Yen intervention points to US financial vulnerabilities

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Commentary on the joint US-Japan intervention last week to prop up the yen has begun to reveal that the operation was more about the stability of the dollar and US financial markets than it was about problems for Japan caused by the fall in the value of its currency.

The official version of events, as expounded by US president Trump, was that the intervention was undertaken to help out a friend and ally who was having some difficulties and that the US was in a position to do because it is “very, very strong financially.”

In fact, the intervention was organised because it was feared the continuing fall in the value of the yen would set in motion processes that would rapidly reveal the fragility of the US financial system and impact on the AI stock market bubble.

The immediate issue was that the Japanese Ministry of Finance, concerned by the boost to inflation which would result from a falling yen—via the increased prices of energy and food imports—would start to sell US Treasuries to obtain the dollars to buy yen in the currency markets.

The effect of this would be to depress the price of US longer-term bonds leading to a rise in interest rates, under conditions where yields at the longer end of the market are already rising and that this would affect the AI boom which is increasingly dependent on debt to finance the trillions being spent on data centres.

In a comment piece in the *Financial Times* Barry Eichengreen, a long-time historian and analyst of the global monetary system, said there was an “important message” from the intervention, but it was more about the dollar and the state of the US Treasury bond market than Japan.

He began by casting doubt on whether the effects of the intervention, which did push up the value of the yen, would be long lasting because if “investors have no reason to think that fundamental conditions have changed, they can just sell a corresponding quantity of yen securities to push the currency back down.”

A more persistent effect required change in those fundamentals which could be achieved by a rise in the central bank interest rate currently at 1 percent, well below that of the US and other major economies. But the Bank of Japan “worried by weak consumer demand” had opted to keep its interest rate low.

Eichengreen noted that the decision of the US to take part in the intervention “contains troubling information about the dollar.”

“The message is that US Treasury secretary Scott Bessent & Co worried that selling dollar securities to prop up the yen would put additional strain on the long end of the US Treasury market.”

This concern was reflected in the decision by the US to conduct its support using euros as a way of “not asking the market to swallow additional Treasures sold to reduce dollar exposure, which would have aggravated an already delicate situation.”

There was another sign of the same concern. This was the use by Japan of a short-term lending facility provided by the Federal Reserve to obtain dollars, rather than by selling Treasuries.

Eichengreen wrote that both moves were an “indication that the dollar’s status as a reserve currency is not what it used to be” and that central banks continue to hold dollars but “not in unlimited quantities.”

The *New York Times* (NYT) journalist Joe Rennison, after giving a nod to the official reason that the intervention was to help an important ally, went on to say that the “unusual move also served to calm anxious investors around the world.”

He cited comments by Matt King, the founder of the research and financial consultancy firm Satoru Insights, who said the intervention was "one part of a big connected picture."

"The decision and the manner of the intervention ultimately say as much about US vulnerabilities as they do about Japan," he said.

One of those vulnerabilities, Rennison noted, is the money betting on the future of AI raising hundreds of billions of dollars for the building of data centres using debt.

He noted that the typical move to defend the depreciating yen would be to sell Treasuries to support it.

"Such a wave of selling could have pushed US interest rates higher, increasing corporate borrowing costs and spooking stock investors already on edge."

However, the US is anxious that the yen does not rise too much because this would hit the so-called carry trade through which investors borrow money at lower rates in Japan and then use it for investment in the US and other markets. The size of the carry trade is hard to measure but the Bank for International Settlements has estimated it be in the range of hundreds of billions of dollars or even the low trillions.

As Rennison noted: "If the yen were to keep strengthening, the cost of the carry trade would increase, eventually prompting traders to unwind bets tied to financing from the yen, putting selling pressure on US stock markets."

The issue of what happens if the carry trade ceases or is severely diminished has been of concern for some time.

George Gonclaves, a macro strategist at MUFG Securities, commented to the NYT that if you "connect all the dots, this is the quintessential global macro dilemma that we knew would happen and it's starting to bubble up to the surface."

Katie Martin of the *Financial Times* also pointed to this issue noting that the yields on Japanese bonds were already "severely elevated by historical standards" and at 2.8 percent for 10-year bonds and 4.0 percent for 30-year-bonds and had entered "nosebleed territory" for a market that had hovered close to zero for a long period.

"The situation is already at the point where global money managers are wondering when Japanese investors will stop bothering to put money to work overseas" and that the US was not in a position "to lose a big buyer of US Treasuries."

US president Trump is clearly concerned about the state of the markets and according to the *Wall Street Journal* has been regularly calling Fed chair Kevin Warsh in bursts sometimes several times in a stretch of days to discuss a range of subjects including how the Iran war and the rise of AI are affecting the economy.

In a statement on this issue, revealing the ever-increasing militarist character of the administration, White House spokesman Kush Desai said the president had his right as an American citizen and his "duty as Commander in Chief to voice his thoughts about the Fed."