Macro & Strategy Research

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JPY: A decisive turning point?

Japan's joint intervention with the USA could mark a decisive turning point for JPY – but several stars need to align to reverse the structural depreciation trend: 1. Lower US rates and higher Japanese rates, 2. Credible, sustained support for JPY before fundamentals reassert themselves and 3. Reversed Japanese capital flows. The critical ingredient is redirecting capital flows back into Japan to ease selling pressure on the currency.

Key points

Three stars need to align for the JPY to strengthen on a sustained basis after the bilateral Japan-US intervention in the end of last month.

1. The yield differential must narrow. A more hawkish Bank of Japan, combined with a softer Federal Reserve, would reduce the attractiveness of the yen as a funding currency and weaken the carry-trade case for selling JPY.

2. The USD/JPY 'ceiling' must prove credible. Sustained and coordinated intervention can discourage speculative short-yen positions and create an asymmetric risk profile for carry trades. Intervention can only buy time and establish a ceiling around USD/JPY 160–165; it cannot, on its own, generate a JPY appreciation trend.

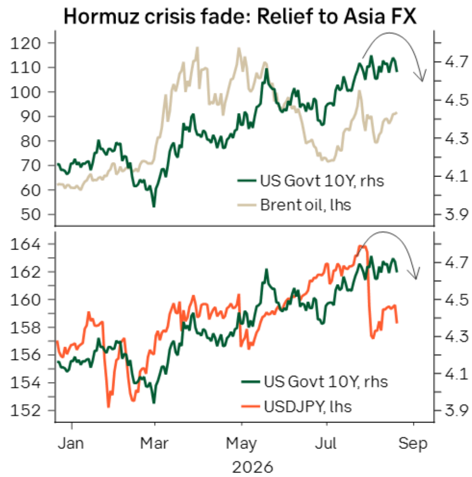
3. Japanese capital flows must reverse. A durable recovery ultimately requires Japanese investors to reduce purchases of foreign assets and redirect capital toward domestic bonds and equities. A GPIF-led increase in domestic allocations could be the catalyst, triggering broader repatriation, higher FX hedge ratios and an unwinding of yen-funded carry trades.

The FX story is in Asia

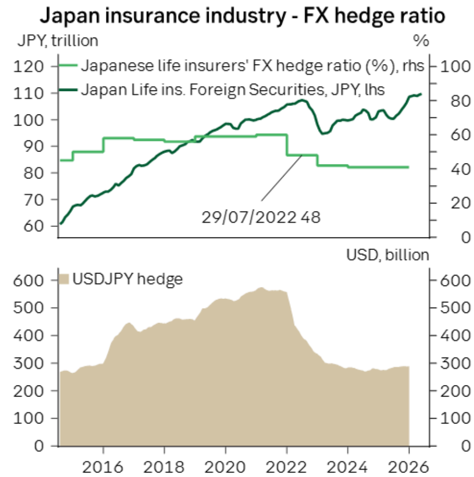
In May we argued that the potential for FX appreciation vs USD was centered on Asia (link). That view has now been catalyzed by the recent yen intervention (and by the AI-stock correction and its effect on especially KRW). **Leading into the summer, a few arguments pointed towards currency appreciation versus the dollar:**

- **Easing geopolitical tensions** and falling energy prices, with global yields peaking/retracing, had potential to support Asia FX.
- **FX hedge ratios** had significantly more scope to adjust in Asia (Japan, South Korea, Taiwan) than for instance Europe. A shift in the direction of the dollar on Hormuz reopening thus had/has potential to trigger hedge ratio adjustments in Asia (i.e. selling USD forward – reducing the open FX position).
- **Potential for repatriation of capital** for domestic investment (Japan specifically), e.g. the pension and lifer sector reallocating holdings from US Treasuries to JGBs.
- **Complacent short positioning in JPY** – largely down to the carry trade.

