

# Toward One Hundred Yen to the Dollar

By Sakamoto Sakae

In September, the value of the yen, which reached ¥79 to the dollar in mid-April, dropped to ¥100. Meanwhile, the Tokyo Stock Exchange average, which at one point had fallen to ¥14,000, recovered the ¥18,000 mark at the end of August. As many economists point out, a strong yen and a faltering stock market were the primary factors behind the renewed slump of the Japanese economy starting in 1995, which bottomed out in autumn 1993. Welcoming the fact that two of the major causes of the economic slowdown were moving towards resolution, Bank of Japan Governor Matsushita Yasuo noted at an August press conference that "there will be a positive effect on the economy. It looks like the downturn of the business climate (for corporate managers) may be checked."

Now that the yen has lost about 20% against the dollar and is at a level comparable to January of this year, many monetary specialists are predicting that the yen's value will return to the ¥100-¥105-to-the-dollar range. In other words, their view is that the strong yen crisis which had put a wrench in the recovery of the Japanese economy, is now over. Of course, the imbalance of overseas income and expenditures underlying the strong yen remains. But the U.S. administration, which before had seemed to welcome the strong yen and weak dollar, has clearly revised its foreign exchange policy to favor a rectification of the overly strong yen, and the exchange markets have finally "recognized" this reversal.

In the correction phase of the overvalued yen at the end of July, standing consultant at the Bank of Tokyo, Honda Keikichi, who had dubbed the mighty yen of the previous six months the "bubble yen," said that the strong yen was "a product of the high atmospheric pressure over the Pacific (the Clinton administration's welcoming of the strong yen and weak dollar) and low pressure over the Japan Sea (Japan's

lengthening economic slowdown). A reduction in this difference will bring an end to the strong yen. This century will not see a stronger yen than the ¥79.75-to-the-dollar record set on April 19. From here on in, the strong yen will resolve itself."

Since then, the yen market has developed just as Honda predicted. The high pressure over the Pacific has been alleviated with the market's recognition of the change in U.S. monetary policy.

## Will one dollar mean ¥105?

The current question, then, is not whether the yen will depreciate, but how far the depreciation will continue. According to Honda's estimates of purchasing power parity (a theoretical value using the 1973 average of ¥272 to the dollar as a benchmark that is calculated by considering changes in prices in the U.S. and Japan in succeeding years), the exchange rate as calculated based on changes in consumer prices in both countries is ¥190 to ¥195 per dollar; calculated based on change in wholesale prices in both countries it is about ¥155 to the dollar; and as calculated by export prices is about ¥100 to ¥105.

From 1986 to 1993 the actual market price of the yen stayed close to the rate as calculated by export prices. But since the advent of the Clinton administration, the actual market price has soared far above that rate. According to Honda, it became planted in the exchange market's mind that the "Clinton administration was committed to supporting a strong yen and weak dollar as a means of correcting the trade imbalance and promoting U.S. exports. "The 'bubble yen,'" he says, "was caused by this 'imprinting.'"

However, as Honda explains, once the market adjusted to the changes of U.S. monetary policy towards the exchange rate, the bubble would burst and the actual market would self-correct to the

level of export price-based purchasing power parity (¥100-¥105). Sakura Bank's overseas affiliated company in the U.K., Sakura Finance International, also predicted in its mid-August report that the yen will return to 100-to-the-dollar.

According to the report, in the regular bidding for U.S. government bonds held by the U.S. Department of the Treasury in mid-August, Japanese bids accounted for only 7% of the total, disappointing a market that had expected a much larger share. It was unrealistic, however, to expect that Japanese Finance Ministry measures for the easing of regulations on foreign investment and lending would immediately come to the aid of the U.S. bond market. Those measures, however, will have a much more important mid- to long-term effect on the market. The incentive effect of these measures on the outflow of funds will push the dollar to ¥100 within one year.

## The importance of the G7 agreement

In its quarterly report on the Japanese economy (summer 1995), the Bank of Japan sketched the yen-dollar market situation in February-August as follows:

The strong yen/weak dollar trend that began in February accelerated through March, peaking in the Tokyo market at a new postwar high of ¥79.75 on April 19. The ensuing fear of a strong yen brought the dollar's value back up to ¥87, but in late May the yen strengthened again to ¥82. Meanwhile, at the end of May, monetary authorities of the principal industrial countries cooperatively intervened in the market, maintaining the dollar's value at ¥84 to ¥85.

In late April, finance ministers and central bank governors from the U.S., Japan and European countries met in Washington for the seven-country G7 meetings, where they reached an important agreement on correcting the strong yen. According to their statements, the



Photo: Kyodo News Service

BOJ Governor Matsushita Yasuo and Finance Minister Takemura Masayoshi attending the G7 conference in Washington in late April.

ministers and governors expressed concern over recent trends in the exchange market. They agreed that the recent movement exceeds justifiable levels for the basic economic situation of the major nations. They agreed that it is desirable to reverse these trends in some orderly fashion to provide a better base for the continued expansion of international trade and investment and contribution to their common goal of continued, non-inflationary growth.

The market, however, was oblivious to the intent of the statement. This was because, as Honda points out, the "imprinting" that the U.S. administration wants a strong yen and a weak dollar was still strong. Only time would change the market trends. As the Bank of Japan material assessment of the situation records, the coordinated intervention on the part of the U.S., Japan and European countries in late May was only the first in what would be several waves of intervention.

## Treasury Department & Japan make waves

The second wave came in early July

as a combination of a concerted cut in interest rates in Japan and the U.S. and the two countries' coordinated market intervention. First, the U.S. Federal Reserve Board lowered the target federal funds rate, the benchmark for short-term rates, by 0.25 percentage point on July 6. The Bank of Japan followed on July 7 with the announcement of a policy of guiding short-term rates lower (to levels around 0.2 point lower than the official discount rate at that time of 1.0%). Thus the Japanese and U.S. monetary authorities slashed interest rates and at the same time widened the interest gap between the two countries. This alone had a great impact on the market, but the two countries also intervened in the New York exchange market on the evening of July 7 Japan time, massively buying dollars and selling yen.

Since then, intervention has become a way of life. The third wave, as touched on in a Sakura Finance International report, was another coordinated intervention that coincided with the August 2 announcement of measures to ease regulations for foreign investment and finances. The gist of the document was

twofold: the promotion of foreign investment through institutional investors, such as insurance companies, and foreign financial cooperation by public corporations such as the Export/Import Bank of Japan. The International Finance Bureau of the Finance Ministry explains its reasons for announcing these measures: "The continuing strong yen, which is not justified by basic economic conditions and persists despite a gradual reduction of Japan's current account surplus, is rooted in insufficient recovery of foreign investment. To correct the strong yen further, we believe it is paramount to promote foreign investment."

Monetary authorities went on taking measures to correct the strong yen, as instanced by concerted market interven-

tion by Japan, the U.S. and Germany, and the Japanese central bank's cut in the official discount rate to a record low of 0.5%.

Looking back from the vantage point of late September, we see that there has been coordinated action at one-month intervals: the G7 statement at the end of April, the coordinated market intervention at the end of May, the joint lowering of interest rates and market intervention in early July, and the promotion of foreign investment and a further intervention in early August. The one-month intervals were probably timed to "convince" the market of the seriousness of the intentions. So why did the U.S. decide it was no longer interested in a strong yen and a weak dollar? As one economist explains, "They must have judged that making the Japanese economy any worse off than it is would have repercussions for economies and financial markets of the world including the U.S."

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