Opinion | 17 August 2026 FX UNITED STATES

Yen: Why Bessent backs himself for successful intervention

In a recent podcast, I drew the conclusion that US Treasury Secretary Scott Bessent fancies his chances of the recent FX intervention being successful. We agree that the yen is significantly undervalued and are reminded that key policy interventions such as this and those seen in Sweden and Mexico in 2023 can warn of significant FX trend changes

Having made his name with speculative bets on exchange rates, it appears as though Bessent is betting the yen will appreciate

Timing is everything

Unlike the 1990s and early 2000s, intervention in major FX pairs is exceptional. And the late July joint intervention between Washington and Tokyo was the first such yen-buying exercise since the Asian FX crisis in 1998. Bessent will have committed a lot of political capital to this intervention and will want to be proved right.

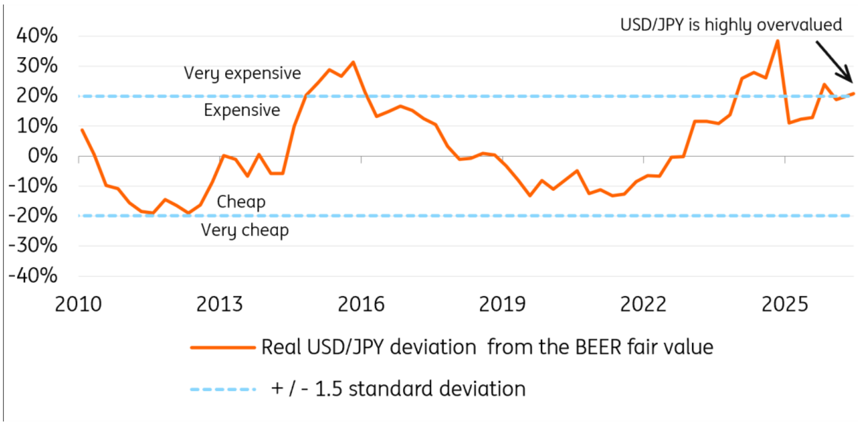
As a former hedge fund portfolio manager, he will know that timing is everything. Japanese unilateral intervention proved successful in the summer of 2024 as it caught the market turn in the Fed cycle, when the US policy rate was subsequently cut 75bp later in the year. But what gives the Treasury Secretary the confidence to intervene now?

We discuss the rationale for the intervention in this article. The timing probably owes to a conviction call that the yen is undervalued, plus a call on yen-supportive policy choices coming out of Japan.

During the intervention, Bessent described the yen as being 'very undervalued'. We agree and, based on our own fair value models, see the yen as around 20% undervalued against the dollar. Here's what ING FX Strategist Francesco Pesole has to say about our fair-value model:

We generally assess medium-term FX valuation through our Behavioural Equilibrium Exchange Rate (BEER) model, which estimates real fair value using quarterly data on terms of trade, productivity, current account balances and government spending. This framework deliberately excludes shorter-term market drivers such as rates and equities, allowing us to isolate the contribution of economic fundamentals to exchange rates. In USD/JPY, it's particularly visible how the erosion in JPY value is inconsistent with long-term economic fundamentals, and the pair has shown persistently elevated real overvaluation – above 20% – throughout 2026.

USD/JPY strength inconsistent with economic fundamentals



Source: ING, Macrobond

Policymakers can pick the turns

While many will be sceptical that joint US-Japan intervention can make any difference in the $480bn per day world of USD/JPY trading, intervention can have an important signalling effect that FX moves have come too far. Two instances come to mind over the past few years when central banks have taken a view on their currencies, and the market has listened.

In June 2023, Sweden's Riksbank surprised the market with a plan to hedge its FX reserves. This all sounded quite strange, but as we discussed at the time, it reflected the Riksbank's view that the Swedish krona was undervalued and that a krona rally could generate some unwelcome losses to the Riksbank's equity capital. At the time, EUR/SEK was trading close to 12.00 and never rose much further. We estimated that the actual hedging might have depressed EUR/SEK by 2-3%, but the Riksbank's signalling that the krona was cheap resonated broadly.

Also in 2023, Banxico in September announced that it was going to unwind its $7.5bn short USD/MXN forward book acquired through peso-supportive intervention in 2017 and 2020. At the time of the announcement, USD/MXN was trading around 17.00, and the move helped convey Banxico's opinion that the peso was getting too strong. Again, the move proved well-timed and USD/MXN has struggled to sustain any moves below 17.00 since.

Will Bessent be proved right?

