21 March 2011 - Japanese FX Markets Likely to Feel Effects of G7 Intervention over Time

The Group of Seven nations agreed to intervene on behalf of the Japanese economy last week, following the yen's rise Thursday to a post-war high of Y76.25. Several sources reported that the G7 spent a total of $25 billion ($2 trillion yen). The Japanese market responded positively, jumping nearly 3 percent as the yen weakened.

But Japan's Nikkei Stock still ended the week down about 10 percent from where it was before the earthquake, tsunami and ongoing nuclear scare. The G7 said Friday that it was ready to take further action if needed. In an interview with AFP, Amarjit Sahota, CEO of Klarity FX, stressed that the G7's intention was to stabilize the yen rather than completely reverse its direction. "What they're trying to do is just put a brake underneath it; slow the pace," he said. "The goal of any central bank is to not see excessive moves in the marketplace. They can't necessarily stop a surge from going in one direction with one fell swoop; they've got to do it bit-by-bit."

Sahota noted that there would be quite a bit of yen repatriation taking place, by domestic individuals on the smaller scale, as well as large insurance companies that are selling assets back into yen to pay for the lengthy rebuild, which could take years. "If you're a large Japanese corporate or an insurance company, you're holding foreign assets; typically high-yielding assets," said Sahota. "So you're going to be invested in U.S. bonds, because although the interest rates aren't that great they're still better than in Japan. Then let's move up the ladder... you're getting into yielders such as the Australian and European bond markets, you're getting into the super-high and less liquid markets like Brazil. It makes sense, if you know you're not going to have to pay out today -you're going to have to pay out in three months -to not necessarily liquidate everything because you're still going to be losing that yield play on some of those higher-earning, interest-yielding currencies and associate asset markets."

The Bank of Japan (BOJ) injected $183 billion (Y15 trillion) into the Japanese economy in response to currency speculators that have been driving up the value of the yen, Sahota said. Now the G7 is providing support on a much smaller scale, so some of the smaller central banks (Germany, Canada) are seeing their own currencies pushed around. "We still think there will be room for the yen to remain strong," said Sahota. "I don't think we'll see the yen hit above Y90. I think it will remain in the low Y80s to the high Y70s in the next few months before we see the next phase of this, which is going to be the real flow impact of Japan flooding the marketplace. And they're already trying to get money out there as fast as they can, but it's going to take a while."

Sahota said there are lessons to be learned from the response to the Kobe Earthquake in 1995, which resulted in a massive flooding of the marketplace with cash that saw the yen devalue over time. "It's been well-reported in financial media that people expect to see the yen weaken because of this flood of money. But the first flow is used to bring money back; they're going to use that money for rebuilding. I think the yen will stay strong for a little while longer here, and then we'll start to see it weaken off. But I don't think that will be today's or tomorrow's story – it going to be one in the months ahead."

By Andrew Deichler