Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Lorcan Roche Kelly, Europe Research Affiliate

TRENDMACRO LIVE!

On the October BOJ Policy Meeting

Friday, October 31, 2014

Donald Luskin

If you can't fire the third arrow, at least first the first arrow a couple trillion more times.

In a narrow 5-4 decision, the Bank of Japan announced it would extend and enlarge its "quantitative and qualitative monetary easing" program. It's being touted as a big surprise, but it really isn't. We knew something was up when BOJ Governor Haruhiko Kuroda was pulled out in the middle of last month's policy meeting for questioning before parliament. At the same time, the Government Pension Investment Fund announced it would double is target for allocation to equities -- after much pressure to do so by Abe's government.

- *Sadly, the least surprising aspect of all this is that it was so obviously necessary, after the failure of Prime Minister Shinzō Abe to deliver on the so-called "third arrow" of Abenomics -- reform of labor markets and trade policy -- while at the same time punishing the Japanese economy with a large hike in the national consumption tax.*
- *Necessary, but not sufficient. An economy can't indefinitely make up for policy errors in taxation, regulation and trade with expansive monetary policy, or arbitrarily targeting investments made with public savings.*
- In April 2013 when the BOJ's program began, it made sense -- it was just what the doctor ordered, a revolutionary turnabout from a decade and a half of deflationary tightness (see "On the April BOJ Policy Meeting" April 4, 2013). And it was but a part of a broader program of economic revitalization, each part designed to work synergistically with the others (see "The Abe Restoration" May 10, 2013).
- But now it's not new anymore -- diminishing returns will set in, as they did with each of the US Federal Reserve's successive QE programs. And there's no synergy -- because there are no other reforms with which to synergize.
- We've been neutral on Japan for the better part of year, as it became clear that Abenomics was going to flop (see "Japan Breaks Out -- Does It Matter?" November 19, 2013") -- and this supposed surprise doesn't change that.
- The immediate reaction by global markets is exuberant -- but perhaps irrationally so, as it plays into the false narrative that the world is lapsing into monetary deflation -- with the BOJ's announcement being seen as an antidote.

Update to strategic view

BOJ, ASIA MACRO, ASIA STOCKS: The BOJ extended and expanded its bond purchases, and GPIF doubled its equity allocation. After Abe's failure to shoot the "third arrow" of Abenomics and his hiking the national sales tax, these moves are necessary -- but they are not sufficient to make up for large policy errors and disappointments. So none of this changes our neutral stance on Japan. The immediate exuberant reaction in global markets may be misplaced if it is based on the false narrative of global monetary deflation, which in fact is only an artifact of falling energy prices.

[Strategy Dashboard home]

- We have come to think the deflation narrative is something between an error and a hoax. Years of too-low inflation, punctuated by short periods of outright deflation, can be explained entirely by real factors -- globally, by more than six years of oil prices coming off their 2008 peak, and in Europe by massive "internal devaluations" in labor markets in rescue countries (see "Don't Let a Good Oil Crisis Go to Waste" October 21, 2014).

Bottom line

The BOJ extended and expanded its bond purchases, and GPIF doubled its equity allocation. After Abe's failure to shoot the "third arrow" of Abenomics and his hiking the national sales tax, these moves are necessary -- but they are not sufficient to make up for large policy errors and disappointments. So none of this changes our neutral stance on Japan. The immediate exuberant reaction in global markets may be misplaced if it is based on the false narrative of global monetary deflation, which in fact is only an artifact of falling energy prices.

Contact TrendMacro

On the web at
trendmacro.com

Follow us on Twitter at
twitter.com/TweetMacro

Donald Luskin
Chicago IL
312 273 6766
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Lorcan Roche Kelly
Agenda Research
Sixmilebridge Ireland
617 600 6969
lorcan@trendmacro.com

[About us]