Economic Research View

Japan: Vice-Minister of Finance Kanda Comments on Yen Depreciation

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On September 6th the yen weakened to the upper 147-yen range against the U.S. dollar, and Vice Minister of Finance and International Affairs Masato Kanda made comments that he would not rule out any options in response to the rapid move. Compared with last year's currency intervention, the balance between the merits and demerits of a weak yen has changed significantly. Last year, the yen's weakness blocked the benefits of expanding exports and inbound spending, but the current situation is expected to boost inbound spending. Though the increased burden on households and companies would be a disadvantage, import prices have decreased compared with the previous year, in contrast with last year where they rose significantly alongside commodity prices. If households associate the depreciation of the yen with the high prices caused by the prolonged cost push and criticism against the government rises, the government may have no choice but to respond. There may be certain pressure on the Bank of Japan (BOJ) to raise short-term interest rates, but this is far from consistent with “easing household concerns”. For the time being, the most likely option would be for both the Ministry of Finance and the Bank of Japan to take a precautionary stance to prevent the yen from depreciating while buying time for the U.S. economic and financial market environment to change its course.

In an interview with the Yomiuri Shimbun on September 9, BOJ Governor Kazuo Ueda revised the course of action on the condition of lifting negative interest rates based on remarks by Deputy Governor Shinichi Uchida, who set a high bar. Concern over the acceleration of the yen’s depreciation is also believed to be behind the governor's remarks. Ueda also said there was a "not zero" chance of seeing a virtuous cycle between wages and prices by the end of the year, and that policy changes could be made as early as January 2024. However, in addition to wage and price developments, overseas economic and political conditions will also influence actual policy decisions. I anticipate the elimination of the YCC in October 2023, but at the same time, I believe the possibility of a decision to eliminate negative interest rates (i.e., zero interest rates plus forward guidance to commit to a low interest rate policy for the time being) has increased slightly. The yen has appreciated by 1.2 yen to the lower 146-yen range as of the afternoon of September 11.

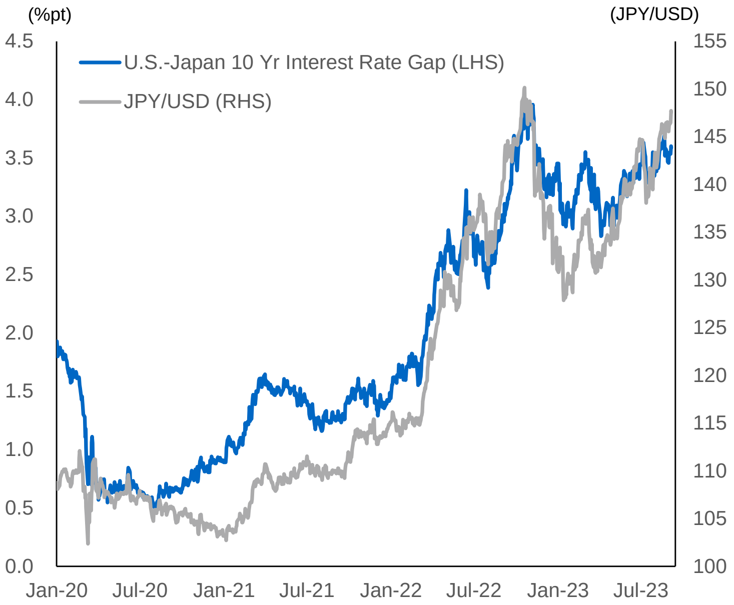
Vice Minister of Finance and International Affairs Kanda comments on Yen depreciation

