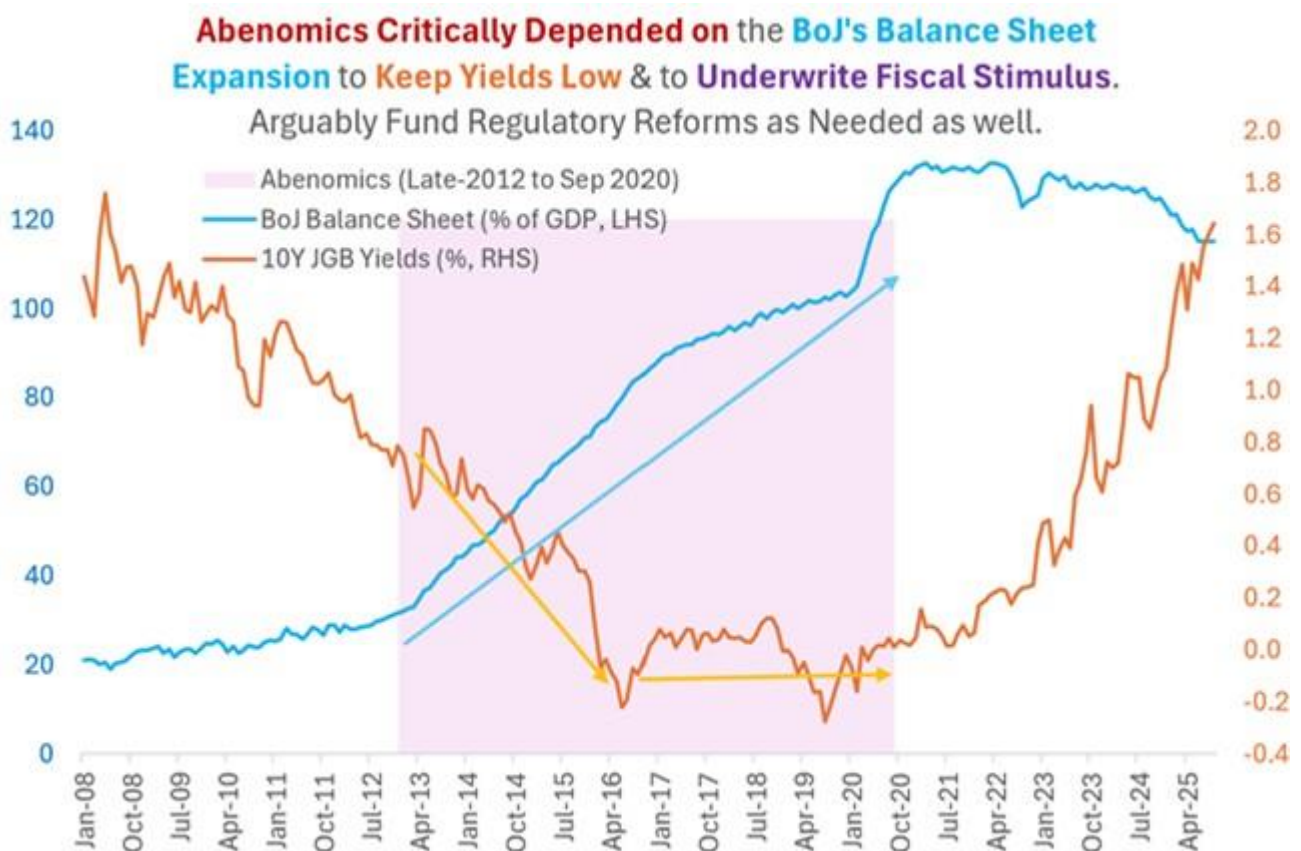


Can 'Abenomics 2.0' Work Without the BoJ's QQE?

In a Nutshell:

- Whispers of “Abenomics 2.0” in the pipeline are ostensibly affirmed by new Finance Minister Katayama.
- But the elephant in the room is that a **reboot of “Abenomics” is not viable without the BoJ's QQE.**
- And even **more problematic is the BoJ's QT plans.**
- Fact is, **balance sheet reduction** will send JGB yields sharply higher, **threatening to upend ‘Abenomics’** as **prohibitively high financing costs come home to roost.**
- Policy tensions are palpable. But **unless the BoJ concedes** (to resuming QQE), **higher JGB yields led by the long end** is likely.
- **Some JPY weakness** (partly offset by diminished BoJ accommodation), but **with haven allure greatly diminished** (as “carry trades” compromised by higher yields deprive JPY of “carry unwind” boost during “risk off”).



- Japan's new **Finance Minister Katayama** has commented that it is **"not unnatural" to reboot a 2025 version of 'Abenomics'.**

- But the **trouble is, any version of “Abenomics” is likely be challenged without the BoJ’s balance sheet (for QQE).**
- The **title question is rhetorical**. The **answer is “no”**. At least not “Abenomics” in any recognizable form.
- Fact is, the BoJ underwriting fiscal expansion (and possibly fund structural reforms) with QQE is a key premise for “Abenomics” to work.
- Point being, **“Abenomics”** in most viable forms *requires effectively subdued borrowing costs* and *guaranteed liquidity*.
- What’s more, **with the BoJ’s QT plans, “Abenomics 2.0” is even more likely to stumble on prohibitively high financing costs.**
- Inevitably, this raises the *specter of fiscal blowout* and all the *attendant threats to financial stability*.
- To make matters worse, the **government’ fiscal strains** could “crowd out” already fragile households and smaller businesses.
- For now, FinMin Katayama has refrained from commenting on monetary policy. But the (Government-BoJ) tensions are palpable.
- But it is **not hard to see** that the **government’s economic policies** and the **BoJ’s objectives** are **diametrically opposed**.
- More than the BoJ’s rate hikes, it is the **balance sheet reduction plans** - thereby no longer underwriting the government’s borrowings – **that threatens to upend “Abenomics reboot”**.
- When Abenomics was first launched in 2012, it was characterized as “three arrows” - a reference to;
 - i. monetary stimulus;
 - ii. fiscal stimulus and;
 - iii. structural economic reforms.
- Arguably, *not all arrows are created equal*. The **BoJ’s balance sheet**, in particular is **not merely an arrow**, but **also the bow from which the other two** (fiscal and structural reform) **arrows are launched**.
- Assuming that the BoJ does not relent on “normalization” and concede to resuming (Q)QE initially, the outcomes are likely to be bearish for JGBs and JPY.
- JGB Yields: The tensions between “Abenomics 2.0” and BoJ QT are likely to **initially*** lift JGB yields and steepen the JGB curve further (on fiscal and JPY risks).
- JPY: By and large, the tendency may be for *some JPY weakening on eventual fiscal risks*. (even if partly offset by diminished BoJ accommodation).
- Notably, JPY may further lose its haven allure as **“carry trades” compromised by higher yields deprive JPY of “carry unwind” boost during “risk off”**.

*Assuming the BoJ does not immediately relent and resume QQE.

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