

# YES, THE BANK OF JAPAN WANTS A WEAKER YEN AND STRONGER BANKS

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**Bank of Japan (BOJ) action today confirmed that Japan wants:** • Stronger banks • A steeper [yield curve](#) • A broader and stronger stock market • A possible overshoot on [inflation](#) **Specific Actions to Achieve These Goals:** • No added [negative rates](#), i.e., no added “tax” on bank reserve deposits • Explicit board call for a steeper curve, to be achieved by shortening [duration](#) of bond-buying program. Note here the quantity of BOJ bond buying stays unchanged—despite a coming increase in [Japanese Government Bond \(JGB\)](#) issuance from a [fiscal package](#). The BOJ also has no specific [bond yield](#) target—it just wants a steeper curve to raise the banks’ margins. • Tilt the ¥6 trillion program to buy exchange-traded funds (ETFs) away from price-weighted [Nikkei 225 \(NK225\)](#) and toward [cap-weighted TOPIX \(TPX\)](#)—(TPX weight up from 42% to 70% of all annual ETF budget) • The commitment to the 2% inflation target was actually strengthened—the board now explicitly seeks an “overshoot” to the target.<sup>1</sup> In short: Nobody is in any hurry to taper or roll back [quantitative easing](#) in Japan. The message could not be clearer. This is a positive for Japanese equities, banks and financials in particular—and in my view, a negative for the yen. From here, a most interesting new challenge will come from the fact that the BOJ did not specify a numerical target for bond yields. A steeper curve is desired, but how steep is steep enough? Personally, I think this is good policy, as it adds uncertainty; in the coming weeks and months it will be interesting to see whether certain yield levels start triggering BOJ commentary. I have no doubt that markets will want to test where Governor Kuroda’s possible pain points may be. However, for now, the JGB yield rose and has room to run, in my view. *Read more about [BOJ meeting implications](#). Read Jesper Koll’s research on the [BOJ stance](#).* <sup>1</sup>Source: Bank of Japan, 9/21/2016.

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## DEFINITIONS

**Yield curve** : Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.

**Inflation** : Characterized by rising price levels.

**Negative interest rates** : Usually borrowers make regular interest payments to their lenders for the money they owe. Under a system of negative interest rates this relationship would be reversed and the lender would pay the borrower for the privilege of lending.

**Duration** : A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

**Japanese Government Bond (JGB)** : A bond issued by the government of Japan. The government pays interest on the bond until the maturity date. At the maturity date, the full price of the bond is returned to the bondholder. Japanese government bonds play a key role in the financial securities market in Japan.

**Bond yield** : Refers to the interest received from a bond and is usually expressed annually as a percentage based on its current market value.

**Nikkei 225 Stock Average Index** : A price-weighted average of 225 top-rated Japanese companies listed in the First Section of the Tokyo Stock Exchange.

**Market capitalization-weighting** : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

**Tokyo Stock Price Index (TOPIX)** : A free float-adjusted market capitalization-weighted index that is calculated based on all the domestic common stocks listed on the Tokyo Stock Exchange First Section.

**Quantitative Easing (QE)** : A government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.