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USD/JPY: Focus shifts to monetary policy after coordinated intervention

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Summary

Japan's FX intervention since the end of July has reached JPY15.4tn, while Japan and the US have signaled that they remain prepared to intervene jointly again. This has helped contain yen weakness to some extent. A September hike is now largely priced in as markets increasingly view BOJ rate hikes as part of the quid pro quo for US support. However, it remains unclear whether the government would accept a rapid series of rate hikes toward the neutral rate, and fiscal concerns are also likely to weigh on the yen. In the US, hawkish remarks from Fed Chair Kevin Warsh have revived expectations of a September rate hike, but such expectations could still recede depending on the employment and inflation data. Japan's trade deficit remains a source of yen weakness, but the impact of intervention, more stable oil prices, and the prospect of further BOJ rate hikes make an accelerating yen-depreciation spiral like that seen in 2022 less likely. Looking ahead, attention should focus not only on US and Japanese monetary policy, but also on potential G20 coordination over currency policy toward China.

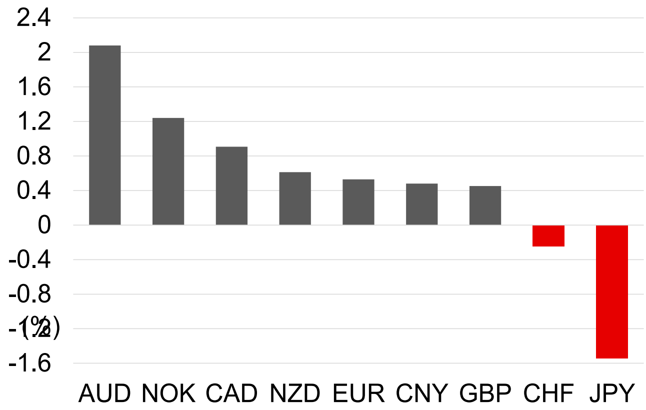
August in review

The USD/JPY opened the month at 157.78. The pair plunged to 155.20 early on 3 August, its lowest level since May, with yen buying dominating after the MOF confirmed that Japan and the US had conducted coordinated intervention. The pair began to recover after the initial yen buying ran its course and an extraordinary Cabinet meeting on 5 August approved a cut in the consumption tax on food. Weaker-than-expected US employment data released on 7 August briefly pushed the pair back below 157, but it climbed above 159 on 10 August despite the absence of a clear catalyst. Trading volumes during Japanese hours were limited by the Obon holidays, but 160 came into view. The pair fell back toward 158 on 19 August after the US Treasury announced plans to double the size of its Treasury buybacks. It recovered above 159 the following day and then gradually moved higher again. Fed Chair Kevin Warsh's speech at Jackson Hole on 28 August was widely viewed as hawkish, pushing expectations of a rate hike at the September FOMC meeting to nearly 60% and triggering broad-based dollar buying. The USD/JPY also moved above 160. The pair was trading around 160 at the time of writing on 31 August (Figure 1). The dollar was generally weaker over the month but recovered somewhat following Warsh's Jackson Hole remarks. Among the major currencies, the Australian dollar outperformed as expectations grew that the RBA would resume rate hikes, while the yen underperformed as it gave back some of its post-intervention gains (Figure 2).

FIGURE 1: USD/JPY (DAILY)