Potential for Asia FX appreciation going into the summer (JPY specifically in charts below)



Source: Bloomberg, Macrobond, SEB



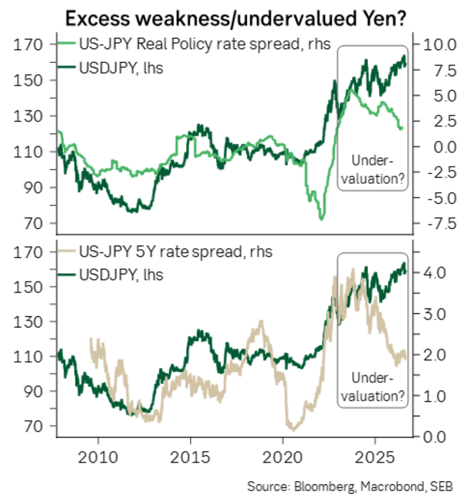
Source: Bloomberg, Macrobond, SEB

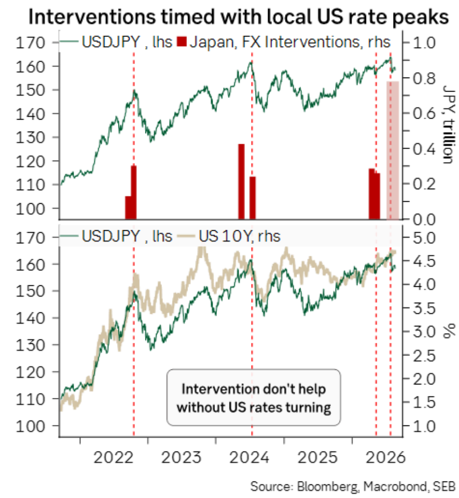
Another JPY intervention: Is this time different?

The threat of bilateral Yen intervention finally came through, and it looks to be well timed – but BoJ now also needs to deliver:

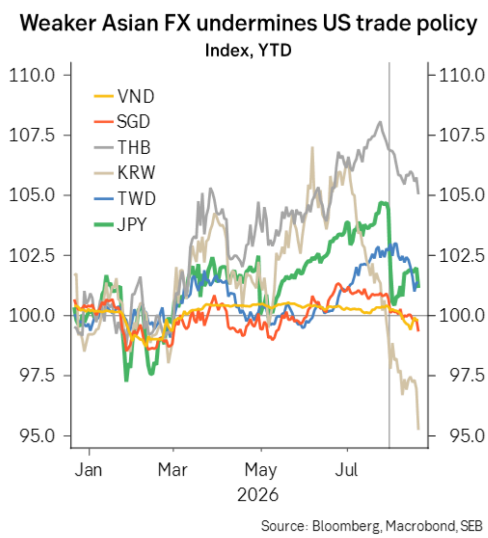
- **There was a valuation argument going into the interventions on July 30-31** – when comparing USDJPY to the US/Japan real policy rate differential as well as the nominal 5-year interest rate spread.
- **Intervention looks to have been well timed with a peak in US rates**, which is essential for some follow-through on the downside in USDJPY.
- **The peak in US data arguing for a hike was before the summer**; since then, momentum has moderated in both inflation and the labor market.
- **The US involvement may partly reflect a desire to facilitate this adjustment in an orderly way**. Large-scale Japanese selling of US Treasuries could otherwise push US yields higher and undermine the intervention itself.
- **JPY an anchor for Asia FX.** Persistent yen weakness pressures Korea, Taiwan and other export-oriented economies to resist appreciation against the dollar to preserve competitiveness versus Japan. In Bessent's view, this is a key reason why trade imbalances with these economies have widened – despite import tariffs (left chart).
- **Intervention aimed to break the regional depreciation loop**. By joining Japan's intervention, Bessent seeks to contain this spillover before yen weakness became an even wider problem for Asian FX and U.S. trade objectives.
- **BoJ now needs to deliver**, as Yen still screens as a decent carry funder, but a few more hikes and the uncertainty of intervention should see the funder appeal migrate from Yen to e.g. CAD and SEK.

