Steady interventions by central bank keep speculators at bay

The Japanese government is defying the logic of the foreign exchange market by keeping the yen from rising sharply in value against the dollar.

The dollar has had a lot going against it this year, including doubts about the strength of the U.S. economic recovery, the lowest interest rates in 45 years and the war in Iraq and its aftermath. But while these concerns helped the euro and some other major currencies much higher against the dollar, the yen has not even left the launching pad.

By selling trillions of yen in the foreign exchange market, Japan has limited the yen's rise against the dollar this year to 2.3 percent at its peak, while the euro jumped as much as 13.5 percent.

Japan's success in keeping the yen from going significantly higher against the dollar and other currencies is helping the country's economy rebound by keeping its exports more competitive abroad. At the same time, however, it is a drag on U.S. economic growth and is making it harder for the United States to reduce its current-account deficit, which now exceeds $500 billion.

Japan is one of the world's major industrial economies, but the government's effort to manage the value of its currency is more reminiscent of a developing economy like China - whose currency is pegged to the dollar.

"The yen is a one-sided floating currency," said David Gilmore, a partner at Foreign Exchange Analytics. "It can only float lower."

C. Fred Bergsten, director of the Institute for International Economics in Washington, said a former top Japanese finance official had told him that without the government's intervention, the exchange rate would be around ¥105 to the dollar, which would make the yen around 12 percent stronger against the dollar than the current rate, which was at ¥117.895 to the dollar in Wednesday trading.

What makes Japan's success all the more surprising, according to foreign exchange traders and analysts, is that speculators and others in the currency market usually make it impossible for governments to manage a free-floating currency over an extended period unless the floating of the currency is backed up with changes in economic policy.

The British were defeated by speculators in such an effort in 1992, in which the hedge fund operator George Soros was said to have made $1 billion in profit. The Asian financial crisis of 1997-98 was aggravated by speculators who bet that countries like Thailand would no longer be able to manage the value of their currencies.

In addition, a recent surge in the Japanese stock market, where the Nikkei 225 index is up 36 percent since the end of April, is attracting foreign investors, whose purchases of yen should strengthen the currency.

But Japan has succeeded by being aggressive, intervening in the market on 34 days this year through the end of June, the latest daily data available, and spending almost ¥9 trillion to buy about $75 billion, effectively stalling the rise of the yen and the fall of the dollar. A further ¥179 billion was used to buy euros.

This persistent intervention, only ¥1.4 trillion smaller in value than Japan's ¥10.4 trillion of market interventions over the previous three years, has basically scared off the hedge funds and other speculators who would be betting now on a rise in the yen and a fall in the dollar, just as they have bet this year on a rise in the euro.

"It has caught people off guard, and people are just staying away," a top foreign exchange executive said about speculating on the yen. Officials in the Japanese Ministry of Finance, he added, "have sent deliberate messages to us to tell our hedge fund clients and proprietary trading desks not to speculate on the yen."

Japan's success is also based on the acquiescence of President George W. Bush's administration, which has not complained publicly about the negative effect of an undervalued yen on U.S. manufacturers. If the yen strengthened, that would make Japanese exports more expensive in the United States and therefore
less competitive.

Rick Wagoner, chairman of General Motors, has not been reticent, however. In a speech in May, he referred to the difficulty of competing with Japanese companies “due to active intervention to keep the Japanese yen weak versus the U.S. dollar.”

In an effort to assuage U.S. governors and manufacturers who say that Chinese imports are undermining American business and costing jobs, the Bush administration is pressuring China to let its currency rise against the dollar. Because it is now pegged to the dollar, the yuan moves with the dollar and keeps its competitive advantage. A stronger yuan would cut into that advantage.

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