MONETARY POLICY

QE & THE BANK OF JAPAN

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Founded in 2010, we now have global presence in over 90 countries, with main offices in the separately regulated markets of Australia, Cyprus, New Zealand and the United Kingdom.

We believe that sound investment and trading decisions begin with a strong grounding in financial education. Our goal is to make this available to everyone - and this free eBook is part of that commitment.

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EXPLORING THE BANK OF JAPAN

FOREWORD

As a Forex trader, you should be acutely aware of the actions from the world's major central banks.

In particular, you should be tuned into the monetary policy each of the central banks. This is because monetary policy can have a direct impact on the price of a currency.

In this eBook, we'll explore the monetary policy of the Bank of Japan. It's one of the major central banks actioning a quantitative easing programme.

Patrick Latchford
CEO, Blackwell Global Investments (UK) Limited

WHAT ARE CENTRAL BANKS?

KICKSTARTING ECONOMIC GROWTH

The Bank of Japan, along with the European Central Bank, is one of the major central banks that is currently pursuing something called a quantitative easing programme.

This is a monetary policy tool that is designed to kickstart sluggish economies. We'll explore how quantitative easing works later in this eBook. But first, it's important that you understand the role of central banks.

WHAT ARE CENTRAL BANKS?

Every major economy or economic region has its own central bank. The major central banks include the: Federal Reserve (US), European Central Bank (EU), Bank of England (UK), Bank of Canada (Canada), Bank of Japan (Japan), Reserve Bank of Australia (Australia), Reserve Bank of New Zealand and Swiss National Bank (Switzerland).

These institutions are independent of government and are responsible for something called monetary policy. Put simply, monetary policy is a means of controlling the money flow within an economy. How capital moves can have big implications for the overall health of an economy. By increasing or decreasing the flow of money within an economy, a central bank can address economic priorities.

These economic priorities - especially since the global financial crisis of 2008 - usually fall into two categories.

LOW ECONOMIC GROWTH

The first is low economic growth - which is often represented by weak GDP data and high unemployment. To solve low economic growth, central banks usually want to increase the flow of capital within an economy. Why? It's pretty simple - more capital within an economy makes it easier for businesses to borrow money, which in turn fuels job creation. More access to capital also encourages consumer spending.

So what monetary policy tools do central banks use to control the flow of capital? There are two in particular that traders need to be aware of. The first tool is low-interest rates. Interest rates can simply be described as the cost of borrowing money. A lower borrowing cost encourages more lending. The second tool is known as quantitative easing. This is where a central bank injects capital into the financial system of its economy, subsequently increasing the flow of capital. We'll explore quantitative easing in more detail in later sections.

INFLATION

The second economic priority is controlling something known as inflation. Inflation is simply the annual rate at which the prices of goods and services increase. Most central banks try to maintain inflation at a rate of approximately 2%. The markets can track the latest inflation figures of an economy on a monthly basis when inflation data is released.

Inflation is typically controlled by central banks by adjusting interest rates. Higher interest rates act to restrict the flow of capital, helping to slow the rate of inflation. Lower interest rates act to increase the flow of capital, helping to increase the rate of inflation.

WHY DOES THIS MATTER?

Hopefully, you've noticed that the monetary policy of a central bank can have a direct impact on the supply and demand of a currency. Therefore, monetary policy directly affects currency price. Clearly, once you understand the monetary policy objectives of major central banks, you can identify long-term trading opportunities.

THE BANK OF JAPAN

THE GLOBAL FINANCIAL CRISIS (2008)

In 2008, the entire global economy was in the midst of a financial crisis. The cause of this crisis was the collapse of the sub-prime US mortgage market, which resulted in major US banks failing. The knock-on effect of this collapse was monumental. Financial institutions across the world also started to fail.

In order to recover from this financial crisis, many central banks embarked upon periods of historically low-interest rates and quantitative easing programmes.

One of those central banks is the Bank of Japan.

In 2011, the central bank decided to embark on an aggressive quantitative easing programme. Specifically, the bank would purchase ¥50 trillion in private financial assets for that year. Remember, by buying private financial assets - such as commercial bank bonds - the Bank of Japan is essentially injecting capital into the Japanese economy.

The goals of the Bank of Japan's quantitative easing programme were clear from the outset. Firstly, the Bank of Japan wanted to use quantitative easing to devalue the yen against the US dollar. Why? The central bank wanted to make Japanese exports cheaper. Secondly, the central bank wanted to move Japan from deflation to inflation (the bank has a target of 2%).

Fast-forward to 2017 and the Bank of Japan is still pursuing its quantitative easing programme. In fact, the bank has increased its asset purchase programme on multiple occasions between 2011 to 2017.

What's more, we know that the Bank of Japan will continue with this policy for the foreseeable future. The central bank has stated it intends to stick with quantitative easing until it consistently overshoots its 2% inflation target. Currently, its inflation rate is only 0.4%.

HOW TO TRADE THE JAPANESE YEN

The Japanese yen is an interesting currency to trade at the moment.

With the Bank of Japan committing to its quantitative easing programme, we know that the yen is unlikely to strengthen from domestic monetary policy. However, because the market is aware of the Bank of Japan's intentions, the currency is relatively stable.

This makes the Japanese yen a good candidate to pair with more volatile currencies. At the time of writing (August 2017), this includes the US dollar and British pound.

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WHY BLACKWELL GLOBAL?

We can't pretend that is easy to become a successful trader. But we are here to help and support you as you make your trading journey, providing dedicated resources such as our demo trading accounts and regularly published research materials.

Founded in 2010, Blackwell Global was established to offer brokerage solutions for private and institutional clients. Blackwell Global is a Straight Through Processing or STP broker who provide their clients with superior liquidity and price feeds from top international banks. These are offered alongside 24-hour technical support, market research tools, educational materials, professional partnership programmes and fully integrated trading platforms.

We offer access to multiple asset classes including more than 60 currency pairs, precious metals and other contracts for differences. As a global broker, we are always striving to achieve excellence in our customer service, as well as developing innovative technology to support our customers needs.

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