

“Mike Tyson: Master Game Theorist”

Everyone has a plan until they get hit in the mouth.

— *Mike Tyson*

My long-term strategy turned into a 12-hour strategy.

— *“Survivor” contestant Dale, voted out in last week’s tribal council*

Reality doesn’t interest me.

— *Leni Riefenstahl, acclaimed German film director and Nazi stooge.*

Ben, there is no such thing as a good redouble.

— *Grace Hunt, my grandmother, in a memorable bridge lesson*

I’ve been wrestling with what to write about the Bank of Japan’s decision last Friday where ... to use a ZeroHedge turn of a poker phrase ... they went “all-in-er” on balance sheet expansion and monetary policy QE. It’s hard to find a middle ground here. On the one hand I could write a copycat oh-my-god-can-you-believe-what-these-madmen-are-doing note, but frankly I’m tired of being outraged, and I suspect most Epsilon Theory readers are, too. On the other hand, I really AM outraged by the increasing number of articles and emails I read where BOJ actions and Fed actions and ECB actions are celebrated in Leni Reifenstahl-esque fashion as some modern day *Triumph of The Will*, as if the

symbolic projection of an unlimited, indomitable, and grandiose State were the highest possible achievement for political leaders. Yes, I just played the fascist card. I don't think I'm wrong.

It was only after reading a quote from Nouriel Roubini – “They had no choice.” – that I had my hook on how to write this note. Because I think Nouriel is right, not in his evaluation of the objective parameters of the decision itself (I think he's dead wrong on that score), but in how a slim majority of the BOJ *perceived* the decision at hand. I think the majority believed that they were *forced* to take this action, and I think that this perspective – when combined with some basic ideas from game theory – can shine some light on what might happen next.

In game theory, to say that “you have no choice” can mean one of three things.

First, it can mean that you have what's called a “dominant strategy”, where regardless of what actions or decisions are made by other players in the game you are always better off to take a singular course of action. Kareem Abdul-Jabbar's sky-hook was a dominant strategy in the game of basketball. No matter what his opponents did, no matter how tall they were, no matter how quick they were ... Kareem could always get this shot off. He might miss the shot, but that was totally on him; a miss had nothing to do with his opponents. Dominant strategies are, as the name suggests, typically the purview of dominant players, which certainly doesn't describe Japan in the Great Game of international politics, so I don't think that's a big part of what's going on here.



Second, it can mean that you've discounted what's called “the shadow of the future” to the point that if immediate exigencies point you in a singular direction ... well, that's the only direction you can imagine. I see this a lot in reality shows like “Survivor”, where contestants must “scramble” (to use the lingo) in a desperate effort just to last one more day in the game. As last week's eliminated contestant Dale said, “my long-term strategy turned into a 12-hour strategy”. That's what happens when the future is discounted severely, and I think that's a significant piece of the BOJ decision last Friday. Even if you believe that current Japanese monetary policy creates a mighty thin tightrope over a mighty deep chasm filled with mighty hungry alligators *a few years out*, that means essentially nothing if you *also* believe that the *immediate* future is a political disaster without doing *something* in a big way. And if



you're a central banker that big something can only be more QE. It's indicative of the degree to which monetary policy has been politicized – particularly in Japan – as central bankers now suffer from the same extreme myopia that elected politicians have always demonstrated.

Third, and I think predominantly in this case, it can mean that you're not even playing a game, but that you are acting in a strategic vacuum where you are only considering your own preferences. We've all fallen prey to this fallacy ... we plan and scheme and strategize to the n^{th} degree, based on our own calculus of our own pluses and minuses associated with our own actions ... and it all goes swimmingly until, as Mike Tyson so brilliantly put it, we get smacked in the mouth. We get popped really hard, and as we're falling to the canvas we think "Oh yeah, I guess the other guy had a plan, too. Maybe I should have taken that into consideration." Or as my grandmother put it when I got totally wiped out by her bridge cronies playing for a penny a point because I was solely focused on the strength of my own hand, "Ben, there is no such thing as a good redouble." Best advice I ever got.

For five and a half years the BOJ has had a clear field to take whatever actions they wished without fear of some other, stronger central bank smacking them in the mouth. There has been a coordination of central bank purpose and effort that hasn't been seen since ... the 1985 Plaza Accords? Bretton Woods? Whatever your reference point might be from an economic history perspective, it's been a very long time since we've seen such a very long period of such a non-strategic, we're-all-in-this-together decision making backdrop for second tier central banks like the BOJ or the BOE. So it really doesn't surprise me at all that the BOJ did what it did last Friday. Like you and me and market participants everywhere, the BOJ Governors have been very well trained to expect that the Fed has got their back, that they can act according to their own narrow and immediate self-interests without concern or fear that their actions will result in someone smacking them in the mouth.

Unfortunately for the BOJ, I think that [this happy state of coordinated policy bliss ended about six months ago](#). I think that they have redoubled this particular contract as if they were playing bridge with doting grandparents rather than chain-smoking, penny-pinching old crones. I think that there is a clear and growing divergence between the US and the rest of the world when it comes to balance sheet expansion and monetary policy intentions, and I think that [for China in particular](#) this latest BOJ action is perceived as an aggressive provocation that must be responded to forcefully.

So what's next? I'm waiting for China's response. I have no idea whether the response will be (to use the political science terminology) symmetric or asymmetric in scale and delivery. That is, the response

could be larger or smaller than the perceived provocation, and it may or may not be a response delivered through monetary policy. I have no idea exactly when the response will occur. But I have zero doubt that a forceful response is coming. I have zero doubt that Japan is about to get smacked in the mouth. And when that happens the monetary policy calculus in Japan ... and the UK ... and even the EU will take on a very different shape. The domestic political dictates may still overwhelm the international economic consequences of extraordinary monetary policy easing. In other words, Japan's politicians (which surely includes the BOJ Governors) may still have a scrambling *Survivor* contestant's view of the shadow of the future, where they're just looking to live another day regardless of the long-term consequences. But they will no longer be making these decisions within a strategic vacuum. And that's a very different – and more difficult – game to play.

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