Note: As at 15:00 JST on 31 August
Source: EBS, MUFG

FIGURE 2: MAJOR CURRENCIES' RATE OF CHANGE VS USD IN AUGUST



Note: As at 15:00 JST on 31 August
Source: Bloomberg, MUFG

Coordinated intervention continues to resonate

On 30 July, reports emerged that the Japanese authorities had intervened in the FX market and that the New York Fed had conducted a rate check. Treasury Secretary Scott Bessent subsequently described the yen as "very undervalued," while Vice Minister of Finance for International Affairs Atsushi Mimura said Japan was receiving US support that went "beyond psychological support." Japan and the US then conducted coordinated intervention on 31 July, bringing efforts to curb yen weakness to a head ahead of the summer holidays. According to the MOF, Japan has conducted JPY15.4tn of FX intervention since 30 July. This exceeds the amount spent during the Golden Week period. Although details of the US operations have not been disclosed, the first coordinated Japan-US intervention since March 2011 appears to have been substantial. A statement by Finance Minister Satsuki Katayama released on 3 August to confirm the coordinated action explained that it had been conducted in accordance with the US-Japan Finance Ministers' Joint Statement issued in September 2025 and was intended to counter the excessive volatility and disorderly movements recently seen in the yen. The joint statement itself opens by affirming close consultation between the US Treasury and Japan's MOF on macroeconomic and foreign-exchange matters. It also reiterates that exchange rates should be market determined and that excessive volatility and disorderly movements can adversely affect economic and financial stability. The apparent judgment was that coordinated action was warranted because yen selling was occurring alongside JGB selling, with a risk that the move could spill over into USTs. Katayama's statement also made clear that Japan would continue to monitor developments and remain in close communication with the US Treasury, adding that the two sides would not hesitate to conduct further coordinated intervention. This has left markets conscious that the July operation may not prove to be a one-off. Following the intervention during the Golden Week holidays, the USD/JPY returned to its pre-intervention level in roughly one month. This time, after about a month, it has retraced only around half of its initial decline. That may itself be evidence of the intervention's effectiveness.

Focus shifts to US and Japanese monetary policy

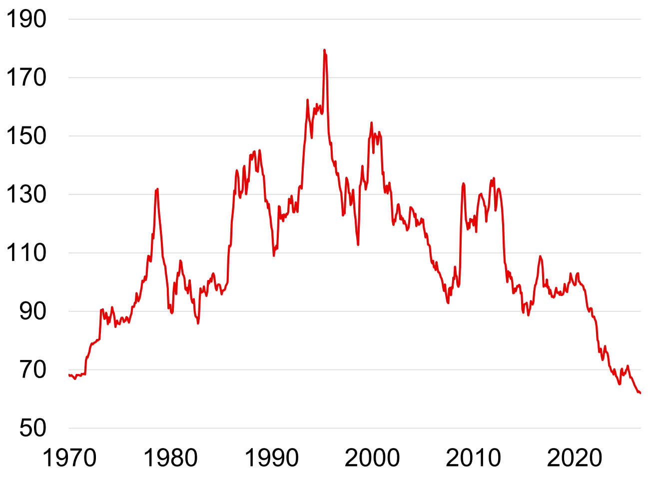
Comments by Vice Minister of Finance for International Affairs Atsushi Mimura and President Donald Trump suggest that the coordinated intervention was probably undertaken at Japan's request. Cooperation between governments inevitably comes at a cost. Trump said the action also benefited the US, suggesting that Washington is likely to expect something in return. However, nearly a month later, it is still unclear what that might be. Nevertheless, there is now broad recognition that Japan cannot ignore what Treasury Secretary Bessent has repeatedly called for: further BOJ rate hikes.

In an interview last August, Bessent said the BOJ was "behind the curve" on monetary policy and would therefore need to raise rates. During a visit to Japan shortly after the Takaichi administration took office in October, the US Treasury noted that conditions had changed substantially in the 12 years since Abenomics began.

Bessent also urged the Japanese government to give the BOJ sufficient policy space to raise rates. The BOJ subsequently raised rates twice, in December last year and June this year, but the US appears to regard this as insufficient. In its Foreign Exchange Report released in July, the US Treasury noted that the yen had depreciated by 51% against both the dollar and on a real effective basis since the end of 2011, leaving it undervalued. It also argued that monetary policy normalization would help anchor inflation expectations and reduce excessive exchange-rate volatility (Figure 3). Bessent reinforced this message in a media interview on 30 August. Asked whether the BOJ needed to raise rates further, he said he expected Governor Kazuo Ueda, with Prime Minister Sanae Takaichi's support, to make the right decision. He went further than previously by saying that Abenomics had probably run its course.

