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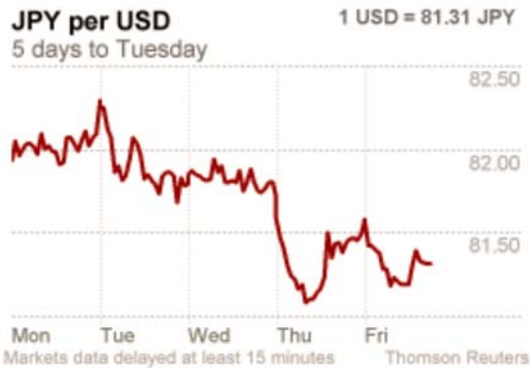
BoJ says: 'Bye, bye bank note rule'

Posted by **Neil Hume** on Oct 05 10:13.

Could the market be underestimating the importance of the BoJ's QE announcement on Tuesday?

Here's the current reaction to the "giant leap" by the Bank of Japan:



In short, equities are up but there's been a pretty muted reaction from the yen.

Gold, however, is on fire:

Which has not unduly surprised analysts at RBS:

> *We think the underlying trend of the strong yen will remain for the following reasons:*
> *1) the Fed continues to expand the QE II on its balance sheet;*
> *2) the BoJ still seems reluctant to eliminate self imposed rule not to buy JGBs from the market more than total amount of banknote, and*
> *3) it is hard for the Japanese authorities to ask other major countries' cooperation in currency intervention.*
>
> *Also, the JPY5trn of newly purchased assets is limited compared to the Fed's QE II. However, we think it paves the way for the BoJ's next QE going forward – when the yen gains further, and signals the additional purchase of JGBs, including making the bank note rule more flexible.*

More QE?

Apparently so.

Although, critically, it's also **bye, bye to the BoJ's bank note rule** — the policy by which the bank keeps total government bond purchases below the amount of banknotes in circulation:

> *In fact, we can also interpret an establishment of asset purchase program including the JPY3.5trn of JGBs and TBs as a virtual abolishment of bank note rule. By putting JGB purchase included in an asset purchase programme, the Bank may flexibly increase the total amount of JGBs by controlling total amount of asset purchase.*
>
> *The Bank said the new funds' JGBs buying is a temporary measure and different with the Rinban, and therefore will be excluded from the banknote rule. We think this is important and meaningful as the Bank has made a new card and left the room for it to expand JGB buying via boosting the amount of the new funds without restriction within the banknote rule. Moreover, it is also possible for the Bank to extend JGBs buying to the longer than the current one to two years zones.*

In other words, the real significance of today's news is that BoJ's purchase of long term government bonds will treated differently from the bonds purchased within the ceiling of banknotes in circulation..

Sean Corrigan at Diapason Commodities puts it like this:

> *BOJ implementation of QE, not really a surprise – hence the muted reaction – **but its ramifications are possibly being overlooked Comment at end of page two -** 'Bank will purchase various FINANCIAL assets [my emphasis] AS WELL AS conduct [sic] a similarly purposed fixed-rate funds-supplying operation against pooled collateral' presumably means they will advance cash on claims to real assets, too, i.e., they will monetize tangible property & perhaps unsecuritized business invoices and receivables… AND they've lifted the long-standing bank note v JGB cap. This does sound like easing 'a outrance', while the aim of 'lowering risk premiums' means PPT in spades, too…. Crushing yields, boosting asset prices (capital allocation RIP)turning all titles into money… **Mrs Watanabe should be scared!***

An action actually anticipated by Ben Davies of the Hinde Capital gold fund on King World News the night before.

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Meanwhile, on the other side of the pacific expectations are building that the Fed will launch the QE2 at its November 2-3 meeting. Well, they are at Goldman Sachs, anyway.

> *We see Friday's speech by William Dudley, president of the New York Federal Reserve Bank, as a strong signal that the FOMC is likely to announce another round of asset purchases at the November 2-3 meeting. Although the initial amount is apt to be $500 billion (bn), most likely in longer-term Treasury securities, we continue to think that the program will cumulate to more at least $1 trillion (trn), possibly much more. In this comment we reiterate and update our views on this issue, again in Q&A format.*

And in case you are wondering why the Dudley speech was so important, Goldman has the answer.

> ***Q: Why is the Dudley speech so important? Didn't he say these were just his views and not necessarily those of his colleagues?***
>
> *He did say that, as all FOMC members do when they give speeches. However, as Vice Chairman of the FOMC, he is one of the three most senior members of the committee. As such, he would be highly unlikely to give a speech of this significance without the concurrence of Chairman Bernanke and probably other key members of the committee. This does not mean that all 17 members, voting or otherwise, are in agreement, but it does strongly suggest that there is sufficient support for additional asset purchases to make it a serious option at the next meeting. More importantly, President Dudley made it clear that current conditions are unacceptable insofar as the committee's meeting its dual mandate is concerned. The clearest statement occurred at the very outset, even before he noted that "what I am going to say [emphasis ours] reflects my own views and does not necessarily reflect the views of the Federal Open Market Committee and the Federal Reserve System":*

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This entry was posted by Neil Hume on Tuesday, October 5th, 2010 at 10:13 and is filed under Capital markets, People. Tagged with Bank note rule, bank of japan, federal reserve, japan, quantitative easing.

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