

TRENDMACRO LIVE!

On Kuroda and Iwata at the BOJ

Monday, February 25, 2013

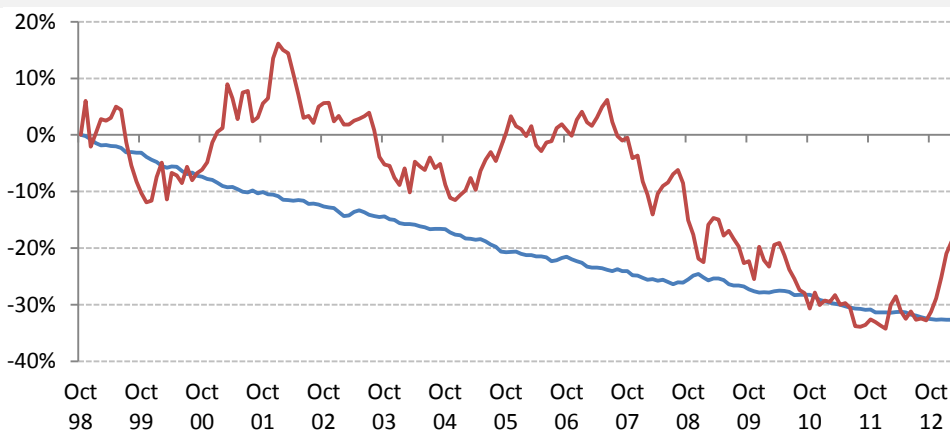
Donald Luskin

Abe picks doves and interventionists -- despite G-20 pressure, he has followed through.

[Haruhiko Kuroda](#) is [reportedly](#) to be nominated as governor of the Bank of Japan by new Prime Minister Shinzō Abe. [Kikuo Iwata](#) is reportedly to be nominated as deputy governor. Both men are interventionists and doves, and selecting them is a courageous move by Abe, fulfilling his promise to reform the Bank of Japan's policy apparatus with the aim of reversing 15 years of punishing monetary deflation and currency appreciation. This is the next step in the reinvigoration of the Japanese economy that we argued might follow the 2011 Tōhoku earthquake and tsunami (see "[Meltdown in Japan](#)" March 15, 2011). It is real. It is why Japan has been the best-performing major equity market year-to-date, and since the US stock market's bottom in June, 2012 (see the chart on the following page, and "[2013 Outlook: Think Globally, Shrink Locally](#)" January 14, 2013).

- At the Ministry of Finance, Kuroda was a strong advocate of intervention to weaken the yen.
- Iwata (not to be confused with former BOJ deputy governor Kazumasa Iwata) is the Ben Bernanke of Japan -- an academic with an eclectic approach to policy embracing untraditional tools.
- Both are aware, as is Abe, that Japan's persistent mild deflation -- while the rest of the world underwent mild inflation -- strengthened the yen via purchasing power parity (please see the chart below).

— Japan CPI deflation versus US — Dollar depreciation versus yen
 Based at zero as of October 1998, the all-time high for Japan's CPI



Source: Bloomberg, TrendMacro calculations

Update to strategic view

BOJ, ASIA STOCKS, ASIA MACRO, FX:

Haruhiko Kuroda and Kikuo Iwata are reportedly to be nominated by Japan's Prime Minister Shinzō Abe to be governor and deputy governor of the BOJ. Both are interventionists and both are doves. This aggressively follows through on Abe's promise to reform the BOJ and lift Japan out of 15 years of deflation and currency appreciation, which has punished the critical export sector. Markets have rightly feared that Abe won't follow through as a reformer, but on this decision he has -- and in the face of diplomatic pressure from the G-20. We continue to expect Japan's equity market to outperform the US, and the yen to depreciate against the dollar at we have warned about.

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- This currency strengthening has been particularly damaging to Japan's growth, because productivity is so unevenly distributed across the economy. Inward-looking sectors such as retail, wholesale and agriculture have languished behind protectionist walls. The "Japanese miracle" was [due entirely to the outward-facing export sector](#), honed to excellence by intense global competition. Inward looking sectors are indifferent to exchange rates, but exporters are not -- so the last 15 deflationary years of currency appreciation have singled out Japan's growth engine for punishment.
- We are not advocating inflation or currency devaluation, *per se*. They are not keys to growth. But in Japan's case both are appropriate and essential, because they reverse 15 years of policy error in the opposite direction.
- Neither do we mean to imply that correcting its deflationary error will cure all Japan's economic problems. But thinking at the margin, whatever else may be wrong with Japan, correcting this one large error -- especially as money touches the very platform of any economy -- will likely make a meaningful difference.
- The biggest risk for Japan is always that its leaders won't follow through. During Japan's two-plus lost decades, there have been many disappointments. It is encouraging, at least, that in the face of diplomatic pressure from the G-20 opposing Japan's small down payment on currency devaluation over the last three months -- to which Abe [seemed to succumb last week](#) -- he is going ahead with these two very aggressive appointments to the BOJ.

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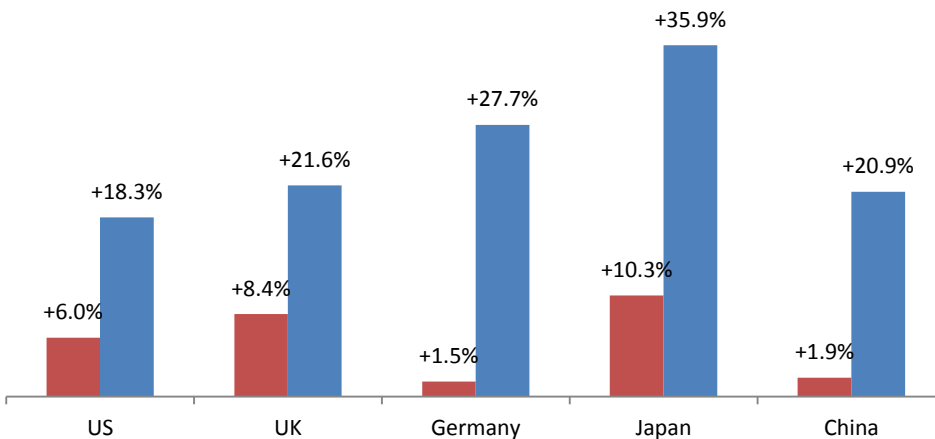
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Equity market performance ■ YTD ■ From 6/1/12 US bottom
Price return, local currency



Source: Bloomberg, TrendMacro calculations

Bottom line

Haruhiko Kuroda and Kikuo Iwata are reportedly to be nominated by Japan's Prime Minister Shinzō Abe to be governor and deputy governor of the BOJ. Both are interventionists and both are doves. This aggressively

follows through on Abe's promise to reform the BOJ and lift Japan out of 15 years of deflation and currency appreciation, which has punished the critical export sector. Markets have rightly feared that Abe won't follow through as a reformer, but on this decision he has -- and in the face of diplomatic pressure from the G-20. We continue to expect Japan's equity market to outperform the US, and the yen to depreciate against the dollar.

