Japanese yen Q&A

Mark Dowding talks us through Japanese inflation, trading the yen and his thoughts on yield curve control.

What do you think the inflation rate in Japan will be if the yen sinks to 100?

We saw inflation move above 2% in the April release. Over the next few months, we believe inflation will remain above this level and potentially move a little higher, partly on the back of the Japanese economy improving as it emerges from the pandemic. As such, we think that inflation will push towards 3% and that number could be exacerbated by further yen weakness.

There are many macro uncertainties at play that could interfere with our predictions, but the one thing I can express some confidence in is that inflation is set to remain comfortably above the 2% target that the Bank of Japan (BoJ) had previously established.

You've previously mentioned that you would increase your JGP selling position if the yen depreciates at 130. Have you sold down your position?

We modestly reduced our position because we thought that the speculation of change policy in June always seemed premature. We were a little bit surprised how markets were almost speculating that the BoJ was going to change policy. Into that speculation, we reduced our position, but in the last few days, we've been building it back. We are actively managing our position.

Do you believe it is possible for a central bank to maintain control over long-term interest rates, as the BoJ does?

I think the BoJ has demonstrated it managed to maintain control over long-term rates using yield curve control – so yes, it is possible. But in economics, we see that while you can control one variable, this can lead to bigger moves in other variables. If you maintain the long-dated bond, you can't necessarily control inflation or developments in the currency market. So, while it is possible to anchor yields by effectively buying all of the debt, this comes at a price.

Rising food prices have become a political issue in the UK and Europe. Do you think the same situation will occur in Japan?

I think the answer is 'not yet'. Japanese inflation remains very low by international standards – just above 2%. What we're currently seeing is more consistent with what we determine to be price stability.

I don't think that inflation, in aggregate, is going to be a particular political issue, as we'd see further weakness in the yen, and that weakness is something that starts to lead to more of an inflation acceleration. If you had a scenario in Japan where inflation was moving to 4% or 5%, then I think it would become a bigger political issue. But at the moment, I don't think that this is something that's going to be correlating with the political agenda.

Given the Swiss National Bank has raised interest rates, is this a reason to expect the BoJ to follow suit?

I think we are quite a long way away from a point where the bank will be thinking about raising rates. Ending yield curve control is something that needs to happen first, and then an ending to asset purchases probably needs to occur before you're in a situation where you can really begin a discussion around raising interest rates. I think that any such discussion is still more than 12 months away.

If the yield curve control is not completed between July and September, will you withdraw from selling JGBs?

It depends – we don't have a fixed time horizon that it has to happen in September. It could be that we get to September and yields are still where they are, inflation is moving up and we become more confident. We will continue to monitor and evolve the position.

I think the one thing that would cause us to close the position would be if we saw weakness in the Japanese economy and it looked like inflation was going back towards 0%. In that scenario, we can see that the Bank of Japan would maintain the policy. That would be a bigger catalyst for us to take the trade off.

Are investors around you interested in selling JGBs?

I think that other overseas investors have come to a similar conclusion that we have. A short position on JGBs is looking interesting because everyone can see that the BoJ is the last international central bank to change its policy. It feels to many, I think, that it's a question of when will the BoJ change, rather than if. I think that this is a position that a number of other investors will be maintaining.

However, I would argue that in many respects, it will always be the actions of domestic investors that really dominate in the market. And it'll be interesting to see if more domestic investors come to the same conclusion that many international investors have.

From an investor's point of view, how do you see the BoJ trying to control the market? Is it unnatural?

Yes, it is completely unnatural. However, for periods it has been necessary. We had a pandemic that we never thought we would live to see – it's been like living in a disaster movie! Things have happened that we could never have expected. So yes, you've seen some very unnatural things occurring. But we think that we are now returning to normality in everyday life and that monetary policy should start to return to normal as well. That's why we think that, on a forward-looking basis, we're going to see policy adjust.

So you're saying that the BoJ's policy was acceptable in times of emergency, but now that the pandemic is ending, it should start to revert to normal?

Yes exactly. It's no longer required. If inflation is above 2% and moving a little bit higher, the yen is going weaker, the economy is doing a bit better. A policy of yield curve control is no longer required.

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