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BOJ's architect of 'shock and awe' plots retreat from stimulus

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TOKYO (Reuters) - More than five years into a radical plan to boost the world’s third-biggest economy, the Bank of Japan sent a message of quiet surrender last week, admitting it couldn’t stoke inflation and walking back steps intended to do so.

The man leading the BOJ away from its program of unprecedented asset-buying and low or negative interest rates is the man who largely crafted the measures in the first place, bank deputy governor Masayoshi Amamiya.

A fan of classical music who has recently begun to favor Russian composers, Amamiya “plays the piano, guitar and flute well,” says a person who has known him for decades.

Unlike many previous central bank leaders, who took an academic approach to policy, Amamiya simply “tries to create something new,” the person said.

The career central banker’s latest creation, a mechanism for unwinding much of his previous work, has been quietly under development for almost a year.

Interviews by Reuters with a dozen people familiar with the bank’s thinking reveal for the first time that there were plans to raise rates twice this year.

In January, market turbulence pulled the rug from under an announcement of an increase. The bank then hoped to signal higher rates in July and raise them in September, but weak inflation data scuttled that idea too.

Neither plan was made public.

Last week, the central bank took more subtle action, rolling back parts of its policies that have hurt banks, paralyzed Japan’s bond market and distorted stock prices even as they failed to ignite healthy inflation.

The move represented a compromise Amamiya forged with his boss, bank governor Haruhiko Kuroda, to appease doves on the policy board with a promise to keep rates very low for an extended period.

He swung a key vote, deputy governor Masazumi Wakatabe, allowing the new policy to move forward without any clouds of doubt from a senior official.

“The latest steps marked a major turning point for Kuroda’s stimulus program,” a source said. “The reflationists have become a minority, which means the BOJ is turning more hawkish.”

Amamiya, who largely crafted Kuroda’s initially successful “shock-and-awe” campaign, may now be more mindful of his own legacy, insiders say. The Bank of Japan declined to comment for this article.

A roadmap to a sustainable stimulus program could serve as his own path to succeeding Kuroda as governor in five years.

But there are no easy answers. A few more years of ultra-low rates could drag down weak regional banks. Explicitly raising rates may trigger an unwelcome increase in the yen that could cool the export-reliant economy and anger politicians.

“Unwinding monetary support is far more difficult than expanding it,” said a former BOJ policymaker who retains close contact with incumbent central bankers.

And looming in the background is the stubborn fact that low rates have done nothing to nudge inflation toward the central bank’s target of 2 percent.

“Everyone at the BOJ knows what they’re doing now is quite radical and needs amending at some point,” another source said.

MR. BOJ

Dubbed “Mr. BOJ” by central bank watchers for innovating most of the bank’s recent bold monetary easing tools, the 62-year-old Amamiya has spent most of his career at the monetary affairs department, which drafts policy and speeches.

His candid, down-to-earth style won him close ties with powerful politicians and business executives, helping lift him to the second-highest position in the central bank.

But even the politically savvy Amamiya was blindsided by public backlash after the bank, desperate to protect a fragile economy from a strengthening yen, pushed short-term rates below zero in January 2016.

The move proved to be a disaster.

Amamiya, who had three years earlier won praise for spearheading Kuroda’s radical stimulus, received daily visits from bank executives furious about low bond yields, which were crushing margins.

At his direction, bureaucrats soon were huddled in the seventh-floor meeting room at the BOJ's headquarters in Tokyo, searching for ways to support yields that had sunk far below the level they were shooting for.

Their brainstorming led to a policy called yield curve control, which kept short-term rates negative and guided long-term rates to around zero.

The policy represented the first tool carefully designed to unwind Kuroda's massive asset-buying program.

It freed the bank from its obligation to buy a fixed amount of bonds, allowing it to steadily slow bond purchases to roughly half of what it had loosely pledged - just enough to keep yields pinned near zero.

"In a way, it was back to orthodox monetary policy that used interest rate targets as a policy tool," a third source said. "It was the first step toward policy normalization."

DEADLOCK

By the middle of 2017, BOJ bureaucrats, emboldened by a strengthening economy, were quietly mulling how to prepare for a future rate hike.

The first hint came in November, when Kuroda referred to the academic concept of a "reversal rate" - the point at which rate cuts by a central bank hurt an economy.

Signals also began trickling out from board members like Hitoshi Suzuki, who called in February for an increase to address the rising cost of stimulus. Former academic Makoto Sakurai warned in May against overstimulating demand with easy policy.

When the bank board met in July, after one abortive attempt to raise rates, members remained deeply divided between those worried about the rising cost of prolonged easing, and those opposed to a quick exit from years of radically expansive policy.

But as inflation data made it clear a second try at a rate increase wasn't possible, Kuroda and Amamiya came up with a proposal that would appeal to both sides.

To appease the reflationists, the bank for the first time deployed "forward guidance," which gives markets an idea of where interest rates will be over an extended period.

The guidance pledged to keep interest rates low. But that message could be tweaked once conditions allow for an increase, the sources say, making it a tool for policy normalization.

The BOJ also created room to reduce asset purchases by saying it would buy "flexibly." Negative rates will be applied to a smaller pool of reserves, diluting their effect and pleasing commercial banks.

“The BOJ was successful in tweaking its policy scheme, which did not greatly impact markets but introduced a tool, forward guidance for policy rates, for future tightening,” said Hiroaki Mutou, chief economist at Tokai Tokyo Research Institute.

The yen weakened after the announcement and Japanese bond yields hit a 1-1/2 year high last week as investors tested the limits of the BOJ’s new commitment to allow markets to move more freely.

Amamiya said the bank had no fixed timeframe for keeping rates low and could take more steps to address the rising cost of easing on parts of the economy.

Some critics, however, say the latest moves already show signs of desperation.

“It’s unclear what the BOJ really wants to do,” said one of the sources. “It’s doubtful how much the latest moves would help banks. The only thing clear is that with a dearth of policy tools, the BOJ is in a deadlock.”

Additional reporting by Stanley White and Tetsushi Kajimoto; Editing by Gerry Doyle

https://www.reuters.com/article/us-japan-economy-boj-policy-insight/bojs-architect-of-shock-and-awe-plots-retreat-from-stimulus-idUSKBN1KR0TA