Tokyo Housewives Lead Yen Lower

By SAKAI Katsuhiko

A record 3,946,000 foreigners visited Japan in the first half of 2007, up 12.0% from a year earlier, attracted by the Japanese yen's plunge to a 20-year low in terms of the inflation-adjusted real effective exchange rate. Foreign tourists arriving at Narita airport must have been surprised to hear that Japanese housewives and working women, rather than professional currency dealers for institutional investors, were the key players who sold yen for foreign currencies to drive down the Japanese currency. These Japanese women, called "*kimono* traders," have become a great presence that Group of Seven (G-7) monetary authorities cannot ignore.

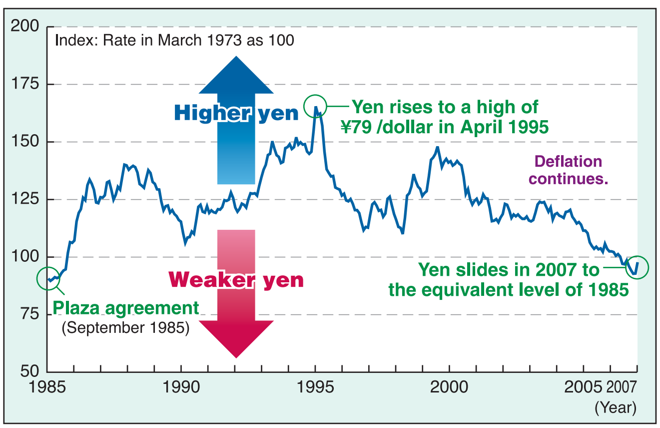
Yen Weakens on Reduced "Home Bias"

The yen got on a downtrend against the US dollar after hitting a high at the ¥101 level in late 2004. When the yen's weakness against all other major currencies grew clearer on heavy yen selling in late June this year, it sank to the ¥124 range for the first time in four years and a half. Wide gaps between Japanese and foreign interest rates have been cited as a main factor behind the heavy yen selling. In a bid to reverse deflation, the Bank of Japan kept money market rates at levels close to zero for more than five years until its termination of the zero interest rate policy in July 2006. Nevertheless, Japan's policy interest rate was at 0.5% as of February this year, far lower than 5.25% in the United States and 3.75% in the euro area. The wide interest rate gaps prompted investors to raise yen funds at lower costs in Tokyo financial markets and sell these funds for higher-interest currencies such as the Australian dollar and the New Zealand dollar as well as the US dollar and the euro for investment in foreign stocks and bonds to get short-term returns. Such speculative transactions, known as "yen carry trade," have been reported as a key factor behind the yen's weakness.

But many economists attribute the yen's weakness over the past years to structural currency market changes, including Japanese individual investors' growing presence. Their money has become a silent majority on these markets, exerting greater influence on foreign exchange rates.

"Recent gaps between Japanese and US government bond yields are almost the same as 30-year trend levels," says Takenaka Masaharu, chief economist and director of the Economic Research Department at the Institute for International Monetary Affairs. "This means it is logical to conclude the change that triggered the yen's decline has occurred on the part of investors rather than on the interest rate gap side." Takenaka has paid attention to a fast increase in Japanese individual investors' purchases of foreign currency investment trust funds. "Individual investors' outstanding investment in publicly offered foreign currency investment trust funds, which stood at ¥8.5 trillion in January 2004, nearly quadrupled in three years and a half to ¥32.2 trillion in April 2007." Japanese individual investors' foreign currency financial assets, including their time foreign currency deposits and foreign securities holdings as well, might have swelled close to Japanese insurance companies' outstanding investment in foreign securities.

Chart 1 Trends of yen's real effective exchange rate
(1985 – 2007)



Source : Compiled from Bank of Japan data on JEF's responsibility

Investors in any country have a "home bias" in which they refrain from investing in financial assets in unfamiliar countries and concentrate investment in their own country. But Japanese individual investors' home bias began to decline conspicuously around 2004, Takenaka says. They have become familiar with global investment through growing Internet transactions. Everyone now has easy access to overseas investment and market information through the Internet. Individual investors, dissatisfied with ultra-low interest rates and investment returns even amid economic recovery in Japan, have naturally turned their eyes to higher-rate foreign currencies. Adding fuel to foreign currency investment have been growing needs for investment of retirement allowances for baby-boomers who have just begun to retire. Massive yen funds have thus been exchanged for foreign currencies, exerting pressures on the yen to decline against other currencies on foreign exchange markets.

Overheating Foreign Currency Investment Boom

On August 24, the Tokyo District Court sentenced a 60-year-old Tokyo housewife to 18 months in prison with a three-year suspension and ¥34 million in fine for dodging tax on some ¥400 million she earned on foreign exchange margin trading. Forex margin trading allows an investor to take advantage of a small deposit to make a forex deal that is worth 10 to hundreds of times as much as the deposit. It is a high-risk, high-return financial instrument. The spread of Internet trading and cuts in trading commissions have fast made forex margin trading popular among Japanese individual investors, including housewives and salaried workers. The convicted housewife was a nonprofessional trader who earned unexpectedly high returns on forex margin trading.

