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Daiwa's View

Government and BOJ fire live ammunition

- Debate over the ammo that remains will begin at end-September, when the amount of intervention during the month becomes known

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The government and BOJ intervened in currency markets on 22 September by buying yen and selling dollars for the first time in 24 years, going back to June 1998. While the Fed announced a 75bp rate hike for a third consecutive FOMC meeting on 20-21 September, the BOJ decided to maintain monetary easing at its policy meeting on 21-22 September. After the BOJ announced results of its deliberations before noon, the USD/JPY momentarily climbed above 145, then quickly retreated back below 145.

After 13:30, with the USD/JPY steadily rising back toward 145, Deputy Finance Minister Masato Kanda said regarding the possibility of currency market intervention that the MOF is "on standby, and prepared to act at any time." Despite this, the USD/JPY broke decisively above 145 prior to BOJ Governor Kuroda holding his usual post-meeting press conference at 15:30. It then started flirting with the 146 level, but right after 17:00 plunged by nearly Y2. At around 17:15 Mr. Kanda announced that the government "took decisive action," making it clear that the government had intervened in foreign exchange markets.

Minister of Finance Shunichi Suzuki held a press conference at 18:30, where he explained the government's intervention, saying "although exchange rates are in principle determined by the market, excessive fluctuations caused by speculation cannot be tolerated." He added that the government would "continue to monitor developments in the market with a strong sense of urgency and take necessary action against excessive fluctuations."

Although the Japanese government did not clarify whether its intervention was a solo one, on 22 September the US Treasury Department issued a statement saying that the US did not participate, thus making it clear that the intervention was not a coordinated one. But it also acknowledged that the recent intervention in currency markets by Japan's monetary authorities is aimed at suppressing the yen's recent high volatility and that the US government understands Japan's actions, and therefore seems to tolerate intervention for purposes of suppressing exchange rate volatility.

The actual amount of intervention was not disclosed, but according to one source it was in the trillions of yen. Because the MOF announces the total amount of currency market intervention every month and releases details on that intervention (the dates, amounts, and currency sold) on a quarterly basis, it should be possible to confirm the amount of intervention from 22 September until the end of the month on 30 September, when the MOF releases its report at 19:00. The MOF plans to release the daily amounts sometime between the 1st and the 8th of November, so the market will have to wait until then for details.

There were three major periods of yen-buying intervention in the 1990s, and Chart 1 shows the change in the USD/JPY following the initial intervention of each of those periods. The data show that the near-term strengthening of the yen was at most Y5 and that the yen weakened back to its level prior to the intervention within about 20 trading days at the longest. During this latest intervention, the rate dropped from a momentary high in the upper 145 range down to a momentary low in the upper 140 range, which is a pretty substantial impact, but at the financial market close the yen went from the lower 142 level back to the lower 143 level the following day.

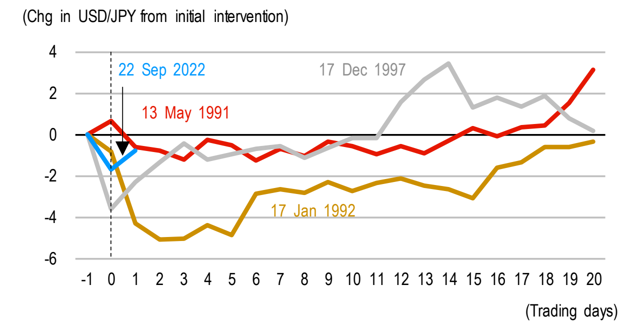
As made clear by Japan's monetary authorities, the latest intervention is a "smoothing" one aimed at suppressing forex volatility and is not targeting a particular level. Because the BOJ conducted a rate check when the USD/JPY was close to 145 and started intervening once it rose decisively above 145, it is likely that Japan's monetary authorities still consider 145 as their line in the sand.

Although the impacts from this intervention may be short-lived, with the market more aware of at around 145, the pace of yen depreciation is likely to be slowed over the near term. Given its strong correlation with the Japan/US 2yr yield spread, however, we think the USD/JPY is poised to head toward 150 (Chart 2). Since the higher-than-expected US CPI for August was announced on 13 September, the Fed terminal rate as priced in by the market has risen nearly 70bp and the 2yr Treasury yields has risen from 3.57% to 4.20%. Even though intervention may be suppressing the rate of increase in the USD/JPY, the yen is still likely to weaken as long as US interest rates do not decline.

It is no easy task changing the trajectory of the USD/JPY using currency market intervention, and ultimately such a change will probably have to wait until the Fed changes its monetary policy stance. The predominant view on the earliest point at which the Fed could stop hiking rates is either December 2022 or February 2023, and that decision will depend on the inflation data. The best scenario for the government and BOJ is that a slowing of US inflation and retreat of the Fed's hawkish stance will be confirmed while it is still buying time with forex intervention, and the yen then starts to strengthen.

As already noted, the actual amount of forex intervention will be published at end-September. It is well understood that dollar-selling/yen-buying intervention is constrained by the level of foreign exchange reserves, and thus the process of figuring out how long Japan can keep up the intervention can begin at that point. If Japan is not targeting a specific level, it will not be that difficult of a task in the interim, but either way the battle between the Japanese government and BOJ on one side and the market on the other is about to get serious.

Chart 1: USD/JPY Rate After Yen-buying Intervention in 1990s



Source: Bloomberg; compiled by Daiwa Securities.

Chart 2: Correlation Between USD/JPY Rate and Japan/US Yield Spread

USD/JPY		2-year US yield				
		2.5	3.0	3.5	4.0	4.5
2-year JGB yield	-0.4	132	138	145	151	158
	-0.2	129	136	142	149	155
	0.0	127	133	140	146	153
	0.2	124	130	137	143	150
	0.4	121	128	134	141	147

Source: Bloomberg; compiled by Daiwa Securities.
Note: Calculated based on correlation between USD/JPY rate and Japan/US yield spread since Mar 2022.

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