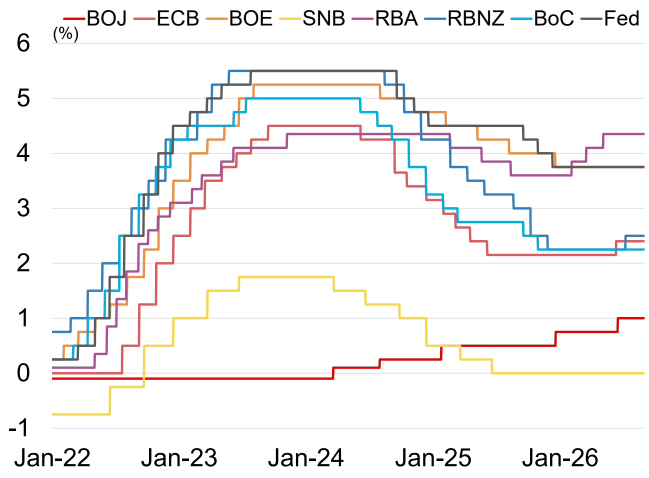
Rate-hike expectations also remain firmly in place in the US. Fed Chair Warsh's remarks on 28 August suggest that upcoming FOMC meetings will focus on whether further rate hikes are necessary. Inflation is being driven in part by a common global factor, higher energy prices caused by developments in the Middle East. Against this backdrop, the prevailing view is that further BOJ rate hikes are difficult to avoid when even the US, where policy rates are already relatively high, is considering additional tightening (Figure 4).

FIGURE 3: YEN REAL EFFECTIVE EXCHANGE RATE



Source: BIS, MUFG

FIGURE 4: POLICY RATES IN MAJOR ECONOMIES



Source: Central banks, MUFG

BOJ does not push back on September rate-hike expectations

Market pricing for further BOJ rate hikes increased sharply in August on the view that additional tightening was part of the understanding behind the Japan-US coordinated intervention. A hike at the 17-18 September meeting is now more than 90% priced in, while a consensus is beginning to form around three 25bp hikes, totaling 75bp, by around next summer. Markets are also beginning to contemplate a terminal rate above 2% in the current hiking cycle (Figure 5). Such expectations appear largely driven by pressure from the US Treasury and Treasury Secretary Bessent, but a September hike now looks highly likely barring a major change in circumstances.

Immediately before the coordinated intervention on 31 July, Governor Ueda said at his post-meeting press conference that the BOJ could accelerate the pace of rate hikes. The BOJ cannot cite yen weakness itself as a direct reason for monetary policy action, so Ueda qualified his remarks by saying faster hikes would be possible if developments in prices suggested that financial conditions had become too accommodative. Even so, this left the door open to another hike just three months after the previous move in June. The key factor that could lead the BOJ to judge financial conditions as too accommodative is upside risk to inflation. The Bank has recently become more concerned that higher import prices stemming from developments in the Middle East could feed through to inflation faster and more strongly than previously expected. Government measures to curb price increases and falling rice prices have kept inflation below 2%, but inflation has nevertheless begun to accelerate. Tokyo CPI excluding fresh food and energy, often referred to as core-core inflation, rose 2.0% YoY in August (Figure 6). The inflation backdrop therefore does not argue against a September hike.

Deputy Governor Ryozo Himino had an opportunity to speak after markets had already priced in roughly an 80% chance of a September hike, but he did not push back against that move. His remarks disappointed some market participants looking for a clearer signal, but nothing in his speech suggested hesitation over further hikes. Although he avoided discussing the specific timing, he stressed the importance of stabilizing underlying inflation at around 2% and said the BOJ needed to be more alert than before to upside inflation risks. His message can therefore reasonably be read as indicating that markets are not wrong to expect a September hike.

