

5 December 2022 (No. of pages:1)

Japanese report: 25 Nov 2022

Caution: Strong Yen Riskier than Weak Yen in 2023

Has the widening productivity gap between the US and Japan had a limited impact on the recent depreciation of the yen against the dollar?

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Summary

- In order to consider the future of the US dollar-yen exchange rate, the relationship between the US dollar-yen exchange rate and the interest rate differential between Japan and the US during the recent US interest rate hikes, is quantitatively summarized. As interest rate hikes approach completion, the impact and sensitivity of interest rate differentials on the US dollar-yen exchange rate tend to be smaller. The likelihood of the interest rate hike ending in 2023 is now increasing, and if this happens, the USD/JPY exchange rate will fluctuate due to impacts such as fundamentals of the economy other than interest rate differentials.
- With the Balassa-Samuelson effect as a backdrop, it has been pointed out that the yen's depreciation against the US dollar was caused by a decline in the competitiveness of Japan's manufacturing industry. However, the productivity gap between Japan and the US has remained relatively stable since the 2010s, and the impact of the recent yen depreciation on the strengthening of the dollar is considered to be limited. In light of the purchasing power parity that exchange market players often pay attention to, the yen is currently at a significant depreciation level. Especially if the United States falls into a serious economic recession, the yen's appreciation against the dollar may accelerate rapidly, partly due to the unwinding of yen carry transactions. In 2023, attention should be paid to the risk of a stronger yen than a weaker yen.
- There are calls for the Bank of Japan to raise interest rates in order to correct the depreciation of the yen. However, the price stability target of 2% is not expected to be achieved, and it is desirable to continue monetary easing for the time being. Using the macro model, we can see that if the BOJ raises interest rates to correct the depreciation of the yen, it is much more likely to have a negative impact on the economy, and it is difficult to find any economic rationality. The revision of monetary policy is largely influenced by wage developments rather than exchange rates, and for the time being, the rate of wage increases in the 2023 Spring Competition will be a point of interest.

Attention

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

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