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CIO View:

Yen Surges on Suspected Intervention - USD/JPY and JGB Markets in Focus

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On April 30, the yen strengthened sharply against the US dollar in the evening and overnight in Japan, briefly moving from the high JPY 160s to the mid-JPY 155 level. The move is believed to have been driven by intervention from the government and the Bank of Japan (BoJ) in the foreign exchange market. Prior to the move, Finance Minister Satsuki Katayama had referred to “decisive action.”

The background to the suspected intervention by the government and the BoJ appears to be the yen’s depreciation to levels clearly above JPY 160 per dollar, a level that had previously been briefly breached before the yen reversed course, and concerns that a weaker yen would have negative effects on the Japanese economy.

The yen had been trending weaker as market participants grew concerned that the BoJ would find it harder to raise interest rates amid uncertainty over the Japanese economy stemming from instability in the Middle East. In addition, at the FOMC meeting on April 29, there was a dissenting vote against maintaining the language on the policy rate’s easing bias, raising the possibility of a shift in views on the previous policy-rate trajectory for Japan and the US—namely, continued rate hikes in Japan and continued rate cuts in the US.

The Japanese government bond market has also come under pressure. In addition to concerns over fiscal policy, there have been worries that the BoJ may have difficulty raising rates even as oil prices and other commodities surge, making it harder to contain inflation. As a result, yields on long- and super-long-term bonds rose sharply this week. On April 30, the 10-year yield exceeded 2.5%, while the 30-year yield rose above 3.7%.

Looking ahead, we expect the USD/JPY pair to remain highly volatile for the time being amid continued caution over the risk of intervention. We believe the BoJ is likely to resume rate hikes as rising oil prices, driven by ongoing turmoil in the Middle East, increase inflationary pressure in Japan. In the US, slower consumer spending due to surging gasoline prices may also encourage the Federal Reserve to ease monetary policy. As a result, the narrowing of the US-Japan interest rate differential is expected to help cap further yen weakness.

The Japanese government bond market is also likely to remain unstable for the time being, particularly in long- and super-long-term maturities, as investors continue to watch oil prices and inflation trends. However, since issuance of super-long-term Japanese government bonds has been further reduced starting in April this year, and strong demand from overseas investors for super-long-term bonds is expected to continue, we believe bond market volatility will gradually subside.

The commentary is based on personal views and does not necessarily reflect the house view.