-opening would push up global growth and commodity prices in 2023 and that the US and Europe economies were not seeming to slow as much as expected. Thus, high inflation in Japan might have been stickier than expected unless there was some surprising global financial accident or major downturn.

As for the effect of this move, a stronger yen will reduce overall profits of Japanese corporations for the next year, but quite a few corporations have hedged a decent portion of their forex exposure over the next six months, so the effects will not be immediate. Meanwhile, many financial and import-cost sensitive companies benefit somewhat from a stronger yen, so this should provide some support for the equity market. Consumer spending will likely be encouraged by lower inflation, which should support companies who cater to such. As for tourist expenditures, Japan still seems a bargain at prevailing yen rates, so there will likely be no slowdown in the surge, especially if tourists from China start to accelerate after its re-opening phase is more fully developed.

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