- On September 5, against the backdrop of the widening interest rate gap between Japan and the United States, the yen depreciated against the U.S. dollar to the upper 147-yen range, reaching as high as 147.87 yen on September 7. The yen has weakened more than it did in September last year when currency intervention occurred. Finance Vice Minister Kanda commented on the same day that "if such a move continues, the government will not rule out any options and respond appropriately" and that "speculative behavior or movements that cannot be explained by fundamentals are being watched with a high degree of attention." Towards the end of May, Kanda mentioned that "we are not focusing on a specific market level per se, but focusing on the fluctuation range which we think is critical." If we examine the fluctuation range, though the last week appears similar to conditions during last year's currency intervention, the six-month range is not as severe as last year.
- The purpose of intervention is not to change the trend of the exchange rate but to check speculative movements and to adjust speed. While the short position in the Chicago IMM currency futures is as high as it was when intervention occurred last year, the yen's forex pain index, which Citigroup calculates as an estimate of foreign exchange market participants' holdings, moved into positive territory, suggesting a buy and hold position for the last few days. The IMM position is disclosed on a weekly basis, and it might be the case that the yen is not expected to weaken further in the immediate future.
- There is a possibility that the government will not intervene even as the rate approaches 150 yen due to a change in the balance between the merits and demerits of the yen's depreciation compared to last year's intervention. Last year, supply constraints and border measures made it almost impossible to enjoy the benefits of a weak yen, such as increased inbound flows and exports of goods. This time, however, there will be positive effects from a weaker yen, especially in the inbound market. On the downside, the yen-based import price index rose sharply last year due to a combination of rising international commodity prices and an acceleration in the yen's depreciation. This time, however, although the exchange rate effect has contributed to the increase in import prices, it has been negative on a contract currency basis. Import prices have remained high, but have not continued to rise. Therefore, compared with last year, the advantages have increased and the disadvantages have decreased.
- On the other hand, the shifting of costs to consumers has been prolonged. Even if the impact of the depreciation of the yen is small, it is difficult to deny the possibility that the government may be affected by the combination of the recent rise in commodity prices and the depreciation of the yen. The government might decide again to intervene to avoid criticism that it has put pressure on people's lives by neglecting the depreciation of the yen.
- If the yen weakens further, the government may expect that the Bank of Japan (BOJ) will keep the yen in check. However, assuming that the aim is to minimize the negative impact on households, the BOJ's options are limited to allowing long-term interest rates to rise. If the Bank of Japan indicates the possibility of eliminating negative interest rates and raising interest rates further, the yen is likely to strengthen during the final phase of U.S. and European rate hikes. However, since the majority of Japanese mortgages have floating interest rates linked to short-term interest rates, there is a risk that an increase in short-term interest rates could lead to a worse-than-expected decline in sentiment. Therefore, the immediate choice would be for the Ministry of Finance and the BOJ to gain time by

keeping the yen in check and comment should there be any rapid fluctuations. Their expectation would be for U.S. factors to halt the yen's depreciation, i.e., for the U.S. economic data to deteriorate and raise expectations for a halt of interest rate hikes and a shift to interest rate cuts.

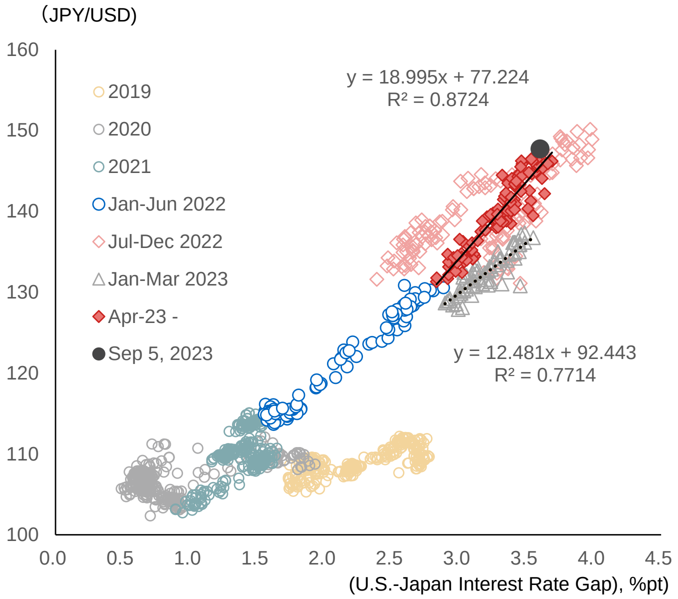
- It should be noted that there are opinions that the yen deprecation is affected by structural factors. The trade deficit is entrenched in terms of financial flows. If the trade balance deteriorates due to a rise in commodities prices, the yen will weaken against this backdrop, and the trade deficit will widen. On the other hand, a large surplus in the primary income balance has also taken hold, and the current account balance has returned to surplus, although it was temporarily in the red. However, much of it is not expected to flow back into Japan or to be converted to Japanese yen, making it difficult for the current account surplus to lead to yen appreciation from a supply and demand perspective. In fact, the yen has become more linked to the trade balance than the current account balance in recent years. In recent months, however, the yen has become less responsive to the reduction of the trade deficit, and the U.S.-Japan monetary policy gap and interest rate differential appear to be taking more effect. Therefore, even if structural factors could be influencing the yen's weakness, in the next 1-2 years, the yen is expected to appreciate mainly due to the U.S.'s shift from a rate hike phase.

