Opinion **Markets Insight**

The real message in the yen intervention

The dollar's status as a reserve currency is not what it used to be

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Satsuki Katayama, Japan's finance minister. Japan this week has announced a joint intervention on the yen by the US Treasury and the Japanese Finance Ministry © Kiyoshi Ota/Bloomberg

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There is an important message behind the joint intervention on the yen by the US Treasury and the Japanese Finance Ministry last week. It's just not the one the markets have been receiving.

The Japanese authorities' estimated ¥14tn ($88bn) intervention over two days is still small potatoes by the scale of the markets. It may produce a boost to the yen but it will be transitory. The Bank of Japan under the direction of the Ministry of Finance can buy yen and securities to push up the currency. But 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 requires a change in those fundamentals. Were the BoJ to commit to raising interest rates faster, which many investors would regard as desirable given that Japanese inflation may overshoot the target of 2 per cent according to the central bank, this would help to counter the weak yen. Instead, the BoJ, worried by weak consumer demand, has opted to keep benchmark interest rates at a not exactly restrictive 1 per cent.

One might argue that the forex market intervention signals the extent of Japan's concern over the exchange rate and that this concern might lead the BoJ to increase interest rates faster in the future to support the yen. This is the so-called "signalling effect" of intervention. But if the weak currency is a significant concern to BoJ governor Kazuo Ueda, surely he would say so more strongly than he has done, and match his words with deeds.

Joint intervention pulled the yen off its recent lows

¥ per $ (Scale inverted)

145

The Japanese authorities have intervened in the yen foreign exchange market before, of course, most recently just three months ago. Thus, the notable fact is that the US Treasury also participated in the intervention, its first joint operation with Japan in more than 15 years, and that it bought yen using euros, not in exchange for dollars.

Last week's intervention thus 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 was already feeling pressure following Federal Reserve chair Kevin Warsh's poorly received press conference last week.

Selling euros partly reflected what the US had to hand to divest from its currency stabilisation fund. But it is also a way of not asking the market to swallow additional Treasuries sold to reduce dollar exposure, which would have aggravated an already delicate situation.

The **dollar** is not as dominant as it once was

Share of global official foreign exchange reserves by currency (%)

Likewise there was a similar signal in Japan’s statement it would use a Federal Reserve tool called the Foreign and International Monetary Authorities Repo Facility, or Fima. This is meant to provide an alternative but limited form of liquidity rather than selling US Treasuries outright.

Both moves are an indication that the dollar’s status as a reserve currency is not what it used to be. Central banks are accustomed to holding foreign reserves in dollars because markets in US Treasury securities are liquid. Central banks hold US Treasuries because they can be freely bought and sold and used in interventions. But not now, at least not in unlimited quantities. Instead, we see the US Treasury stepping in with euro sales as part of its contribution to the intervention, thus limiting the volume of dollar sales needed by the Japanese authorities.

This intervention by the US Treasury is better than a Trumpian response of threatening the Japanese authorities with consequences — with, say, a tariff — if they are bold enough to increase their selling of dollar reserves. Bessent, in explaining why the two governments engaged in co-ordinated intervention, stressed friendly relations between the US and Japanese governments. But when intervention to support a currency is undertaken instead by a government towards which the authorities in Washington do not harbour such warm feelings, US deterrence may then take the Trumpian form.

The bottom line is that Washington, fearing the consequences for US financial markets, is reluctant to see foreign central banks use their dollar reserves. This is telling us that the dollar is not the attractive reserve currency it once was. When this message sinks in, other countries will redouble their search for more attractive, readily usable alternatives. Reserve diversification is apt to gather steam.

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