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MOF's another round of FX intervention: first impression

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Longer-term perspective

・Mr. Azumi, Minister of Finance, announced that the MOF has intervened the foreign exchange market since the morning of today. According to his comment at the press briefing, they only traded USD/JPY, and the currency pair jumped from ¥75 low level to ¥79 low level. Because of such sharp reaction as well as his strong comment ("We would continue the operation as far as I'm convinced") , the markets seem to suspect the amount of transaction would become as large as the last one (¥4.5tn in August). In this note, I discuss several aspects of this round of FX intervention from longer-term perspectives.

Coordination with monetary policy

・Readers of the Note would recall, on 27 October, I circulated the previous issue of the Note with a quite similar title (BOJ's another round of monetary easing). As this fact suggests, there is a widely shared view that additional monetary easing by the BOJ and this round of FX intervention is the coordinated policy action. If it is the case, this is the fourth one within almost an year.

・Unlike the previous there cases, the timing of policy decision by the BOJ and FX intervention by the MOF is not on the exactly date this time (ie, the MOF's operation lagged two business days). Nevertheless, this may largely be a technical issue. The BOJ's monetary policy statement referred to the uncertainties of financial markets as major threat to our economy. And the MOF seemed to seek the appropriate opportunity to enter the market. As Minister Azumi suggested at the briefing, USD/JPY rate this morning may have provided good opportunity, because its movement accelerated to some extent and the risk of going below ¥75 became higher. In other words, the MOF could argue that the intervention is intended to battle against (possible) "excess volatility".

・If such flexibility in timing supports the effectiveness of FX intervention to a certain degree, it would be important for the MOF. Also for the BOJ, it would not always be necessary for to hold an unscheduled and contingent meeting to decide additional easing. Although it may seem trivial, it is expected to have some implications for the relationships between the MOF and the BOJ in the long run.

Strategy of the FX policy

・While the initial reaction in the market is notable as reviewed above, there is a strong skepticism in the markets that the effect of the FX intervention could disappear in a short period of time. Experiences of the previous three cases provide reasons to think so, and this may be why the attention by the domestic press has been gradually diminished.

・The currency authority may share the same view as they may be collecting the same set of information as the market participants (although they might think that the effectiveness could be improved to some extent). Still, if they are successful in either reducing the volatilities or in preventing the acceleration of the movements, the FX intervention could become a meaningful policy measure. Because, it could provide some time for Japanese corporations with large exposures of currency risks to take a sigh of relief. As I discussed in the previous Note, they are suffering from factors both from longer-term (possible losing technological advantages) and shorter-term (another round of global supply-chain disruption). In light of these, even a prevention of further appreciation of JPY itself is strongly requested.

・Against the criticism of "ineffective" FX intervention, the MOF has also introduced a set of policy initiatives in foreign exchange. Among them, they are launching a foreign currency fund program for Japanese corporations to conduct outward FDIs. This is partly funded by our foreign exchange reserve (loaned to the JBIC (an government owned financial institution)), and extended to borrowers by major Japanese banks. This could support cross-border M&A deals by Japanese corporations, which has already been on record pace in the first half of this fiscal year.

・The fact that this kind of policy measure – rather pursuing to maximize the blight side of the strong JPY－ is actually launched would be a tiny but notable change in the line of thoughts. While this idea could be dealt with great care as it could damage domestic investment and employment, balancing the strategies of FX policy between the short-term measures like FX intervention and the longer-term measures like supporting outward FDIs would be more welcome by Japanese corporations and beneficial for our economy in the long run.

International perspectives

・Minister Azumi reportedly admitted that this round of FX intervention is unilateral. This would not be surprising for the markets, because it would be hard to seek support from our major trading partners for now. For the US economy as well, weaker USD would be beneficial for the economic activities as far as it attracts foreign capital and commodity prices stabilize. While the EMU economies may like to stabilize EUR rates against major currencies in order to support the capital flows to the region, recent rapid recovery of EURUSD rates might be enough for the time being.

・Still, it deserves attention to the reactions from overseas economies when they wake up in the morning of Monday. Of course, the focus would be the US as the MOF purchased USD/JPY only. From the point of view of the Japanese government, there could be an opportunity of G20 summit only a few days ahead to explain the backgrounds of the FX intervention and seek some understandings. In the US, however, there is an expectation that an introduction of "QE3" at the FOMC meeting just ahead of G20 summit could have renewed downward pressure on USD rates.

・In the longer-run, however, rather than USD/JPY rates, developments of TPP would be dominant for the trade between the US and Japan. Whether to participate in its multilateral process becomes a hot political issue in Japan and the US government seems to watch it closely. Although there is no evidence available to outside observers including me, discussion over FX policy should sometimes be discussed in such a broader context of economic relationships.

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