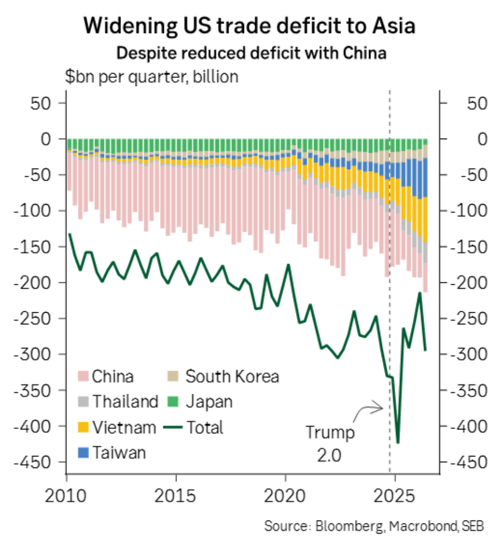
Intervention looks well timed, but BoJ needs to deliver hikes to lessen the funder appeal





"A stable yen is not only important for the U.S., but very important for the entire region" – Scott Bessent



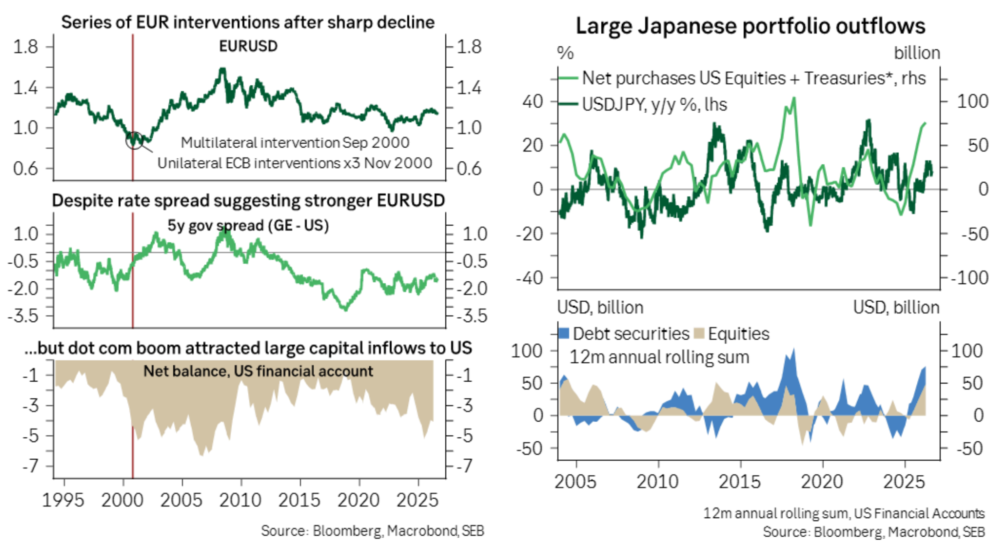


Coordinated intervention to stabilize, rather than appreciate – Euro 2000 analogy

The euro's experience in 2000 offers a useful parallel for the yen today, underscoring that this round of intervention seeks to establish a ceiling in USD/JPY rather than to necessarily engineer an immediate and lasting yen appreciation.

- **The euro weakened well beyond what fundamentals appeared to justify**, even as the euro–dollar interest-rate differential moved in the euro's favor (left chart below).
- **Persistent capital outflows to the US were a key driver**, as the dot-com boom attracted European investment – a dynamic that echoes today's AI-driven capital flows into the US.
- **Coordinated intervention by G10 central banks helped establish a floor under EUR/USD**. However, it did not trigger an immediate or sustained recovery. It took roughly two years for capital flows to turn and for fundamentals to regain influence.
- **The implication for the yen is that the goal of the intervention should primarily be viewed as an attempt to establish a ceiling in USD/JPY around 160-165**, rather than to generate an immediate and lasting appreciation of the currency – before fundamentals and shifting capital flows can take hold.