Rate hikes still hinge on political considerations

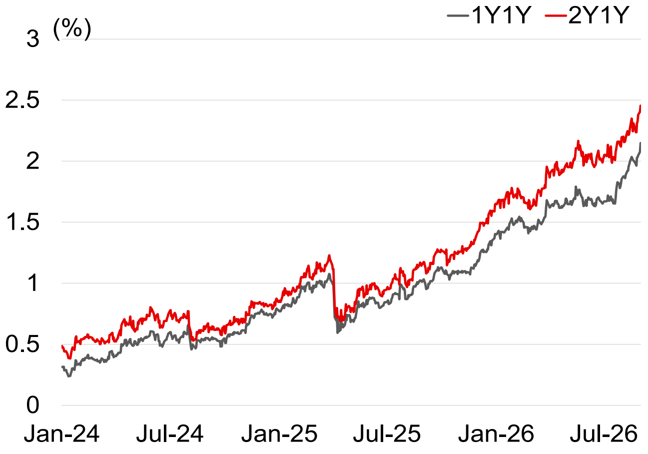
We have long viewed September as the earliest possible timing for the BOJ's next rate hike. However, we have also expected the decision on whether to bring the move forward to September to depend partly on political considerations. The earlier Basic Policy shock reinforced the view that the government remained cautious about further rate hikes. There was also a possibility that the BOJ would face political pressure to hold off after the extraordinary Cabinet meeting approved a reduction in the consumption tax rate on food and beverages to 1% from next April. Raising rates while the government was easing fiscal policy could have revived the familiar argument that policy was simultaneously pressing the accelerator and the brake. However, senior government officials have not made notable comments on monetary policy since the coordinated intervention. Japan asked the US government for support and proceeded with coordinated intervention at a time when inflation was beginning to accelerate, with yen weakness one of the contributing factors, despite government measures to curb price increases and falling rice prices. Whatever individual members of the administration may think, curbing yen weakness now appears to be government policy. Given the additional pressure from Treasury Secretary Bessent, we therefore think the government can be seen as accepting a September rate hike. Reports suggest that a Cabinet reshuffle could take place at around the same time as the BOJ meeting, but it is becoming increasingly difficult to envisage the Bank postponing a hike simply to accommodate the political calendar.

However, such acceptance may only extend to the September meeting. Bessent's previous remarks suggest that he wants Japan to move beyond a monetary policy stance that is "behind the curve." His comment that Abenomics has probably run its course also suggests that he is looking for more than a single September hike and expects the BOJ to raise rates toward the neutral rate relatively quickly. It remains unclear whether the government is prepared to go that far. This lingering uncertainty may be one reason why the yen has failed to strengthen in line with the sharp increase in market expectations of further BOJ rate hikes.

Fiscal concerns will take time to ease

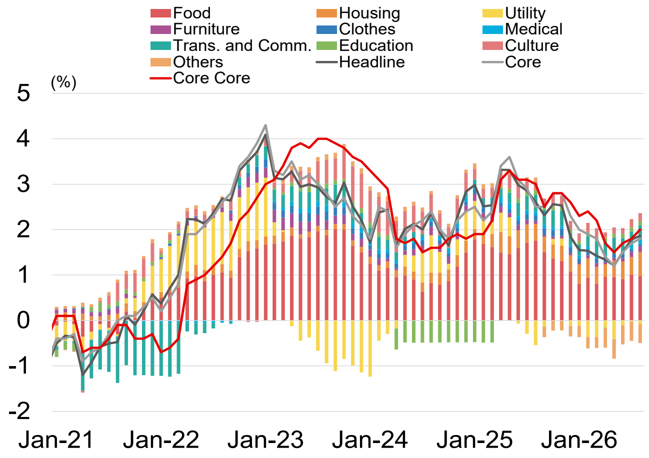
Long- and superlong-term yields have continued to rise alongside expectations of further BOJ rate hikes. The 10y JGB yield reached around 2.96% on 31 August, driven by higher inflation expectations and a wider term premium, putting the psychologically important 3% level within reach. As we noted in last month's report, JGB and yen selling have tended to move together, giving the market the appearance of a broader Japan sell-off. Fiscal concerns have also been reinforced by the Cabinet's decision to cut the consumption tax rate on food and beverages and by the FY27 budget process. Ministries and agencies faced a 31 August deadline for submitting their budget requests. The MOF plans to announce the aggregate figures in early September. According to the Yomiuri Shimbun, general-account requests are expected to total around JPY140tn. This would represent a substantial increase from initial budgets of around JPY117tn in FY25 and JPY122tn in FY26. Headlines emphasizing a record total and the absence of spending caps on investment are unlikely to dispel the fiscal concerns that have built up so far. However, the Takaichi administration has rejected a fiscal approach that assumes a supplementary budget will be compiled at year-end. This means the JPY140tn figure does not necessarily represent a major deterioration when viewed against the combined total of the FY26 initial budget and the FY25 supplementary budget (around JPY140.6tn). Prime Minister Takaichi also told the Yomiuri Shimbun that she intends to keep new government bond issuance to around JPY40tn. There are therefore signs that the government is mindful of market concerns. However, it will take time to establish confidence that these commitments will actually be delivered. Near term, attention will turn to the treatment of Finance Minister Katayama and Minister of State for Economic and Fiscal Policy Minoru Kiuchi in the Cabinet reshuffle expected around mid-September. The Sankei Shimbun and other media have reported that Katayama is likely to retain her post, while there has been relatively little reporting on Kiuchi. If Kiuchi is replaced, speculation over a shift in fiscal policy could increase depending on his successor.

