MORLEY FINANCIAL
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BANK OF JAPAN "EASING"

Market Perspectives

April 12, 2013

On April 4, 2013, the Bank of Japan announced an aggressive "quantitative and qualitative easing" program that targeted a 2% price stability goal within two years. Elements of the plan include doubling the monetary base by the end of 2014, increasing the monthly purchases of Japanese government bonds (JGB) to ¥7 Trillion from current levels of ¥4 Trillion, extending the maturity of the purchases to the 40 year sector from the 3 year sector, increasing purchases of Exchange Traded Funds (ETFs) and Real Estate Investment Trusts (REITs), and communicating the need to maintain the policy until the 2% target is achieved.

We believe the announced program is significant. To give some context, the pace of Bank of Japan's JGB purchases is equivalent to 1.5% of Japan's Gross Domestic Product (GDP); the Federal Reserve's current purchases of Treasuries and mortgaged-backed securities (MBS) represent 0.5% of US GDP; JP Morgan estimates that the Bank of Japan will purchase 161% of 2013 net issuance versus roughly 60% under the Fed's quantitative easing program. That would translate to ¥19 Trillion (approximately $192 Billion at current exchange rate) in crowded out bonds that needs to be invested elsewhere.

The market has responded strongly on the new monetary regime. Since the election of Prime Minster Abe and his pro-monetary stimulus policies, the Nikkei, a stock market index for the Tokyo Stock Exchange, is up approximately 35%, the exchange rate of the Yen to the US Dollar depreciated 18%, and the 10 Year JGB yields have dropped to approximately 58 basis points from 75 basis points, the level at the time of the election. Our view is that this is another supportive technical factor in fixed income markets. We believe that Japanese domestic investors (insurers, banks and retail) will re-allocate to non-Yen denominated assets. If such a reallocation occurred, fixed income sectors that may benefit from the Bank of Japan's plan, from our perspective, could include sovereigns, MBS, and credit.

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