Figure 1. U.S.-Japan interest rate gap and yen trends



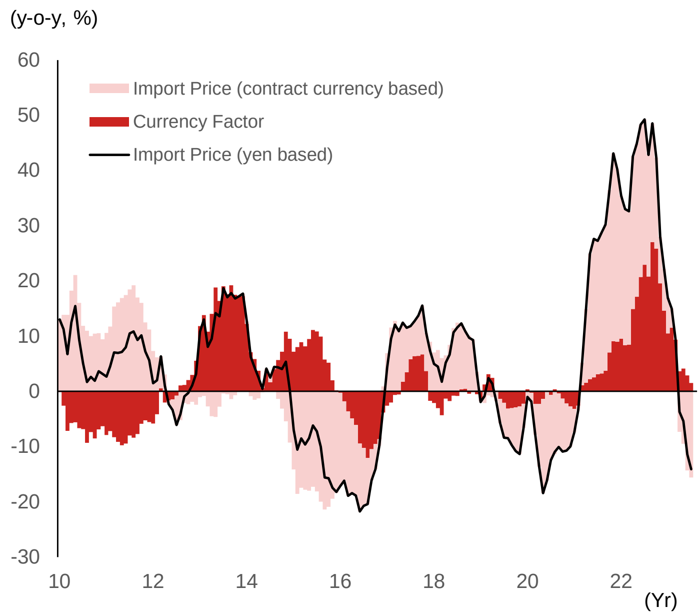
Source: Nomura Asset Management based on Bloomberg data.

Figure 2. Correlation between the U.S.-Japan interest rate gap and yen trends



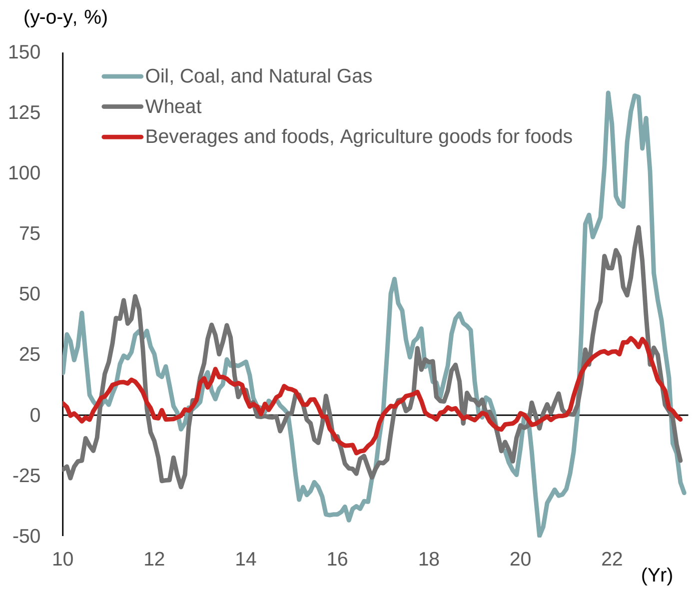
Note: *Japanese Branch of foreign banks, HQ and branch account and asset data.

Figure 5. Import price index



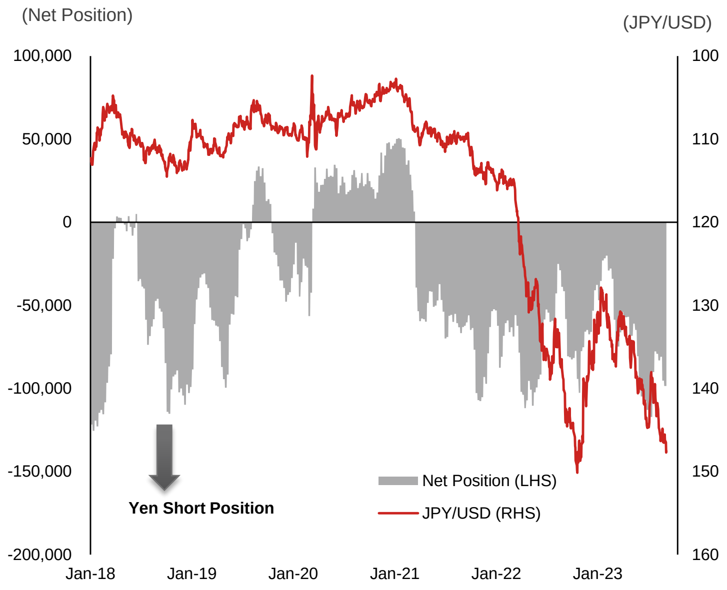
Source: Nomura Asset Management based on Bank of Japan data

Figure 6. Food and energy import prices (yen based)



