

# Soaring Yen Produces First Trade Deficit in 28 Years as Japanese Authorities Watch the US

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Japan's currency has gained by almost a quarter against the US dollar this year and a third against the euro, making life even harder for the country's exporters, such as Sony and Toyota. Yet Tokyo is unlikely to halt the rise, out of concern over its relations with the United States, its key ally.

Japan's concern to maintain relations with the United States, its closest ally, on an even keel means Tokyo will seek to allow its currency to continue its steady appreciation, despite the profit erosion this causes in the key exporting sector.

The Ministry of Finance (MoF) may refrain from selling the yen, say currency strategists, even after the currency has advanced to the highest in 13 years against the US dollar and as many of the country's biggest exporters struggle to maintain profit margins.

The yen has advanced 24% versus the US dollar this year, 32% against the euro and 60% against the pound sterling. It traded at 90.25 against the dollar and 123.40 per euro at 5:45pm in Tokyo on Tuesday. It may reach 80 per dollar in one or two months, forecast Umemoto Toru, chief currency analyst in Tokyo at Barclays Capital.



Japanese yen rose to 96.63 against the dollar on March 17, 2008

Japan will be criticized internationally, especially by the US, the country's strongest ally, if it acts to stem the currency's gain as US automakers are still on the brink of bankruptcy, said Umemoto. The stronger yen drives up the price of cars imported to the US.

The US Senate rejected a rescue plan for Detroit-based GM and Chrysler last week, and hopes for the companies now hinge on the George W Bush administration dipping into the Treasury Department's US\$700 billion fund set up to rescue the financial industry.

The yen rose to 88.10 against the dollar on December 12, its strongest level since August 1995, as investors fled to the safe haven of the Japanese currency.

"I expect there will be no foreign exchange intervention," Umemoto told Asia Times Online. "It should be very hard for Japan to undertake intervention, because such an act would be regarded as lending some help to Toyota vis-a-vis the Big Three [US carmakers]. Politically it's

simply unfeasible."

row.



Godzilla Toyota attacks GM

## Rising yen and plummeting exports

Even so, the strengthening yen is taking its toll of Japan's exporters, who are threatening to move plants offshore to maintain sales. That could further add to the country's mounting number of people without work. The unemployment rate "may break the existing record of 5.5% and more than 1 million people might become jobless", Labor Minister Masuzoe Yoichi was quoted as telling a meeting of public employment security officers of the Ministry of Health, Labor and Welfare last Friday, according to a Kyoto report.

Japan posted a 63.9 billion yen trade deficit in October, the first red ink figure for the month in 28 years, as a stronger yen made Japanese exports more expensive in dollar or euro terms, according to data released by the Ministry of Finance on November 20.

Japanese exports declined 7.7% from a year earlier in October, the worst fall since December 2001. Japan's trade surplus with the US fell 27.5% to 519.2 billion yen, down for the 14th straight month, while the trade surplus with the European Union fell 24.8% to 357.4 billion yen, down for the second month in a



6,000 construction workers demand higher wages on Nov. 20, 2008 as Japanese exports plummeted in October. Kambayashi Shizuo photo

Should the Japanese currency rise by just 1 yen against the dollar and the euro, Sony Corp would lose 4 billion yen and 7.5 billion yen, respectively. Toyota Motor Corp has also said if the yen appreciates a similar amount, it would lose 40 billion yen to 60 billion yen on an annual basis, respectively.

Nissan chief executive Carlos Ghosn on Monday told reporters the sharp appreciation of the yen "is very dangerous. If the current situation continues, companies will be forced to move production offshore."

The gain nevertheless pleases some Japanese consumers, as imported goods and holidays to such popular destinations as South Korea become cheaper.

The Japanese yen has been the biggest winner out of the current global financial meltdown as investors increasingly unwind the so-called yen carry trade, in which yen borrowed at Japan's ultra-low interest rates are changed into other currencies and invested for higher yields than the interest charged on the yen loan. Japan's interest rate is 0.3%, the lowest among industrialized economies.

Narrowing interest-rate gaps between Japan and other nations have helped accelerate the reduction of yen carry trades. The US Federal Reserve has cut rates to 1.0% from 5.25% in nine steps over the past 15 months to counter a credit crisis that started with the collapse of the US mortgage market and which has spread around the world. The US central bank is widely expected to cut rates by at least a half-percentage point on Tuesday. The European Central Bank has slashed rates to 2.5% by 1.75% since October.

The Bank of Japan has trimmed the key overnight lending rate only once in the past seven years - to 0.3% from 0.5% in October - and has little room to lower it much further.

Japan's monetary authorities haven't stepped into the currency market since they sold a record 14.8 trillion yen in the first three months of 2004. The central bank hasn't purchased yen since 1998.

Calls for less interference in currency markets from the Group of Seven industrialized nations, especially targeting China, have made it difficult for the Japanese authorities to justify any intervention in recent years. In Japan, the Bank of Japan conducts foreign exchange intervention operations, based on decisions by the minister of finance.

If the Japanese monetary authorities were to intervene, it would be more out of concern for the plunging stock market that a surging yen has triggered, said Yamamoto Masafumi, head

of foreign-exchange strategy for Japan at the Royal Bank of Scotland Group Plc.

"Should the decline in stock market prices and the appreciation of the yen keep happening simultaneously, the Japanese monetary authorities are highly likely to engage in a smoothing operation to slow the yen's appreciation," said Yamamoto, who expects the yen to rise to 85 a dollar in one or two months.

On Friday, when the yen advanced to a 13 year-high, the 225-issue Nikkei Stock Average lost 484.68 points, or 5.56%, from a day earlier to 8,235.87. This closing price was much higher than a year-to-date low of 6,994.90 hit on October 28, making Tokyo's currency intervention less likely for the time being, Yamamoto said.

### Verbal intervention

Top Japanese Finance Ministry officials such as Shinohara Naoyuki, vice finance minister for international affairs, have expressed concern about the sharp rise in the yen.

"We will take appropriate action in response to the situation [in the currency market]," Shinohara told reporters after the yen broke through 90 a dollar.

Finance Minister Nakagawa Shoichi, a champion of conservative causes who is well aware of international political circumstances, said on the same day the government had no immediate plans to intervene.

Describing the dollar's fall below 90 yen for the first time since 1995 as "shocking", Nakagawa told reporters, "We will keep watching the markets, particularly the foreign exchange market, with great interest."

"Japan's MoF officials said they would watch markets with 'great interest'," Nizam Idris, a currency strategist in Singapore at UBS, wrote

in a research note published on Monday. "We however expect this 'interest' to translate to more verbal interventions rather than a physical one for now."

One-month implied volatility for the dollar-yen fell to 21.5% on Tuesday, from 41.79% on October 24, indicating investors see less price fluctuation in the currency pair next month. Dealers quote implied volatility, a gauge of expectations for currency moves, as part of pricing options. A drop in volatility reduces the risk of the carry trade by making profits easier to predict.

"Financial authorities most fear a market crash, which brings about excessive volatility," said Saito Yuji, head of the foreign-exchange group in Tokyo at Societe Generale SA. "Falling volatility suggests the Japanese government does not need to intervene to prevent the yen from appreciating too quickly."

Japan's currency may rise to 80 per dollar in one or two months, Saito said.

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On the steep decline in Japanese exports, the appreciation of the yen, and broader patterns of recession see also Toru Fujioka, [Japan Exports Plunge Record 27% as Recession Deepens](#) (Update1) , Bloomberg Report, December 21, 2008.