FIGURE 5: YEN FORWARD SWAP RATES



Source: Bloomberg, MUFG

FIGURE 6: TOKYO CPI INFLATION



Source: MIC, MUFG

Rate-hike expectations may be getting ahead of themselves

Expectations of a rate hike at the 15-16 September FOMC meeting have recovered to around 60% following Chair Warsh's remarks at Jackson Hole. Earlier in August, the probability had fallen to around 30% after the 7 August employment report showed an unexpectedly sharp deterioration, with nonfarm payrolls falling by 23,000 MoM in July (Figure 7). July CPI subsequently came in broadly in line with market expectations, doing little to revive expectations of a hike. Warsh's remarks therefore attracted considerable attention for their hawkish tone and drove rate-hike expectations sharply higher. However, the contrast with the roughly 90% probability currently priced for a September BOJ hike is striking. With more than two weeks remaining before the FOMC meeting, we see ample scope for both the economic outlook and market expectations to change.

Warsh's remarks were viewed as hawkish partly because he remained upbeat about the labor market despite the decline in July payrolls. He described labor-market conditions as stable and concluded that they were consistent with full employment. He then made clear that inflation was the Fed's predominant concern. Warsh also broadened his assessment of inflation beyond measures such as trimmed mean and core PCE. He noted that 54% of the goods and services in the PCE basket had risen by more than 3% over the previous 12 months. He said the inflation data released over the summer had been better than expected, but had not convinced him that the underlying trend had meaningfully improved. He said his standard was to be confident that underlying inflation was moving clearly and sufficiently quickly toward the Fed's target (Figure 8).

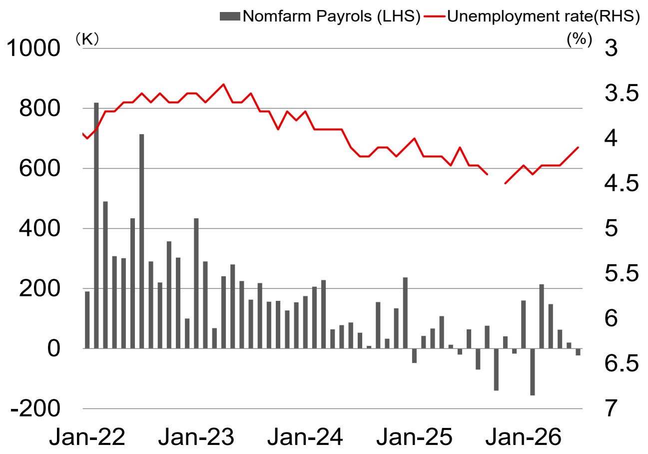
However, the speech should not necessarily be read as advance notice of a September hike. Warsh reiterated his long-standing discomfort with signaling future policy decisions well in advance and argued that the regular use of forward guidance had outlived its usefulness. His hawkish comments on inflation were also not entirely new. Given his emphasis on changes in inflation expectations, a cautious stance is understandable while gasoline prices remain elevated. The Fed is therefore likely to wait for the August employment and CPI reports before deciding whether to raise rates in September. We think it would be premature at this stage to regard a hike as a foregone conclusion.

President Trump has also stepped up his calls for rate cuts as the November midterm elections approach. One possible interpretation is that Warsh is seeking to keep inflation expectations anchored without necessarily raising rates. His comments after the July FOMC meeting that higher market rates were already exerting a de facto tightening effect are consistent with that interpretation. The August employment and inflation data could therefore cause rate-hike expectations to recede again ahead of the FOMC meeting, potentially renewing downward pressure on the dollar.

