Daiwa Securities

# Daiwa's View

## Dim prospects for both yen-supporting intervention and BOJ policy change

- Monetary authorities are not yet serious about forex intervention
- We also see a low probability of the BOJ tightening monetary policy to deal with "bad" yen depreciation
- Neither forex intervention nor a BOJ policy change would be likely to change the yen's weakening trajectory anyway

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### Dim prospects for both yen-supporting intervention and BOJ policy change

**Monetary authorities still lack seriousness about forex intervention, and the probability of the BOJ starting to tighten policy to combat "bad" yen depreciation is also low**

Since the USD/JPY temporarily climbed above 125 on 28 March, Japan's monetary authorities (the MOF and BOJ) have started talking more about exchange rates (Chart 1). As the frequency of their comments aimed at checking the yen's decline increase, some market participants have begun discussing the possibility of yen-buying FX intervention and changes to accommodative monetary policy. In this report, we summarize current conditions and consider the likelihood of FX intervention and a change in the BOJ's accommodative policies.

The Japanese government and BOJ have made numerous comments about the forex market over the past two weeks. The first of these came from Vice Finance Minister Masato Kanda on 29 March, when he said, "stable exchange rates are important and rapid changes are undesirable." Then on 30 March, BOJ Governor Haruhiko Kuroda commented after a meeting with Prime Minister Fumio Kishida that he had told the prime minister that "it is desirable that exchange rates reflect economic conditions and are stable."

The yen has steadily weakened since then, and monetary authorities have been commenting to check the yen's decline on almost a daily basis. On 13 April, when the USD/JPY broke through 125.86, its highest under Abenomics, and rose above 126, the highest it has been in 20 years, Finance Minister Shunichi Suzuki said, "abrupt changes in exchange rates are a big problem."

**Chart 1: Monetary Authorities' Remarks on Forex Market**

| Date | Speaker | Comments |
|---|---|---|
| 29-Mar | Vice Finance Minister Kanda | · Exchange-rate stability is important and rapid changes are undesirable<br>· There is absolutely no disagreement between the central bank and government<br>· Exchange rates are determined by the market<br>· We will respond appropriately while maintaining close communications with monetary authorities in the US and elsewhere |
| 30-Mar | BOJ Governor Kuroda | · I told (the prime minister) that it is desirable that exchange rates reflect economic conditions and are stable |
| 31-Mar | Prime Minister Kishida | · I have no comment on currency market intervention<br>· I think stable exchange rates are important and rapid changes are undesirable<br>· We will respond appropriately with our currency policy while continuing to maintain close communications with monetary authorities in the US and elsewhere |
| 1-Apr | Finance Minister Suzuki | · Stable exchange rates are important and rapid changes are particularly undesirable<br>· (Forex market moves) are decided by the market based on various factors |
| 5-Apr | BOJ Governor Kuroda | · I think (recent changes in exchange rates) may have been a bit too abrupt |
| 12-Apr | Finance Minister Suzuki | · Stable exchange rates are important and rapid changes are undesirable<br>· We will respond appropriately while maintaining close communications with monetary authorities in the US and elsewhere |
| 12-Apr | Prime Minister Kishida | · Stable exchange rates are important and rapid changes are particularly undesirable<br>· We still want (the BOJ) to conduct monetary policy appropriately toward achieving the 2% inflation target |
| 13-Apr | Finance Minister Suzuki | · Abrupt changes in exchange rates are a big problem<br>· I have no comment on exchange rate levels; I cannot afford to exert impacts with careless statements |

*Source: Various media reports; compiled by Daiwa Securities.*

Such language from bureaucrats and the BOJ is thought to be rooted in the Kasumigaseki and BOJ cultures, but it is difficult to construe from these oral interventions how serious officials are about actually intervening in forex markets. However, a look back at the sort of comments made during previous episodes of forex intervention shows that the phrasing used in oral interventions incrementally changed as the actual intervention drew near. Furthermore, Kasumigaseki seems to have an official glossary that predetermines to some extent the language to use in oral interventions, and once this is understood it becomes possible to gauge how seriously monetary officials are thinking about actual market intervention.

Using historical examples, Chart 2 summarizes the different levels of comments by officials. Because the interpretation of these expressions is subjective and their granular categorization is not very meaningful, we have separated these out into five different levels of a forex intervention warning. In warning levels 1 and 2 are the phrases "stability of exchange rates is desirable" and "rapid changes in exchange rates are undesirable." In warning level 3 we see "it has overshot" and "it is unidirectional," while warning level 4 is reached when there are hints of actions being taken, such as "we will respond appropriately." The language becomes stronger in warning level 5, such as "we will respond resolutely," and this indicates that the time for actual intervention is drawing near.

