

Case Study – Japanese Monetary Policy Decision

Summary

Word	“The Japanese Government is going to make a fiscal or monetary policy decision that will be bad for the economy / market” - Nighttime word I received from the Holy Spirit Jan 2, 2007
Sense	BOJ will make decision at some point to change rates in conjunction with monetary policy shift (last raise was July, 2006 from 0% to 0.25%). This will cause the Nikkei (at 6 year highs) and possibly other equity markets to fall
Plan	Wait for BOJ action, then short the Nikkei; think through effects on Yen; also knock on effects on global financial markets
Trigger	BOJ Raised Rate to 0.5% February 21, 2007 to address “carry trade” concerns in Yen despite fragility of the economy
Trade	Short Nikkei 225 (Feb 22, 2007)*
Result	February 27, 2007 - Shanghai Composite drops 8.8%; global markets plunge March 5, 2007 - Nikkei 225 fell 8.6% over 5 trading sessions

* Proposed and documented via email on 2/22/07, not executed



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Select Quotes – Before

Financial Times 2/21/07 - Yen weakens further after BoJ rates move

“ ... In an unprecedented split of the BoJ board's senior members, Kazumasa Iwata, one of two deputy governors, voted against the rise. Mr. Iwata has argued that weak consumption and wages and a headline inflation rate of just 0.1 per cent did not justify a rate increase ...

The bank was also influenced by a strong stock market performance and continued yen weakness, according to people close to the board. Reflecting concerns that continued **easy monetary policy** could encourage **speculation**, including in the **so-called carry trade**, the bank said: 'If expectation takes hold . . . that interest rates will remain low for a long time regardless of economic activity and prices, there is a possibility that sustained **economic growth will be hampered by misallocation of funds.**' ... “

Wall Street Journal 2/22/07 - Japan Raises Rate to 0.5% Amid Outside Influence

“ ... Nonetheless, the governor said the central bank wanted to quash expectations that Japanese rates would stay very low for very long, which might cause investors to take "extreme positions." He told a news conference: "As world financial markets become integrated, the time has come for us central bankers to conduct monetary policy while keeping firmly in mind its external consequences." He said the **Bank of Japan had in mind the so-called carry trade**, in which investors borrow money at Japan's low rates and invest it elsewhere where returns are higher. Mr. Fukui said that **if such borrowing were unwound suddenly, it could present a risk to the global economy** ...

Mr. Fukui said recent policy analysis had been "a process filled with pain," as he was **caught between the needs of the domestic economy and those of global markets**. The bank's policy board voted for the decision by eight votes to one. But the debate split the three internal members of the policy board -- the governor and his two deputies -- for the first time since the current policy-making system was established in 1998 “

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Select Quotes - After

Wall Street Journal 2/27/07 5:50pm - **Stocks Take a Plunge On Chinese Sell Off**

A bout of profit-taking in the Chinese stock market Tuesday sent shockwaves through major exchanges in Mexico, Canada and Brazil, causing some of the biggest single-day plunges in years.

Wall Street Journal 3/5/07 5:32am - **Japanese Shares Fall Back**

In mainland China, the Shanghai Composite Index fell 1.6% at 2783.31. After rising 13.6% since Jan. 1, **China's stock market indexes plunged 8.8%** Tuesday last week, their sharpest drop in a decade.

As Regional Indexes Extend Losses **Japan's Nikkei 225 Index** fell 3.34% to 16642.25, extending a slide for a fifth day that was sparked by last week's plunge in Chinese and U.S. stock markets. Exporters were hit hardest on the yen's recent rally. Since climbing to its highest in nearly seven years last Monday, the index **has slid 1573.10 points, or 8.64%, over the last five trading sessions.**

