

Does Japan really want a stronger JPY?

The risk of intervention from Japan may be rising as Japan's Finance Minister Fujii says that Japan will take action in FX markets if JPY moves are excessive and one-sided. Fujii went on to say that global competition to devalue currencies would be wrong and FX level should reflect underlying fundamentals.

JPY is trading at an eight month high versus the USD supported by safe haven demand, repatriation flows into Japan's fiscal half-year end and speculation that the new Japanese government opposes intervention in FX markets. The new Japanese government has pledged to boost Japan's domestic economy and move away from reliance on export growth. The previous Japanese government had relied on a weak JPY policy to support exporters. The recent JPY rally has sparked debate as to whether Japan will intervene to counter JPY strength. The current rise in the JPY contributes to weakening of the Nikkei and has weighed on Japanese exporter share prices. Strong JPY contributes to the erosion of exporter earnings in Japan. Last week the Nikkei stock index lost 5.2% and is trading at its lowest level since July. The Nikkei decline continued in Monday's trade. Japan's quarterly Tankan business sentiment survey showed that business sentiment is improving but Japanese companies plan to cut spending by 10.8% in the fiscal year ending March 2010. The cut in spending by Japan's corporations and strong JPY puts the Japanese recovery at risk.

The new Japanese governments focus on boosting domestic demand and shifting away from dependence on export growth may mean that Japan will have greater tolerance for JPY strength. Recently Fujii said the strong JPY is a positive for Japan in the long run. Stronger JPY makes imports cheaper which would help to boost domestic growth. We suspect that the pace of JPY rise will be more important than the level determining whether Japan elects to intervene in FX markets. USD/JPY traded at a 13 year low in January at 8800 and Japan did not intervene. The threat of verbal intervention will increase if JPY rally remains one-sided. USD/JPY decline below 8500 would increase the risk of physical intervention. Because the new Japanese government seeks to shift away from export lead growth any intervention would likely be confined to smoothing operations as opposed to outright efforts to weaken the value of the JPY. In addition, FX intervention needs to be coordinated with other nations to have lasting impact. There is no G-7 consensus for coordinated intervention to support the USD or weaken the JPY. The G-7 communiqué expressed concern about excessive FX volatility but stopped short of calling for support of the USD. Intervention inspired breaks in JPY will likely be seen as opportunities to buy the currency at a better level.



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