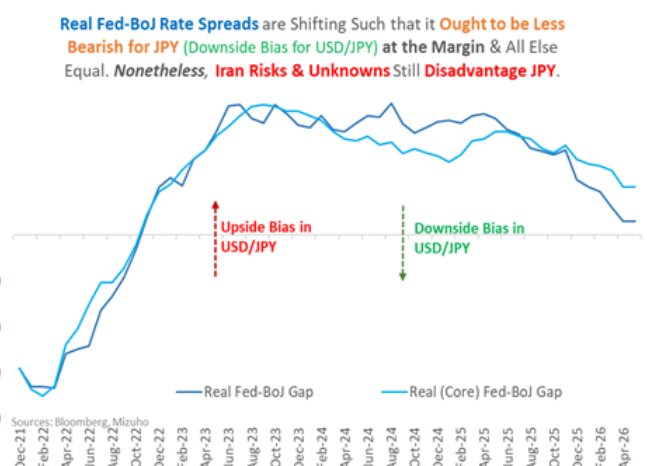
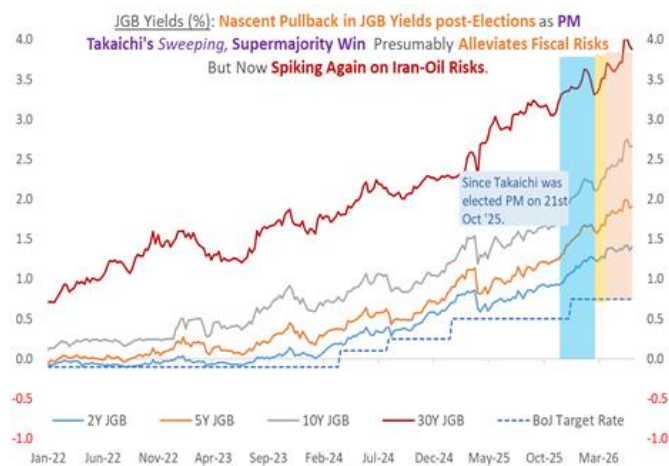


## BoJ Watch: One, But Not Done

"I am what you have made me. Take all the praise. Take all the blame." - Charles Dickens, 'Great Expectations'

### In a Nutshell:

- The **BoJ is widely expected to announce a 25bp rate hike to 1.00%** at the 16th June meeting.
- But with this hike ostensibly **fully baked in**, the risk is that *if further hikes are not clearly signaled* **JPY and JGB bears may not be deterred**.
- The **BoJ faces an unenviable dilemma**:
  - On one hand, *acting too aggressively could hurt fragile domestic demand*;
  - Yet, on the other, while *not acting decisively/emphatically enough may fail to prevent JPY and JGB sell-off*, especially with **negative real rates** amid imported inflation risks.
- *JPY bears may persist if BoJ hikes are deemed to lag behind other major central banks, particularly the Fed.*
- **External shocks** like the "**Iran/Hormuz crisis**" **compound JGB and JPY pressures**, and *complicating BoJ policy trade-offs*.
  - FX: Renewed JPY pressures and resultant intervention risks in response are par for the course.
  - JGBs: Meanwhile JGB yields are likely to remain upwardly pressured, *especially at the long end*.
- All said, there are **no clear resolutions to the BoJ's policy challenges**, and the *effectiveness of the upcoming hike* in addressing market concerns *remains uncertain*.



- At the (16th) June **BoJ meeting**, a **25bp hike is widely expected** by policy watchers.
- **But for JPY Bears, expectations are greater**. Whereby *even a hawkish hike* (with distinct references to further rate hikes in the pipeline) *may fall short* (of great expectations!)
- Crucially, the **BoJ will need to convince FX markets**, *especially "carry trade" opportunists*, that the BoJ is **far from done (hiking) with this one (25bp) hike to 1.00%**.

- Trouble is, this is a tall order. Especially as the **BoJ is painted into an awkward corner**, where it *simultaneously risks*:
  - *having to do "too much, too soon" to avert adverse demand shocks.*
  - *yet "not nearly enough" to stave off JPY and JGB sell-off* (amid disadvantageous rate differentials and increasingly daunting fiscal/debt woes).
- Point being, the **perverse dilemma of real rates in Japan languishing in deeply negative territory**, and a **fragile domestic recovery** that **necessitate checks on extent and speed of BoJ** hikes vis-a-vis other Major Central banks - including the Fed.
- Which means that **JPY bears may not be resoundingly suppressed** *if markets gather that BoJ hikes* (and terminal rate) *will ultimately still lag* (and fall short) vis-a-vis other Major central banks - and prominently, *the Fed*.
- Underscoring our long-held view that the "*(bearish) JPY is a BoJ problem with a Fed solution*".
- Further instigating the "carry trade" camp is the "Iran shock", which amplifies JPY pressures, all else equal.
- Compounding JPY pressures and exacerbating the policy trade-offs is the fact that (JGB) bond bears have the BoJ in a "heads, I win; tails, you lose" bind. Fretting that the BoJ is behind the curve on rate hikes, means markets sell off bonds (lifting yields). Yet rising yields render fiscal strains/debt burden even more stressed sending long-end JGB yields even higher in an adverse loop (with attendant JPY pressures).
- The **BoJ is in an unenviable bind** whereby on one hand it *needs to be compellingly hawkish to convince markets to back down from "Sell Japan" dynamics* hurting JPY and JGBs.
- Yet on the other, it *needs to have sufficient wiggle room to manage economic/fiscal pain from rate hikes* that are **perversely amplified by JPY and JGB stress**.
- For now, the **BoJ is set for a hawkish hike. But still risks fall short of arresting JPY and JGB bears** given how great expectations (and baked in the hikes) are.
  - FX: *Watch for fresh JPY pressures*, subsequently to be *met with heightened intervention risks*.
  - JGBs: And for *JGB yields to remain upwardly pressured*, led by the long end.

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