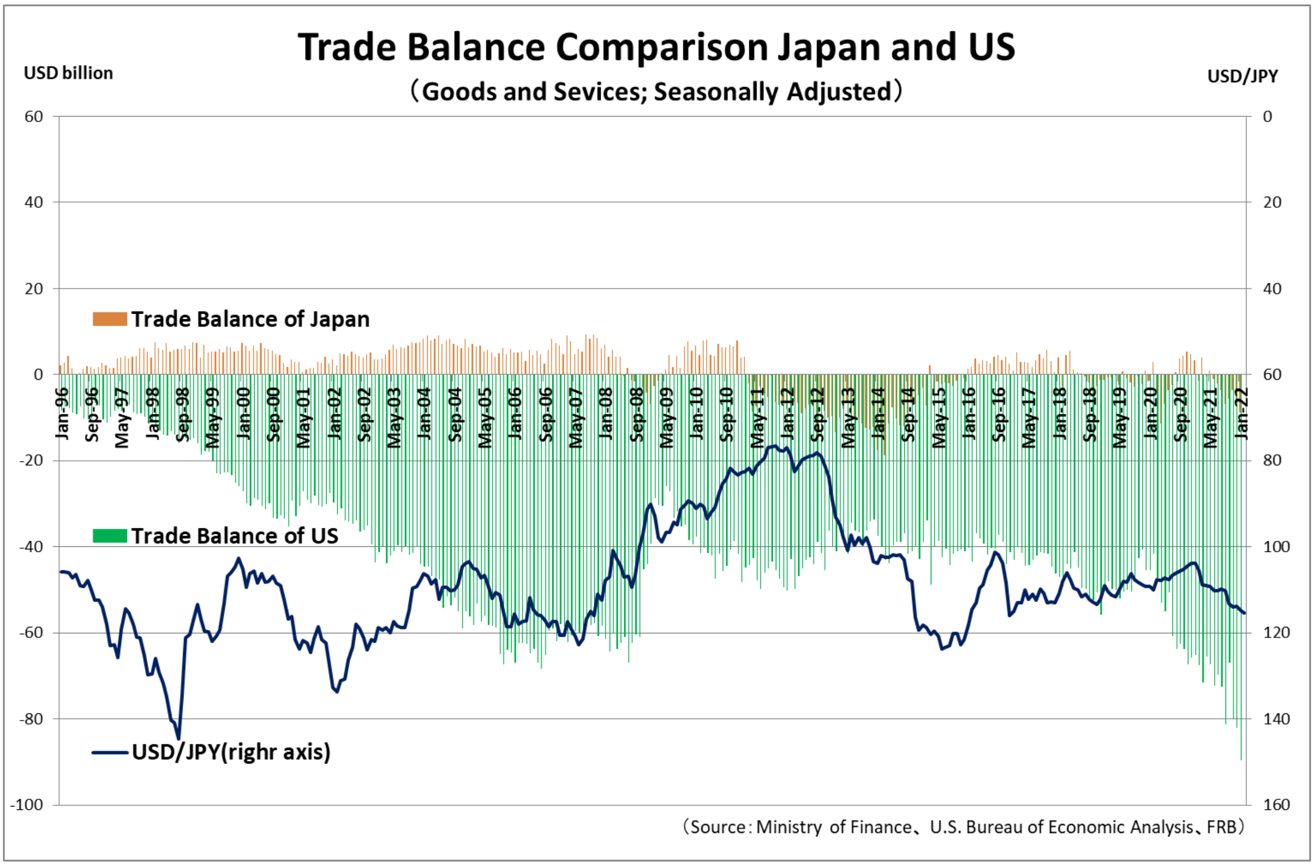
Chick Kawakami's Eye #14 : JPY depreciation will not last longer