Portfolio outflows weighed on EUR in 2000 and is a problem for JPY today



Three stars need to align for JPY to strengthen against the USD on a sustained basis:

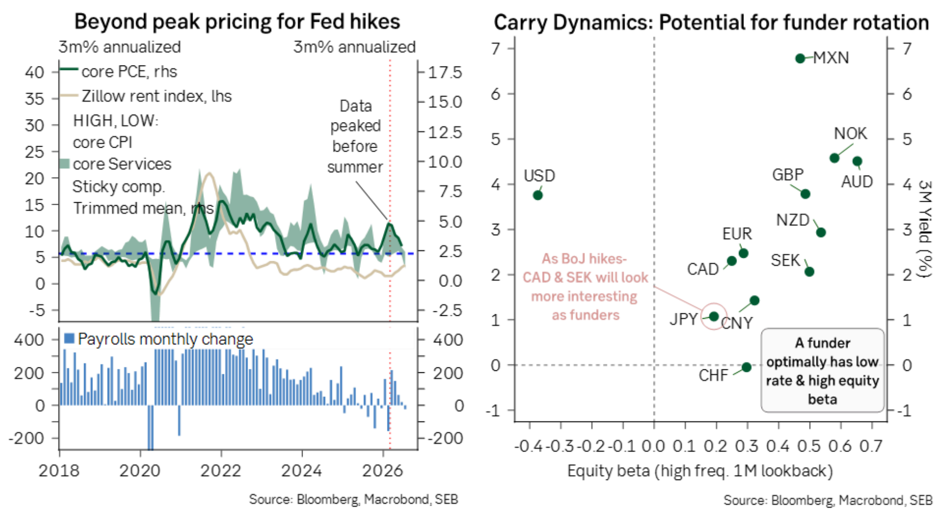
1. **Reduced yield differentials** – hawkish BOJ and softer Fed.
2. **Successful defense of the USDJPY ceiling** – creates an asymmetric risk profile for carry trades.
3. **Reversal of capital flows** – contingent on narrower yield spread and institutional investors reallocating away from foreign securities to Japan.

1: Hawkish BOJ, dovish Fed needed to reduce carry appeal

Intervention alone cannot overcome the yen's role as a funding currency if the policy-rate differential and carry dynamics remain attractive. The BoJ therefore needs to validate the intervention signal with real rate normalization while the peak US rates environment stays intact.

- **The Bank of Japan is becoming more hawkish**, as the political appetite for a faster pace of tightening seems to have increased recently. The market is currently pricing in roughly half a rate hike per meeting over the next four rate decisions – taking the policy rate to 1.5% in the beginning of next year from the current 1.0%. The terminal rate stands at 1.75% next year.
- **Fed hikes would undermine intervention.** The market is pricing in one full hike over the same time period, under immense uncertainty of the "new" Fed's reaction function under Kevin Warsh. Although cuts are not likely in the immediate future, reduced expectations of rate hikes would take USDJPY into a "BOJ hiking cycle, Fed sideways" environment. The Jackson Hole symposium at the end of August could be an important catalyst for the
- **In this scenario, the rate differential narrows, reducing the attractiveness of JPY as a funding currency** and increases the likelihood that intervention translates into sustained pressure on USD/JPY.

Peak US rates and hawkish BoJ a requirement for JPY strength



2: How much firepower does Japan and the US have to defend USD/JPY?

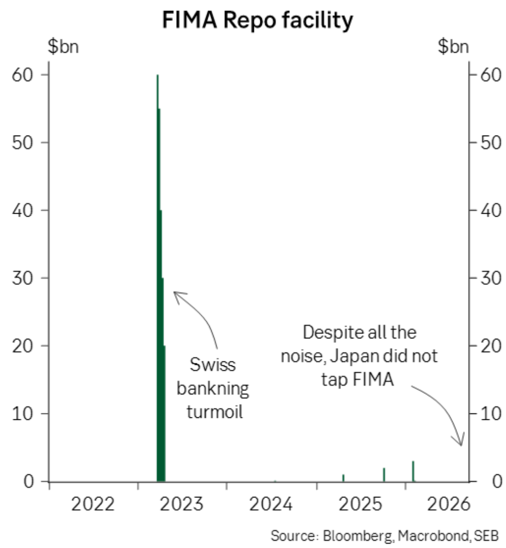
There needs to be a **continued and credible threat of intervention** to discourage carry traders / speculators to bet against the Yen. Firepower and facility design matter for credibility and near-term impact, but they cannot substitute for a shift in fundamentals and flows. The FIMA foreign repo facility and related tools are best understood as buying time for a portfolio reallocation story to play out, not as a permanent support mechanism for JPY.

