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Daiwa's View

Heavy FX intervention after yen hits 32yr low

- This was a stealth intervention

Fixed Income Research Section
FICC Research Dept.

Senior FX Strategist
Kenta Tadaide
(81) 3 5555-8466
kenta.tadaide@daiwa.co.jp

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Last Friday, the government and BOJ once again intervened in the FX market by buying yen and selling dollars. This was only indicated by those in the know, and both Minister of Finance Shunichi Suzuki and Deputy Finance Minister Masato Kanda said "no comment." Mr. Kanda said he "could not comment on whether there was intervention," and Prime Minister Fumio Kishida said that he "could not comment specifically" regarding forex intervention. They had admitted to the first intervention on 22 September immediately afterward, but this latest intervention appears to be stealth.

The USD/JPY rose above 150 on 20 October (see our 21 Oct 2022 Daiwa's View, *Will USD/JPY rate exceeding Y150 spur currency intervention?*) and continued rising steadily in the Tokyo morning of 21 October. The rate of increase accelerated when European markets opened, and after climbing above 151 the yen went on to rise as high as 151.95, its weakest level in more than 32 years, going back to July 1990. With the BOJ's Monetary Policy Meeting coming up on 27-28 October, dollar buying was apparently sparked by US long-term rates reaching as high as 4.338%, their highest since November 2007.

The trend changed late night Japan time around 23:40 on the 21st (Chart 1), when the USD/JPY dropped suddenly from above 151 and declined intermittently until the yen had strengthened by over Y5 yen to 146.23 (according to Bloomberg, although other news outlets had the yen strengthening by over Y7 to 144.5). Based on the above-noted comments from those in the know and on the price action, it is very likely that the government intervened.

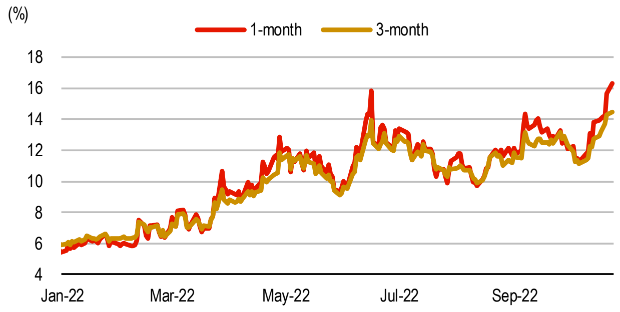
The extent of the yen's rebound suggests that this intervention exceeded the one on 22 September and may have been the biggest ever. Alternatively, because this currency market intervention by MOF occurred at the same time the US was sending signals encouraging a backing off from the terminal rate currently priced in (explained later), one could argue that this may have been a pseudo-coordinated intervention and therefore had more impact than the usual unilateral intervention. Another factor suggesting there was coordination with overseas monetary authorities is that most of the yen buying intervention that occurred when the yen was falling took place when overseas markets were open.

Some market participants had speculated that there may have been some stealth intervention on 13 October (see our 17 Oct 2022 Daiwa's View, *Stealth intervention?*), and the monthly intervention amounts that will be announced at the end of October will also include this latest intervention. Although not a problem if estimates of the amount of intervention using projections for changes in current account balances at the BOJ on 25 October do not deviate much from the actual amount of intervention, if the data on the change in current account balances at the BOJ fluctuates much, it will be difficult to determine whether there was any stealth intervention on 13 October. This would necessitate waiting until the detailed quarterly data (date and amount of intervention and the currencies traded) is released.

Chart 1: USD/JPY Rate on 21 Oct

Source: Reprinted from Bloomberg.

Chart 2: USD/JPY Implied Volatility



Source: Bloomberg; compiled by Daiwa Securities.

Looking back at the intervention on 22 September, Japan did not intervene right after the USD/JPY rose above 145 but instead waited until the yen had risen to just below 146. This time around, Japan did not intervene right after the USD/JPY rose above 150 but instead waited until the yen had risen to just below 152. This alone suggests that intervention may be timed in Y5 increments, in which case the next intervention would be likely to occur after the yen is solidly above 155 and approaching 156. Looked at from a volatility perspective, a possible benchmark could be an implied volatility for the 1-month USD/JPY of 13-14% (Chart 2).

Either way, we still think that the current level of US interest rates suggests a natural level for the USD/JPY in the range of 150-155 (Chart 3). As we noted in the paragraph above, we are starting to see indications that the accelerated rise in US interest rates may be ready to slow down.

The Wall Street Journal reported on 21 October that at its next FOMC meeting on 1-2 November, the Fed will debate whether to slow its pace of rate hikes starting with the next FOMC meeting in December and how to signal that if it does decide to do so. Immediately prior to entering the blackout period, the Fed has sent tangible signals for the market to start rolling back what is now priced in, which is a terminal rate of over 5% and a 75bp rate hike at the December meeting.

If the Fed hikes by another 75bp (instead of 50bp) at its December meeting, for both the market and economy, it may imply an additional hike of 25bp or more. A rise in the terminal rate to 5.375% would create expectations of a further increase in the USD/JPY, but that now seems less of a risk. If the inflation data continues to come in above expectations or the stock market rises in anticipation of a Fed pivot as it did last Friday, it would make it more difficult for the Fed to slow its pace of rate hikes.

In that sense, there is still no way to predict which way this will go, but the combination of a change in the Fed's monetary policy stance with currency intervention by the Japanese government and BOJ (or fear of such intervention) would make a USD/JPY over 155 much less likely.

Chart 3: Correlation Between USD/JPY Rate and Japan/US 2-Year Yield Spread

USD/JPY		2-year US yield (%)						
		2.0	2.5	3.0	3.5	4.0	4.5	5.0
2-year JGB yield (%)	-0.4	125	132	138	144	151	157	163
	-0.2	123	129	135	142	148	154	161
	0.0	120	127	133	139	146	152	158
	0.2	118	124	130	137	143	149	156
	0.4	115	121	128	134	140	147	153

Source: Bloomberg; compiled by Daiwa Securities.
Note: Calculated based on correlation between USD/JPY rate and Japan/US yield spread from 1 Mar 2022 to 21 Sep 2022.

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