

14 June 2024

## BOJ goes slowly in move to quantitative tightening

### Key takeaways

- The Bank of Japan announced on 14 June that it would begin scaling back its government bond purchases but would announce a more detailed plan in July.
- BOJ Governor Ueda Kazuo would like to move towards more market-determined interest rates but has to proceed cautiously in light of government concerns about a sharp increase in rates – while also being mindful of the continuing impact of yen weakness.

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The Bank of Japan (BOJ) indicated it would take a deliberate approach to scaling back its purchases of Japanese government bonds at its 13-14 June policy board meeting, which have remained roughly JPY 6tn (USD 38.14bn) per month. Although the BOJ announced a policy change would be forthcoming, the details of the policy will not be finalized until the 30-31 July policy board meeting. The bank wants more time to consult with market participants and develop what it has said will be a schedule for reducing long-term bond purchases over the next 12-24 months that balances transparency for markets with the BOJ's desire for the flexibility to react as circumstances change.

This meeting perfectly encapsulates the challenges Governor Ueda Kazuo's BOJ faces in engineering policy normalization. While the governor said that his goal is to move towards "free price formation" for JGBs in financial markets, the BOJ – and political authorities – want to move slowly in "liberating" bond markets, given [anxieties](#) around the impact higher interest rates could have on the government's finances, households, and businesses. The BOJ may be inclined to move more slowly than anticipated with short-term rate hikes than when it changed its policy program in March, given ongoing uncertainty surrounding the outlook for prices and incomes.

But the BOJ also has to be sensitive to the ongoing impact of yen weakness, which continues to affect Japan's economy and prices even as the BOJ is limited in its ability to reverse the yen's decline. In his press conference, Ueda unambiguously acknowledged that "exchange rates have a significant impact on the economy and prices," noting that companies can pass price increases due to exchange rate movements to consumers easier than in the past. While quantitative tightening could close the gap between Japanese and US interest rates and relieve some of the downward pressure on the yen, the need to prevent interest rates from rising too sharply will ultimately determine the shape of the policy more than exchange rate considerations. The result could be downward yen pressure as seen immediately following the BOJ's policy announcement, when the yen fell below JPY 158/USD for the first time since April. In these circumstances, the possibility of further foreign exchange intervention cannot be ruled out.

Accordingly, the Kishida government will be monitoring how the BOJ manages quantitative tightening and could make its desires more explicit if necessary, as it previously [did](#) when Ueda downplayed the impact of yen weakness. As Prime Minister Kishida Fumio fights for survival – and his Liberal Democratic Party (LDP) frets about a possible electoral disaster – political leaders will be looking to the bank to find a sweet spot whereby it closes the interest rate gap with the United States and reduces downward pressure on the yen without triggering a sharp increase in short-term interest rates that fuels a public backlash.

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