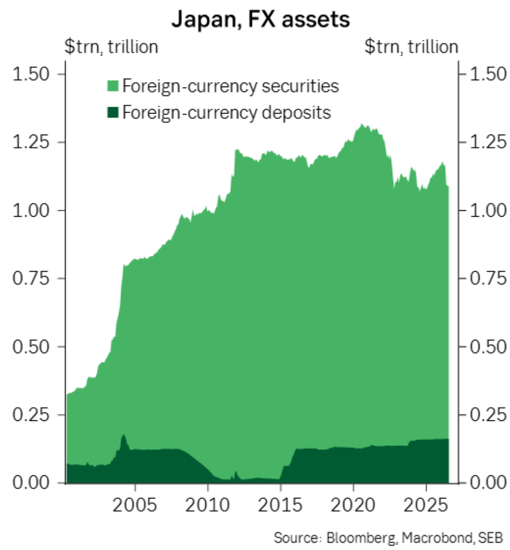
- **Japan has substantial resources**: its official reserves exceed USD 1 trillion. However, large-scale Treasury sales could push US yields higher. This is likely why Scott Bessent has called for an expansion of the Fed's FIMA Repo Facility.
- **FIMA would allow Japan to obtain dollar liquidity against its Treasury holdings without immediate selling them outright.** It could therefore support yen intervention while limiting the risk of an adverse feedback loop through US rates and yen-funded carry trades.
- **It could very well be the case that all this talk about FIMA is just posturing**. Bessent's calls for an even larger facility, and Japan's indication that they intend to use the facility in the future, are a way to signal that there is capacity for large and swift interventions without immediate contagion to the Treasury market.
- **But the FIMA channel is not a sustainable intervention tool.** The BoJ can use FIMA repos to temporarily shield the Treasury market from added supply by rolling the repos (typically at negative carry), but this is not a permanent intervention tool. To unwind, the BoJ must either buy back USD and sell JPY – thereby reversing the intervention's market impact – or sell USD assets (e.g., Treasuries), which could lift US yields albeit allowing them to sell at a more orderly pace.
- **Using the FIMA facility should hence be regarded as a means to scare off short JPY speculators and reduce Treasury market volatility** by imposing temporary FX losses for a short period of time rather than a permanent intervention tool**.**

What about the US? How much can they participate in further intervention?

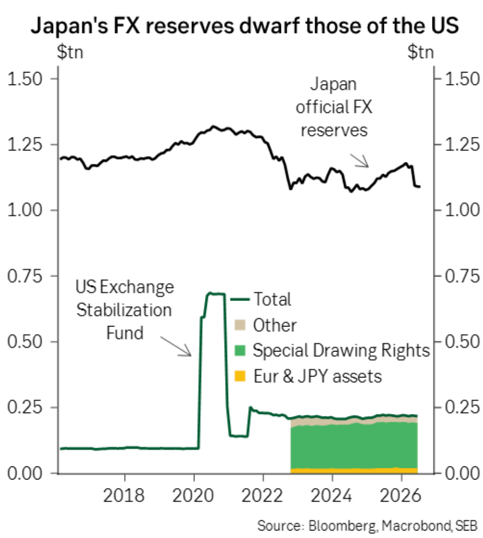
- **US (official) direct firepower is limited.** The Treasury holds euro and yen in its official reserves (Exchange Stabilization Fund & SOMA), of which it held EUR 26 billion in the end of Q2, so the reported sale of USD 5–10 billion of euros may have used a significant share of its readily available FX reserves.
- **The Treasury also holds around $172bn of Special Drawing Rights (SDR)**, which can theoretically be exchanged for dollars through the Federal Reserve. This would be a controversial, but viable, path to obtain intervention funds. Ultimately, this gives the US more capacity than its ordinary FX holdings suggest, although its overall firepower remains limited relative to Japan's (chart below).
- **Other potential (and less orthodox) options** include mobilizing gold reserves, using forwards or other derivatives, and coordinating intervention with G10 central banks and governments

