Daiwa Securities

Daiwa's View

All-time record high reached for yen-buying intervention

➢ Focus of attention is on how resources for intervention were procured

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The Ministry of Finance (MOF) announced on 31 October that the total scale of foreign exchange intervention by the government for the monthly period from 29 Sep to 27 Oct amounted to Y6,349.9bn, an all-time record high for yen-buying intervention on a monthly basis. There was an announcement immediately after the currency intervention on 22 September. However, thereafter, the authorities did not disclose whether they were conducting currency intervention. This announcement formally confirms that they implemented stealth intervention.

From 29 September to 27 October, market speculation about stealth intervention spread on three days—13, 21, and 24 October. That said, the speculation about intervention on 13 October was caused by fluctuations in data used in estimating the scale of currency intervention, and, therefore, we do not think it is necessarily the case that the authorities implemented monetary intervention. (See our 17 Oct 2022 Daiwa's View, *Stealth intervention?*)

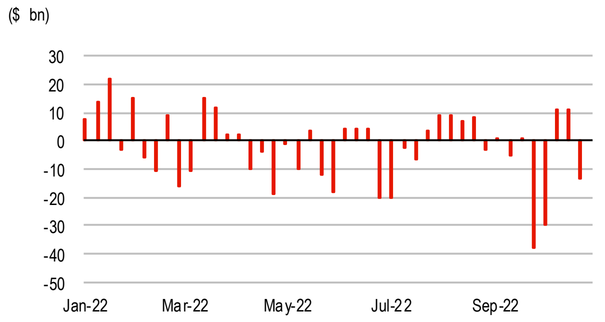
Judging from exchange rate movements and the estimated scale of currency intervention, it is highly likely that intervention was conducted on 21 and 24 October. The estimated scale of intervention for these two days totaled Y6,070.0bn, which corresponds roughly to Y6,349.9bn, the total scale of currency intervention announced by the MOF. Both Minister of Finance Shunichi Suzuki and Deputy Finance Minister Masato Kanda made no comment regarding the intervention on 21 October. However, the media has reported that currency intervention took place based on comments from those in the know.

On 1 November, Finance Minister Shunichi Suzuki explained that the purpose of stealth intervention in October was to maximize the effect of taming rapid fluctuations. He stated that intervention had been effective to a certain degree, and that the authorities would carefully monitor forex market trends with a strong sense of urgency and respond appropriately to excessive fluctuations.

With respect to currency intervention in October, the market will be paying close attention to the situation surrounding foreign exchange reserves as of end-October, which is to be announced by 8 November. Running counter to expectations, the intervention in September appears to have been funded through the sale of bonds held and redemption proceeds, without authorities resorting to using any of the $135.5bn (about Y20tn) in foreign currency deposits at overseas central banks and the BIS, which had been the anticipated source of funding.

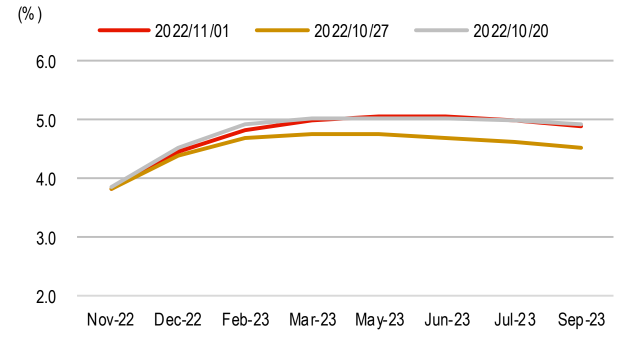
Confirming the balance of US securities held by global currency authorities (Fed custody accounts) showed drops in the balance in three weeks—reductions that came to $37.7bn in the week ending 28 September, $29.8bn in the week ending 5 October, and $13.2bn in the week ending 26 October (Chart 1). As these figures include sales made by currency authorities in other nations, precise figures are unknown, but it is estimated that most of the sales were made by Japan's Ministry of Finance.

Chart 1: Weekly Change in Fed Custody Accounts



Source: Fed; compiled by Daiwa Securities.

Chart 2: Market Pricing in Fed Rate Hikes



Source: Bloomberg; compiled by Daiwa Securities.

The total scale of currency intervention in September and October was Y9,188.1bn (about $62.0bn). If we assume that the resources for intervention were procured in the weeks when currency intervention was conducted, it's hard to imagine that the funds for intervention in October could have been raised via the sale of bonds and/or redemption. Therefore, a portion of foreign currency deposits may have been used. Or, the authorities might have prepared for intervention by selling US Treasuries by the week ending 5 October. In either case, foreign exchange reserves data as of end-October will provide a clearer general picture of how the MOF managed to procure the funds used for the intervention in October.

As we have mentioned previously, we continue to feel that the current level of US interest rates suggests a natural level for the USD/JPY rate in the range of Y150-155. After the US Wall Street Journal published an article on 21 October implying a slowdown in the pace of rate hikes by the Fed, market pricing of Fed rate hikes had diminished partially due to a series of global revisions to excessively hawkish stances, such as the Bank of Canada's reduction in the size of its rate hike and the ECB's dovish rate hike. However, market pricing has now returned to previous levels (Chart 2).

At the FOMC meeting that began yesterday, the Fed appears to be discussing a slowdown in the pace of rate hikes at the December meeting, together with fine-tuning of the terminal rate. As around 40% of market participants have factored in a 75bp rate hike at the December meeting, there is leeway for reduction here. However, the November FOMC meeting is unlikely to trigger a major revision to the dovish stance seen up until last week.

The US ISM Manufacturing Index for October (released yesterday) exceeded market estimates. While the index itself has been coming close to falling below 50, looking at the breakdown indicates that things are not that pessimistic, with new orders, production, and employment all on the rise. We'll see what series of events the market has in store for us from here onwards, but, provided we don't see major downturns in October US jobs data and October US CPI (to be released next week), the USD/JPY rate is expected to test the Y150 level once again.

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