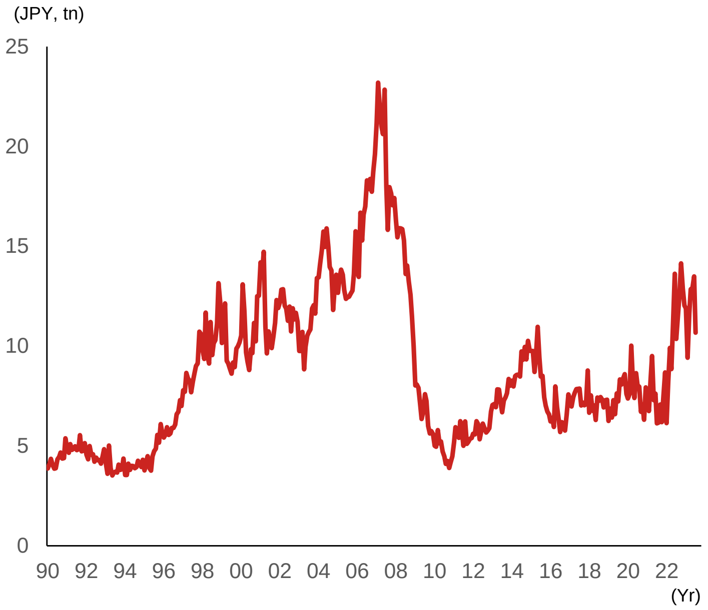
Source: Nomura Asset Management based on Bloomberg data.

Figure 3. Speculator's yen selling position



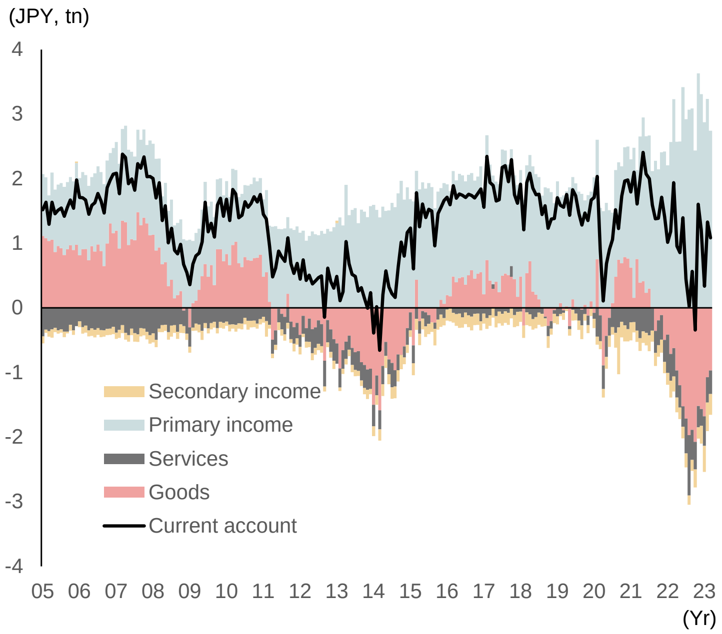
Source: Nomura Asset Management based on Bloomberg data.

Figure 4. Broad yen-selling positions by overseas investors



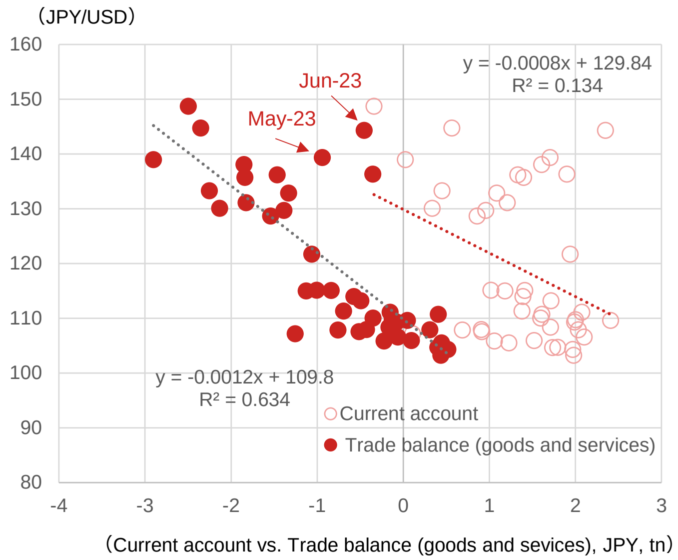
Note: *Japanese Branch of foreign banks, HQ and branch account and asset data.
Source: Nomura Asset Management based on Bank of Japan data.

Figure 7. Current account



Source: Nomura Asset Management based on Ministry of Finance

Figure 8. Current account, trade balance, and currency



Note: Data since 2000
Source: Nomura Asset Management based on Ministry of Finance and Bloomberg data.

*This commentary is based on personal views of the author and does not necessarily represent Nomura Asset Management house view.

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