Wall Street Journal 3/5/07 - **Japan's Consumer Prices Are Flat**

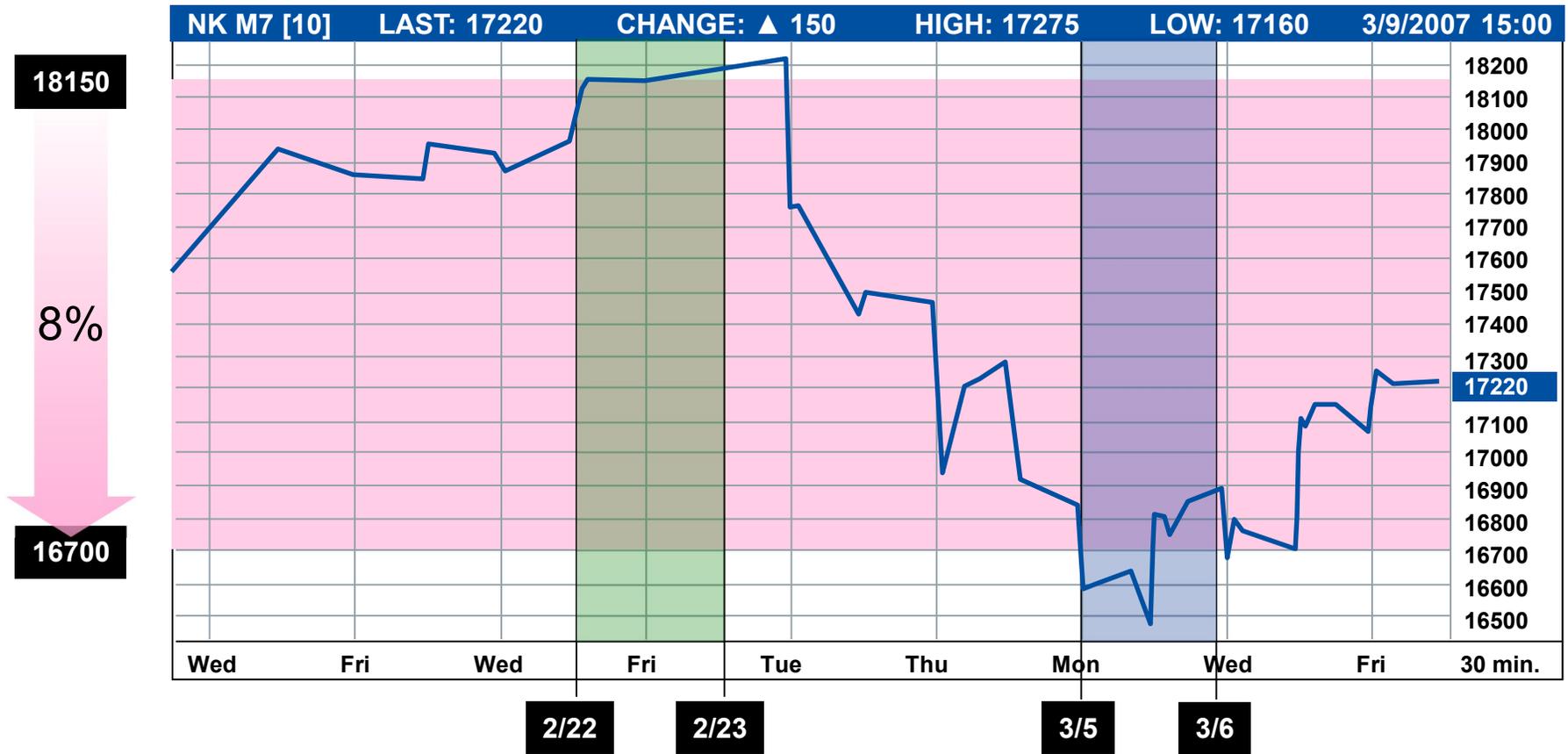
... Japanese consumer-product prices posted their first flat reading in eight months in January, strengthening expectations that the central bank will put off raising interest rates until after parliamentary elections in the summer.

After last month's rate rise, which some government officials called premature, analysts say that fading inflation and the slightly murky economic outlook at home and abroad suggest the Bank of Japan is more likely to stay put for a while than risk facing political heat by rushing rate increases before July's upper-house elections.

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Nikkei 225 June CME '07 Futures Short Performance – 8% return in 12 days

Window to get in 2/22 – 2/23
Average Price 18150



Window to get out 3/5 – 3/6
Average Price 16700

