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Is the Weak Yen Good or Bad for Japan's Economy?

The weak yen has a positive effect, but the effect is smaller than before.

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Summary

- The yen is depreciating against the backdrop of widening interest rate differentials between Japan and the US. The U.S. dollar-yen rate temporarily exceeded 116 yen/dollar at the beginning of January 2022, the first depreciation of the yen in five years. Under these circumstances, due in part to soaring commodity prices, some have called this a case of "bad yen depreciation," in which the negative side of the yen's depreciation outweighs the positive side. This paper summarizes how exchange rate fluctuations affect the Japanese economy and how they have changed, and then quantitatively examines the impact of the yen's depreciation against the U.S. dollar on corporate profits and employee compensation by industry.
- The "J-curve effect," in which the yen's depreciation increases export volumes and improves the trade balance, has become less apparent since the 2010s. On the other hand, even when the exchange rate changed, corporations increasingly sought to keep export prices unchanged, which made it easier for them to increase their foreign exchange gains when the yen depreciated. In addition, with the overseas expansion of Japanese corporations, the effect of improved income balance also increased. On the negative side, the worsening of terms of trade is cited, but on a macroeconomic basis, the impact of depreciation is minimal. Nevertheless, the negative impact of the depreciation of the yen is increasing amongst non-manufacturing SMEs. Furthermore, due to an increase in the weight of imported consumer goods, the purchasing power of households became prone to decline when the yen depreciated.
- Taking into account both the positive and negative impact of the yen's depreciation, we have found that it has an overall positive effect, but it is believed that this effect has shrunk compared with the past. Dividing the impact on corporate profits into direct effects and spillover effects, we find that while the amount profits boosted from direct effects is large amongst large manufacturers, profits declined amongst non-manufacturers. However, considering the spillover effects, the yen's depreciation is also expected to have a positive effect on profits in the non-manufacturing industries.

Attention

This report is a summary translation. The official document is only in Japanese.