The number of Japanese individual investors' forex margin accounts doubled in a year to 644,802 at the end of March 2007 and is expected to exceed one million by March 2008, according to the Yano Research Institute. On the Tokyo Financial Exchange, forex margin trading volume for individuals in July nearly quintupled from a year earlier to 4.31 million contracts, far more than 2.89 million contracts for three-month Euroyen futures contracts for banks and securities companies. Forex margin trading volume exceeded three-month Euroyen futures turnover for the first time ever, indicating that individual investors replaced professional traders as dominant players on the exchange that had long been controlled by professionals. The number of companies managing forex margin accounts for individual investors has also been increasing. "In three or four years," an industry player says, "the number of forex margin accounts for individual investors may exceed five million."

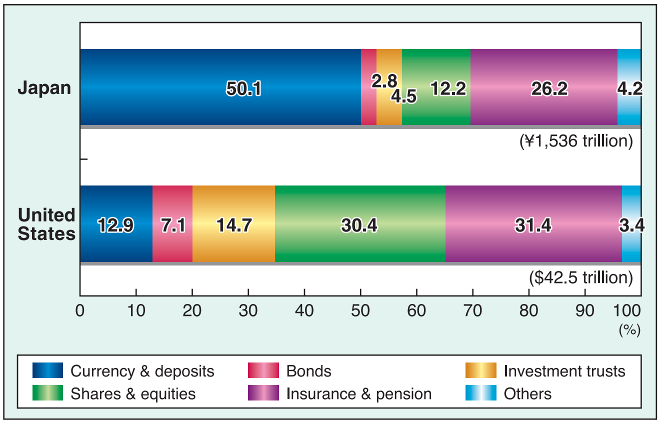
Koike Shoichiro, representative of Canonbury Group's Tokyo Office, holds regular asset investment seminars for individual investors. The group is a London-based advisory service provider for investors. "A rising number of participants pose questions, leading me to feel their growing interest in forex margin trading," says Koike, who is a qualified financial planner. "Some people conduct day trades at 5 to 10 times leverage as if they play games. Others have paid attention to cheap trading commissions and utilized forex margin trading as an alternative to investment in foreign currency deposits."

Trading Against Trends Working to Stabilize Markets

In his speech in Washington on July 2, Bank of Japan Policy Board member Nishimura Kiyohiko officially admitted that *kimono* traders have become influential players in currency markets. "The advent of Japanese households as major investors seems to have affected foreign exchange markets. Years ago, it was the gnomes of Zurich who shook the foreign exchange markets. They have now been replaced by the housewives of Tokyo, who speculate in various currencies." The gnomes of Zurich mean Switzerland-based speculators. Forex market experts say individuals' yen selling outdoes large-lot buying by institutional investors frequently. Forex dealers at banks and life insurance companies have tended to refrain from leading currency rates to deviate from ranges that monetary authorities view as desirable. Some of them are concerned that such tacit communication between authorities and market players may fail to work in future.

But Japanese monetary authorities have seemingly taken individual investors' massive overseas investment as sound and desirable, discriminating such investment from yen carry trade and other speculative deals. "Whereas the gnomes of Zurich were accused of destabilizing markets, Tokyo housewives are apparently acting to stabilize them," Nishimura said in the speech. He thus appreciated Japanese individual investors' trading against the trend as contributing to reducing market volatility. Koike says: "European and American investors follow the trend in a manner to chase their prey, representing the Western hunting people. Contrarian investors who sell on rally and buy on dip represent agricultural people. Even investment behavior reflects racial differences."

Chart 2 Financial assets held by households in the United States and Japan (End of March 2007)



Source : *Compiled from "Flow of Funds (1st Quarter of 2007)-Japan and US Overview," Research and Statistics Department, Bank of Japan (June 15, 2007) on JEF's responsibility*

Japanese household financial assets of more than ¥1,500 trillion have been shifting "from savings to investment" steadily, albeit slowly. The BOJ's flow of funds account statistics indicate currency and deposits captured 50.1% of financial assets held by households at the end of March 2007, down from 53.1% seven years ago. Investment, which covers bonds, investment trusts, shares and equities, expanded its share of household financial assets from 15.8% to 19.5% in the seven years. Such a change may accelerate in future. The yen's weakness has seemingly come to a lull on a financial market turmoil triggered by the US subprime mortgage debacle in August. Many Japanese investors involved in forex margin trading have reportedly incurred heavy losses on fast forex rate changes amid the turmoil. But gaps between Japanese and foreign interest rates may take much more time to narrow. Tokyo housewives are expected to remain influential as obsessive sellers of the yen on currency markets. JS

Sakai Katsuhiko is a senior staff writer and deputy editor at the Economic News Division, Jiji Press Ltd.