Japan normally gains approval from the US and other Western countries before it intervenes. Accordingly, at warning level 5 you can expect comments indicating close coordination with overseas officials as well as comments from the overseas officials themselves. For unilateral interventions, there is a possibility of overseas officials making no comment, and when oral interventions reach warning level 5 there is probably a need to prepare for action irrespective of what overseas officials are doing.

So far, comments from monetary authorities on forex markets have been along the lines of "rapid changes in exchange rates are undesirable." Because this equates to warning level 2 in Chart 2, we see a low probability of forex intervention anytime soon. Vice Finance Minister Kanda commented on 29 March that "there is absolutely no disagreement between the central bank and government," and our impression from comments by officials is that the Prime Minister is coordinating closely with Japan's monetary authorities, the MOF and BOJ.

The same can be said of the BOJ's monetary policy. At the plenary session of the lower house on 12 April, Prime Minister Kishida said, "We still want (the BOJ) to conduct monetary policy appropriately toward achieving the 2% inflation target." The following day, Mr. Kuroda pointed out that "the inflation caused by the recent rise in the cost of imports is putting downward pressure on Japan's economy by lowering disposable household incomes and worsening corporate earnings" and reiterated his stance of "steadfastly adhering to the current policy of powerful monetary easing."

**Chart 2: Language Concerning Future Interventions Categorized by Warning Level**

| Warning level | Language |
|---|---|
| 1 | Stable exchange rates are desirable<br>We are watching market moves closely |
| 2 | An overshooting of yen depreciation is undesirable<br>Rapid market changes are undesirable |
| 3 | Yen depreciation has gone too far recently<br>Movement in JPY exchange rates have been unidirectional |
| 4 | We will respond appropriately to excessive yen depreciation<br>We will watch the market trend closely and respond appropriately |
| 5 | We will respond resolutely to excessive moves<br>We do not rule out implementing a variety of measures to deal with excessive market moves |

*Source: Nikkei Telecom, Bloomberg; compiled by Daiwa Securities.*
*Note: The likelihood of forex market intervention increases approaching warning level 5.*

The statements from Prime Minister Kishida and BOJ Governor Kuroda noted above suggest that the government and BOJ agree on sticking with the current monetary policy. The whole world is watching the negative effects of yen depreciation pushing the inflation rate higher and some are calling for the BOJ to normalize monetary policy, but we see a low probability of the BOJ changing to monetary tightening to combat "bad" yen depreciation.

Because large manufacturers benefit the most from a weaker yen and yen depreciation's negative impacts are felt more by the overwhelmingly more numerous smaller companies and households, further yen depreciation is likely to trigger an even stronger public backlash. We cannot rule out the possibility of the Kishida administration bowing to public opinion and changing direction if its approval ratings decline ahead of the upper house elections. Although we see it only as a risk scenario, we think it necessary to consider the arguments for currency intervention and a BOJ policy change.

The biggest barrier to currency intervention is getting the international community on board. There is international agreement on the need to avoid currency devaluations aimed at improving export competitiveness, but government interventions aimed at propping up the home currency do not attract much interest. Accordingly, if these were normal times Japan would probably not meet much resistance to yen-supporting intervention.

The majority of countries are now suffering from inflation, however, and it is not only Japan that wants to relieve inflationary pressures by strengthening its currency. When intervening in currency markets, coordination with the US is especially important, but the biggest priority for the US economy is to dampen inflation, which is now running at its highest in 40 years, and do so without a hard landing. From the perspective of the US and elsewhere, Japan's inflation rate is just about right, and we think any appeals from Japan about the need to combat inflation would fall on deaf ears.

Furthermore, we think the BOJ is unlikely to suppress yen depreciation through forex intervention while it is using yield curve control (YCC) and a negative interest rate policy (NIRP) to provide powerful monetary accommodation. Before intervening in forex markets, it would need first to make changes to its monetary easing. Some of its options in that regard are to widen the allowable trading band under YCC and to eliminate negative interest rates. Provided there was no change in the Fed's monetary policy stance, we think it likely that a change in interest late levels of about 10-25bp would only have a small impact on the USD/JPY rate.

We would expect adjustments to forex intervention and changes in BOJ policy would be a very bumpy ride, and do not think there is even any certainty that such action would change the yen's weakening trajectory. We think that the yen is likely to continue weakening as long as the Fed does not change its monetary policy stance, and that it would naturally rebound to a trend of yen appreciation if the Fed does change its stance. The question is whether Japan can wait until then.

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