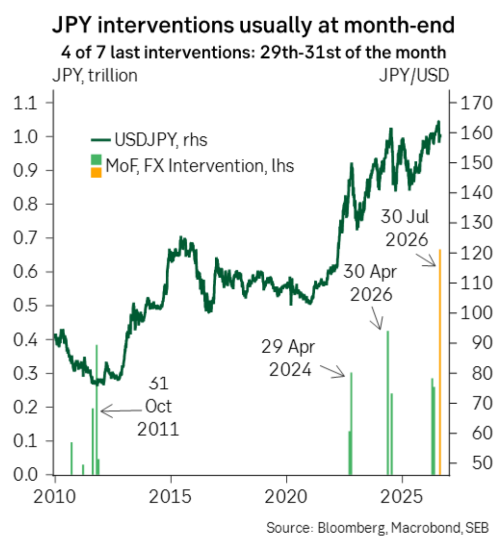
Japan didn't use the FIMA facility - MoF FX intervention report due August 28th





US has essentially no official firepower left, Japan to do the heavy lifting - possibly at end of the month?



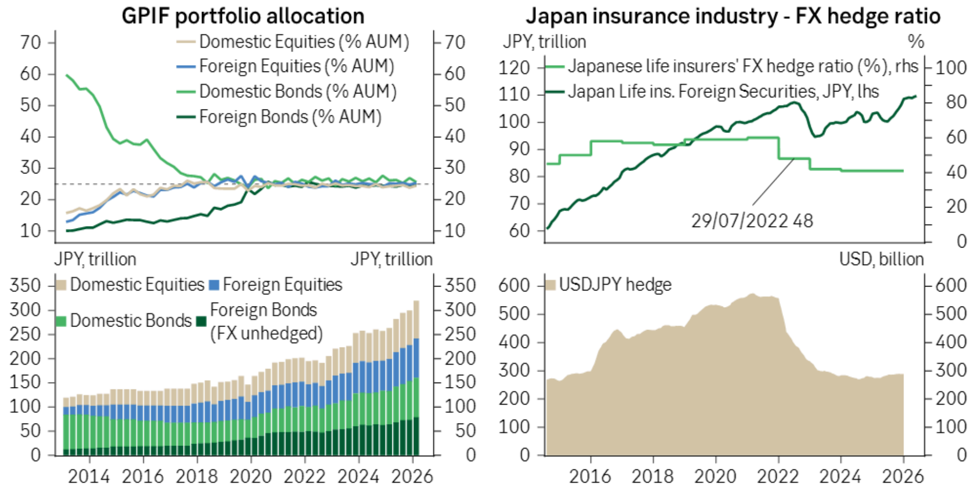


3: When will capital flows shift?

Ultimately, fundamentals – and capital flows – need to shift to facilitate a sustained yen recovery. Japanese net financial flows into US Treasuries and equities are currently at the highest level since 2018.