The Treasury Secretary is betting that the downside for the yen is limited and that a weaker USD/JPY can help US manufacturers compete more, both in Japan and in third markets. There are clear Mar-a-Lago currents running through this activity. The added benefit of intervention, as Bessent has admitted, is to discourage the rest of Asia from weakening their currencies to compete with Japan. China's 30% devaluation in 1994 was widely blamed for the Asian FX crisis in 1997/98.

But to be successful with this high-profile intervention, Bessent will need the fundamentals to change. Part of that will be higher interest rates in Japan. Hence the suggestion, both from Bessent himself and from reports out of Tokyo, that the government will tolerate a faster pace of Bank of Japan tightening. In other words, more than one 25bp BoJ hike every six months. The chances of an earlier BoJ hike in September are now being priced around 75%.

But durable yen appreciation requires Japanese capital to stay onshore or to be brought home. And that is why growth differentials and the attractiveness of investment returns are so important.

In July, Tokyo announced a new growth strategy, aiming to deploy JPY370tr ($2.3tr) of public-private investment by 2040. The US supports this strategy not only on the geopolitical grounds of having a strong defensive bulwark in the region, but also on commercial grounds of a potentially bigger export market.

The link between investment returns and the yen

The success of Japan's growth strategy has a clean link to the yen. Asian nations like Japan and Korea acknowledge that weak productivity growth amidst ageing populations is leading to investment outflows in search of higher returns. The significance of relative international investment returns is discussed in a brilliant research paper recently published by economists at the Bank of Korea.

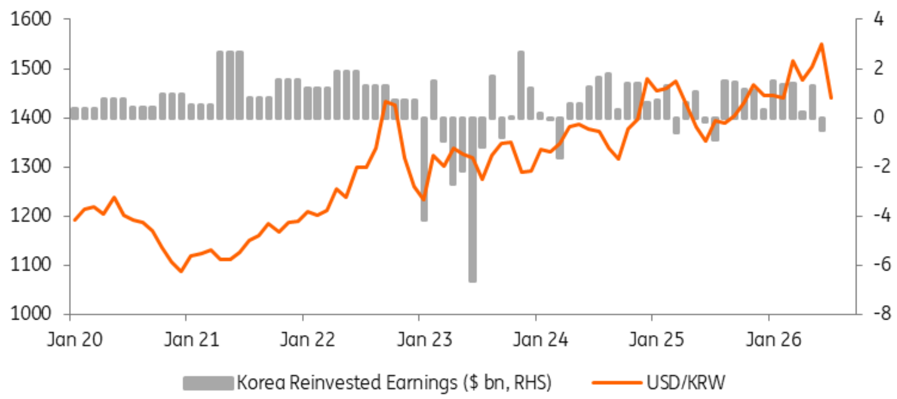
They note that Korea is heading the same way as Japan, where investment income is representing an increasing portion of the current account surplus. Even though the large current account surplus looks good on paper, the problem is that higher investment returns overseas mean the investment income is staying offshore as reinvested earnings. The paper cites some reinvestment ratios – or the portion of overseas investment income that stays offshore as retained earnings – as Japan (46%), Korea (40%), Germany (28%) and Taiwan (18%).

While a quick fix of a foreign dividend tax holiday, like the one in Korea introduced in 2023 (see chart below), might temporarily bring reinvested overseas income home, the lasting solution, as the authors note, is to deliver lasting productivity enhancements at home through investment. Hence Japan's current focus on a massive investment plan. Bessent is clearly supportive of this plan and is betting that some well-timed intervention can at least buy some time for it to bear fruit.

And in any case, Japanese companies have enjoyed 95% tax exemption on retained earnings since 2009, so new tax breaks here look unlikely to make much difference to the path of the yen.

But there could be other structural solutions, such as domestic assets (JGBs) being included in NISA accounts and much focus placed upon the investment allocations of Japan's Government Pension Investment Fund (GPIF). Currently the GPIF has a 25% benchmark for JGBs and 50% for domestic assets. Speculation is already building that there could be a repeat of the October 2014 'big bang' announcement co-ordinated between the BoJ and GPIF – perhaps at the 30 October BoJ meeting this year – where the GPIF could announce a re-orientation to domestic assets alongside a BoJ hike.

Korean tax changes brought reinvested earnings home



Source: Bank of Korea, ING

The above policy changes are speculative at this stage. But having made his name with speculative bets on exchange rates, it looks like Bessent is betting the yen will appreciate. Joint intervention has created a catalyst, but lasting yen appreciation ultimately depends on higher domestic returns, stronger growth and a supportive Bank of Japan policy path. Our base case assumes that US-Japan growth and interest rate differentials narrow – resulting in USD/JPY at 158 by the end of 2026 and 152 by the end of 2027.

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