Keep an eye on Bessent's maneuvering

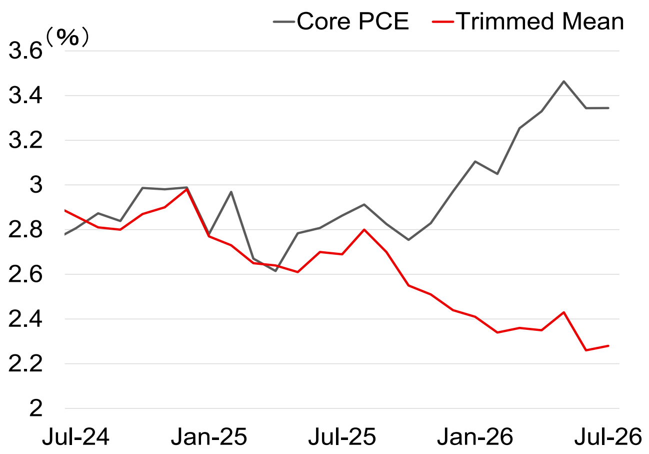
The G7 and G20 finance ministers and central bank governors meetings start from 31 August. Ahead of the meetings, Treasury Secretary Bessent urged G20 members to reassess their trading relationships with China, arguing that the world cannot tolerate China running a USD1.2tn trade surplus. He has also taken a more assertive line on Japan's fiscal policy, saying Japan should "sit back and enjoy the success of Abenomics and let that run." Bessent therefore appears to be laying down markers on several fronts ahead of the meetings. It is also worth recalling his comments around the time of the coordinated Japan-US intervention. Bessent said that many Asian currencies were moving with the yen, that the Korean won was weak because the yen was weak, and that yen weakness was making China more reluctant to allow the renminbi to appreciate. There have also been signs of coordination with the South Korean authorities alongside the Japan-US action. A visit by Chinese President Xi Jinping to the US is also being discussed for the second half of September. Meanwhile, Washington has been stepping up pressure on China, including over sanctions related to Iran. When the second Trump administration took office, there was considerable discussion over whether a Mar-a-Lago Accord or some other arrangement resembling a new Plaza Accord might emerge. There are no indications that this G20 meeting will produce anything so concrete, but any moves toward coordination on currency policy with China in mind will bear watching.

FIGURE 7: US EMPLOYMENT DATA



Source: US Bureau of Labor Statistics, MUFG

FIGURE 8: CORE PCE DEFLATOR AND TRIMMED MEAN PCE INFLATION



Source: US Bureau of Economic Analysis, Dallas Fed, MUFG

Further yen weakness looks increasingly unlikely

Treasury Secretary Bessent said on 30 August that recent yen moves were not disorderly and were "pretty well contained." The yen weakened in the first half of August as some of the impact of the coordinated intervention unwound. However, when the USD/JPY recovered to 160 following Jackson Hole, there was little corresponding movement in the yen crosses. Bessent's assessment that yen volatility has remained contained therefore appears reasonable. The dollar has also strengthened broadly as expectations of a Fed rate hike have increased, making further coordinated intervention difficult to envisage under current conditions. However, this does not mean investors can sell the yen without concern. Yen weakness and the policy response remain a focus for the media, and Bessent is likely to comment when asked. For the time being, those comments are likely to lean against further yen weakness.

Meanwhile, as BOJ Deputy Governor Himino noted, Japan appears to be making progress in securing alternative energy supplies amid developments in the Middle East and the closure of the Strait of Hormuz. Imports have consequently begun to increase in value, widening the trade deficit and adding to yen depreciation pressure. However, oil prices have stabilized compared with their earlier highs, while more than JPY26tn of FX intervention so far this year has absorbed substantial yen-selling pressure. Japan has therefore avoided a repeat of 2022, when the escalation of the war in Ukraine led to a sharp widening of the trade deficit and rapid yen weakening. Even if the Fed resumes rate hikes, the meeting calendar would put the BOJ in a position to follow with a hike of its own. This is another important difference from 2022. We therefore see little risk of the yen-depreciation spiral accelerating substantially from here.

QUARTERLY FORECAST RANGE AND PERIOD-END FORECAST

	Sep 2026	Oct-Dec	Jan-Mar 2027	Apr-Jun
USD/JPY	155.0～165.0	153.0～163.0	151.0～161.0	149.0～159.0
Period-end forecast	158.0	156.0	154.0	152.0

Our forecast range estimates the high and low for each quarter. The period-end forecast is our forecast for USD/JPY at 17:00 New York time at the end of each quarter.

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