

Macro Musings – JPY Depreciation Spells BoJ Tension, Not Trigger

“It’s a dangerous business, Frodo, going out your door. You step onto the road, and if you don’t keep your feet, there’s no knowing where you might be swept off to.” – Lord of the Rings

In a Nutshell: **Sharp JPY depreciation (~3% in a week) is a legitimate concern** for the MoF and the BoJ entailing worries of self-perpetuating JPY weakness and policy tensions. **But** a falling JPY is **not a decisive trigger for a BoJ hike** (this week). In fact, a hike will be misguided given the **threat of lasting demand destruction in exchange for hollow and ephemeral JPY prop renders rate hikes too prohibitive a policy response**. In addition, the **threat of adverse exports-shock for Japan** from **US trade antagonism**, even if only by collateral damage, **further raises the bar for the BoJ to hike** (into a potential negative economic shock). Instead, intervention in FX markets (actual intervention only if verbal warnings fall short) may be a more desirable, albeit not ideal, tool than a rate hike.

- Inconvenient JPY Bears: The **unabated (bearish) direction and speed of travel of JPY**, which has slumped nearly 3% in a week (from 150 to 154+) is **discomforting** to say the least.
- MoF Vigilant: Imaginably, the **MoF that is watching JPY moves** for signs of speculative overdrive like a hawk. Arguably, *ready to move in with intervention as required to stem excessive and self-perpetuating downside volatility*.
- BoJ Tension ...: The **BoJ’s policy dilemma is also accentuated** as it convenes for a policy decision later this week (Thursday, 19th Dec).
- ... Not Trigger: **But** it would be **misguided to assume that the BoJ will be triggered into a hike**. It will not, given countervailing and compelling economic risks.
- "Wrong Tree": Point being, **a hike to quell JPY pressures is a response, not a resolution**. Pointedly, it is **barking up the wrong tree**.
- Fleeting: Not just because the experience dictates that **resultant JPY support** (from a rate hike) often proves *disappointingly fleeting*.
- Miscalculation & Pain: But worse, **a hike to address JPY pressures risks considerable policy miscalculation and attendant economic pain that endures**.
- (Prohibitively?) Costly Conspiracy of Risks: Especially insofar that a **significant JPY rebound risks adverse income shocks*** that may **simultaneously involve negative wealth effects** (via negative JPY-Nikkei correlations). In turn, these could conspire to **wreck already fragile household confidence**.
- Accentuated by Trump Tariff Risks: And the **Trump tariff threat**, even if only by collateral damage, inevitably **amplifies the risk of adverse, potentially debilitating economic shocks** for Japan.
- Uncomfortable vs. Unacceptable: To be sure, the **BoJ may be uncomfortable with JPY depreciation**. But this may be managed with other tools. Whereas **a rate hike into treacherous trade uncertainty is unacceptable**. That **flirts with a costly policy mis-step**.

- Fat-Tails BoJ Cannot Afford: What's more, **acute, about-turns in JPY volatility entailing a sharply stronger JPY** is a “fat tail” that BoJ simply cannot afford**. Nor can it discount in exceptionally mercurial markets.
- Intervention Options & Rising Odds: All said, the least offensive/risky option then is intervention. And so the **odds of some form of intervention will mount** (if and) as JPY stumbles further.
- Non-Ideal but Less Undesirable: Fact is, while **intervention** of any form is **non-ideal**, it is **less undesirable than** knee-jerk, but *unsustainable* (and *unsubstantiated*) **high-cost, short-lived rate hikes**.
- Verbal Preferred: And at least **initially, verbal intervention is a much higher probability if USD/JPY ascendency** (JPY decline) is *unbridled* and *disproportionate to broad-based USD moves*.
- Actual Next Step Conditional: *If verbal intervention is shrugged off* by markets and JPY slide worsens **actual FX market intervention is the next logical escalation**.
- Step Conditional: And even then, **actual intervention will require a couple of conditions** to be fulfilled to ensure that future intervention threats are not undermined.
 1. One of which is **justification**. *excessive JPY weakness* (with **signs of speculation**) *well beyond broad USD-driven FX shifts*. that's for justification.
 2. A second is **reasonable likelihood of efficacy**. Which translates into “favourable” market conditions (where USD is at least not rising sharply, if not relenting) to set off a sharp enough JPY squeeze to be an effective deterrent (at least for a while).

* Compromised exports earnings as the first pass that could then go on to depress wage increments as a second-order impact.

** While *worrying about sharp JPY appreciation amid unremitting JPY pressures appears far-fetched it is par for the course given exceptionally volatile markets*.

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