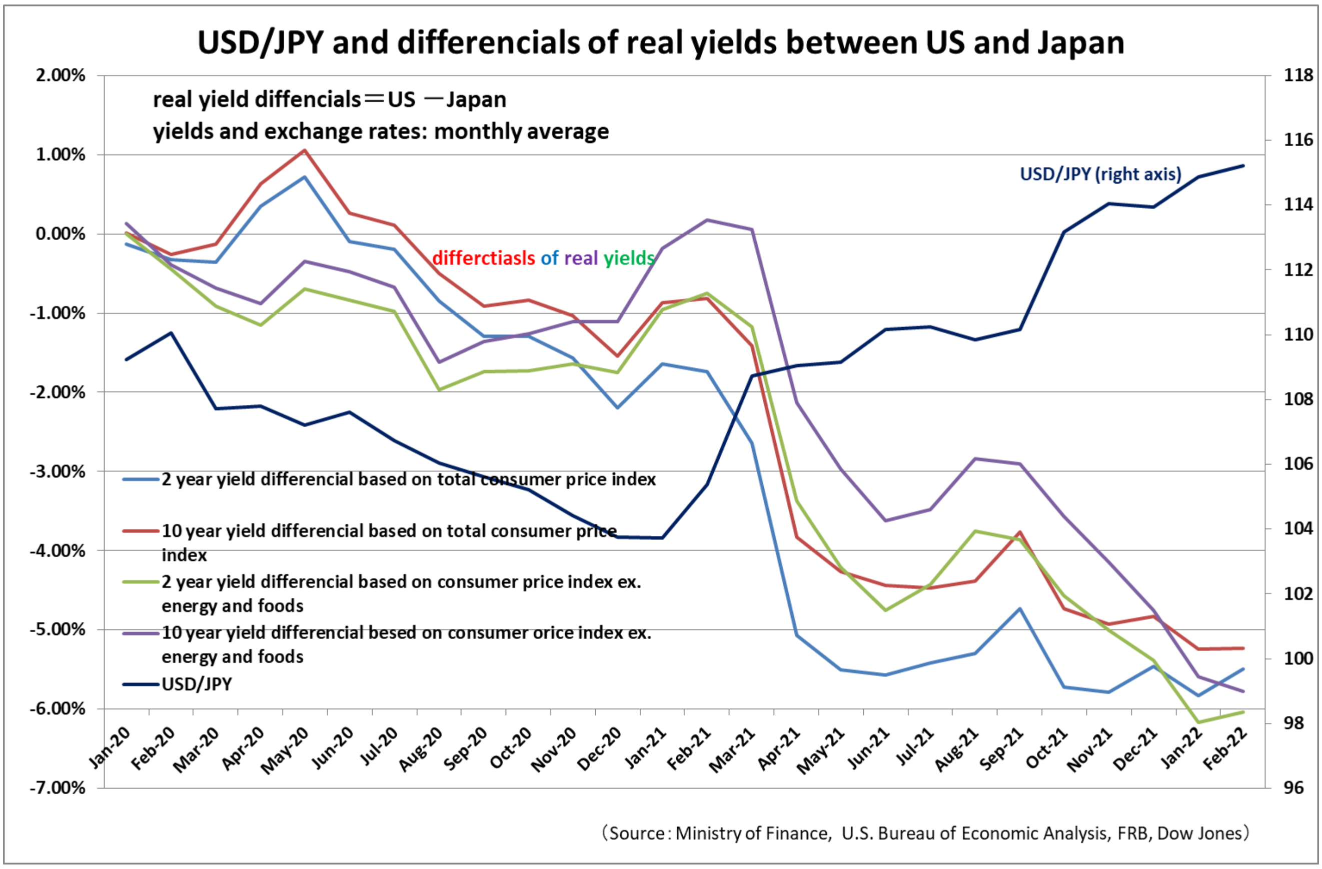
21st March 2022

With Russia's invasion of Ukraine, energy and grain prices have risen, that has led to greater inflation fears and higher global interest rates.

On the currency front, the dollar continues to strengthen, and the yen has sold off significantly against the dollar, especially in the last two weeks, entering the USD/JPY119 yen level. Since we import a lot of energy and foods, the trade deficit will widen, which is a reason for a "sell the yen" exchange rate. However, in fact, without the energy factor, the U.S. continues to have a huge trade deficit that is at an all-time high. Considering the difference in scale of trade deficits, focusing on the trade factor and actually continuing to sell the yen do not really fit economic sense. In fact, it should be seen as an effect of a temporary increase in demand for the dollar as an international settlement currency due to the sharp rise in prices of primary commodities.



Another reason is that the yen is selling off because of the interest rate differential, but the factor that is driving interest rates higher is inflationary pressure. The higher the rate of inflation, the more it causes the value of money to fall. For this reason, the real interest rate is often used as a measure of the movement of the value of money. It is defined as difference between the market interest rate reflecting the state of the economy and monetary policy and the rate of increase in consumer prices, So we see that the real interest rate differential from the U.S. minus Japan's real interest rate. The 2-year differential was -0.125% in January 2020 and -5.5% in February this year, while the 10-year differential was +0.01% in January 2020 and -5.24% in February last month. These developments do not explain logically the dollar's appreciation against the yen since 2021. Since the theoretical factors will eventually come into effect, we believe that a phase will come not far in the future when the yen's excessive depreciation will be gradually corrected from a temporary increase in dollar demand.



Chick Kawakami

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Contact:

info@yamasawa.biz

kawaat@da.mbn.or.jp