- **Capital flows into and out of Japan have both cyclical and structural drivers.** Cyclical flows could reverse on a traditional market correction – lower US equities and yields – via e.g. an AI bust, stronger JPY safe-haven demand, and increased repatriation. If Japanese investors reduce US equity and fixed-income exposure, or increase hedging, amid yen-intervention uncertainty or fading confidence in the US tech boom, cyclical flows have the potential to rotate back toward Japan.
- **Structural flows**: Another channel runs through idiosyncratic domestic behavioral shifts –such as Japanese pension funds and life insurers reallocating toward domestic assets. Reversing structural capital outflows has real potential to reduce JPY depreciation pressure. **The ultimate lever would be to change the allocation of the world's largest pension fund**, the Government Pension Investment Fund (GPIF), to favor more domestic securities.
- **The GPIF currently maintains a broadly balanced strategic allocation,** with 25% each in domestic bonds, foreign bonds, domestic equities and foreign equities.
- **The government has clearly expressed a desire for GPIF and other public funds to increase domestic investment**, although a formal change of the allocation mandate is not likely in the immediate future. However, the GPIF can move within its existing deviation bands of ±6%-points for each asset class – meaning that they could raise the allocation to domestic bonds to 31% without breaking any rules.
- **This reallocation alone would involve up to $100bn,** and a similar reallocation of the equity mandate would double that size – potentially triggering further repatriation/increase hedge ratios from the private life insurance industry.
- **With the BoJ actively shrinking its balance sheet**, adding upward pressure to long-term rates, the question is if investors stay sidelined until the central bank finishes its program and eventually becomes a net neutral player on the JGB market (not shrinking or expanding holdings). The current plan is to halt the reduction in JGB purchases by March 2027. See more here.
- **Should this repatriation scenario unfold, it would mark the start of a decades-long structural shift in capital flows**, with immense global market consequences and a major headache for the US: selling US assets and buying Japanese ones while US Treasury yields sit at multi-decade highs. How Tokyo should navigate such a politically contentious shift with Washington is another question...

Buy Japan, sell (and/or hedge) USA?



Source: Bloomberg, Macrobond, SEB

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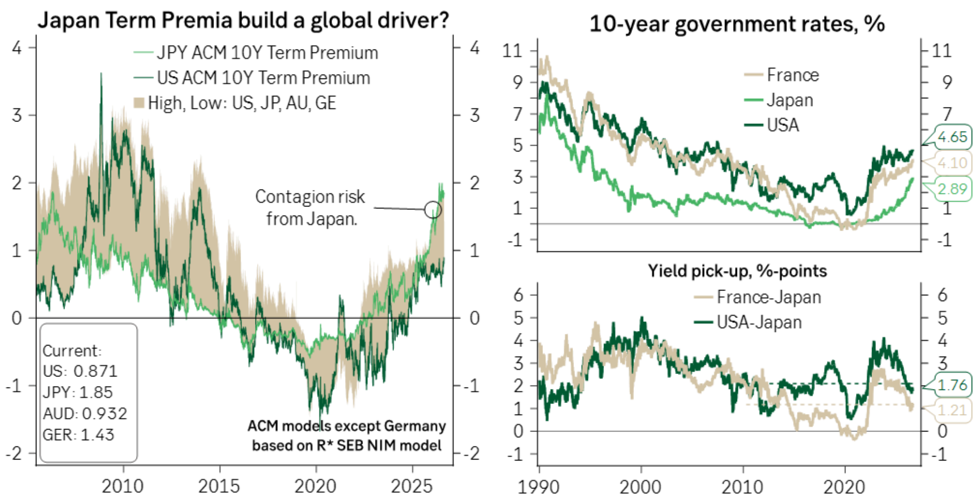
What yield is required for Japanese capital flows to turn homeward?



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Market implications and signposts

Our base case is that the combination of well-timed bilateral intervention, a local peak in US yields and further BoJ tightening will establish a ceiling in USD/JPY around 160–165, allowing for episodic downside moves but not guaranteeing a structural JPY bull market.

The structural JPY bull case, by contrast, requires that this ceiling be perceived as credible while the US–Japan yield spread narrows and a GPIF-led "Buy Japan" shift takes hold, triggering self-reinforcing repatriation, higher hedge ratios and carry-trade unwinds that together underpin a durable appreciation trend.

Key signposts to monitor are:

1. The Fed's rate path and Jackson hole in the end of August.
2. The BoJ's communication, the pace of hikes and balance-sheet reduction.
3. The AI-equity narrative, which drives the relative return and risk profile of foreign versus domestic Japanese assets.
4. Evidence of GPIF or other large institutions moving within or beyond their deviation bands toward domestic assets.
5. Trends in Japanese net purchases of US Treasuries and equities and in FX hedge ratios.

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