Dollar fears prompt US-Japan yen rescue operation

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The US Treasury joined with the Japanese Ministry of Finance last Friday in an operation to try to prop up the value of the yen, which had fallen to its lowest levels in 40 years despite the tens of billions of dollars spent since April to try and support it.

Like virtually everything he says, comments by US President Trump on the US intervention stood reality on its head.

Asked on Sunday why the US had stepped in—the first such combined action in 30 years—Trump said: “To support the Japanese currency. We have a good relationship with Japan. We’re very strong—very, very strong financially—and … they have a weakening yen, and they wanted a little bit of bit of help, and we’re always there for Japan.”

It was also “good for the world economy,” he said.

The image of Trump as some kind of benevolent guardian for the global economy and financial system, after he has spent his second term tearing down the institutions which maintained stability, not least with measures that have hit Japan, does not square with reality.

In fact, the intervention was undertaken because of fears of its repercussions for the US financial system. The chief concern was that continued action by Japanese authorities to support the yen, which involved the further selling of dollars, would send down the price of US Treasury bonds and push up their yields, adding to upward pressure on US interest rates.

Trump’s much touted “strength” of the US financial system is belied by the runway escalation of its debt.

At the end of 2020, US federal debt was around $27.7 trillion. In June this year it was $39.5 trillion. It has been rising at the rate of $334 million per hour, or $93,000 per second, meaning that a trillion dollars is being added every five months, with the annual interest bill standing at more than $1 trillion.

The foreign inflow of capital into the US has played a key role in financing this debt explosion, but there are increasing concerns over how long this will continue, with the US having been written down from first grade status by all three of the world’s major credit rating agencies.

Japan is now the largest foreign holder of US Treasury bonds, with a stock of $1.2 trillion. On top of this, it holds $1.2 trillion in US equities and around $300 billion in corporate bonds, bringing its total holding of US financial assets to almost $3 trillion. If large amounts of this money are pulled out it could cause turbulence in US financial markets.

A major factor in the rapid fall in the value of the yen—it has gone to as low as 164 yen to the US dollar in recent days to hit its weakest level in 40 years—is the divergence between interest rates in Japan and the rest of the world.

Japan has kept its interest rates at ultra-low levels in a bid to try to stimulate the economy. This did not cause problems for the currency while the interest rates set by other central banks were also very low. But they have been on the rise, with more increases in the pipeline because of the resurgence of inflation, while the Japanese rate has only risen to 1 percent, compared to 3.5 percent in the US.

The Japanese government has been trying to stem the fall of the yen because it boosts the prices of imports—particularly for oil, energy and food—and increases inflation. In recent months it has been threatening speculators betting on a continued fall in the yen with warnings that it will take “tough action” to halt the slide and with purchases in the market. However, these measures have had little impact.

In Friday’s joint intervention with the US, Japan is

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estimated to have spent $52.8 billion, with the US outlay calculated to be $26.3 billion. But in a sign of concerns over the value of the dollar, the US intervention was carried out using euros to make purchases of the Japanese currency.

The move had an effect, with the yen strengthening from 164 to the dollar to 155. But how long this may last is another question because such measures have a poor record in market stabilisation.

In a bid to bolster the intervention, both governments made statements that further action would be taken if necessary.

In a statement on Monday, Japan's finance minister Satsuki Katayama said: "This joint action … countered excessive volatility and disorderly movements in the Japanese yen in recent months. We will not hesitate to conduct further joint intervention."

In a move which indicated concern over the bond market, Katayama said Japan would use a facility by the Fed for short-term lending. This would allow it to borrow dollars for its foreign exchange actions, under conditions where the yield on the US 30-year bond reached its highest level since 2007 last week.

US Treasury Secretary Scott Bessent, who before action was announced had been photographed at a cabinet meeting with a note in front of him reading "To Do. Buy Japanese Yen (JPY) $5-10 bil," said on social media that the "coordinated foreign exchange actions countered disorderly yen movements" and that the Treasury would "not hesitate to participate in further joint intervention."

Katie Martin of the *Financial Times* described a release from the US Treasury announcing the move and the decision to carry it out using euros as "very weird."

"It's incredibly rare for one country to help out another like this," she wrote. Martin wondered: "Where's the volatility? The decline in the yen against the dollar has been perfectly orderly."

Her puzzlement raises the question of what both the US and Japanese authorities knew about major problems that could have erupted to the surface if the fall had continued.

Japan has been at the centre of the so-called carry trade in which investors borrow money at a lower rate in Japan and then use it to buy assets in the US. In the past, this activity has been significantly impacted by currency movements in either direction.

Early last month, as the yen slide was developing, an article in the *Asia Times* pointed to what deeper problems it may express.

For decades, it said, the global financial system had assumed that the US would pile up more debt while countries like Japan would continue to finance it, but this bargain was now beginning to crack.

The falling Japanese yen was often portrayed as a domestic Japanese concern, but the weakening yen may be the expression of a structural problem that could shake global markets, "exposing vulnerabilities not only in Tokyo but also in Washington."

"Ironically," it continued, "what begins as a currency crisis in Asia could become a debt crisis in the United States. The greatest danger is not merely a falling yen; it is the possibility that one of America's largest creditors may no longer be willing—or able—to finance America's expanding fiscal excess."

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