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Skepticism about the Strong Yen Theory

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Trend or transient?

The rapid appreciation of the yen is progressing. The dollar yen rate, which had been trading in a range of between 108 yen and 114 yen last year, has surged 5% from 110 yen to 105 yen at a stretch in response to the global risk-off mood triggered by the sudden crash in US shares at the beginning of February. It has become a matter of concern whether this yen appreciation represents a long-term trend or whether it is merely transient.

Dollar cycle may still be in a bull phase

The greatest reason for the strong yen theory is that the wave of long-term dollar circulation has already entered the dollar depreciation phase. Looking back on the dollar cycle marked out over more than 40 years, the dollar has been strong for seven years, then weak for ten years. If this pattern is applied, then the dollar strength that began in 2011 simply cyclically shifted to dollar weakness in 2017. However, the main factor that dominated the long-term cycle of the dollar was the economic conditions and the policy priorities in the US. The firmness in the US domestic economy due to the priority placed on suppressing inflation, issuing warnings of a bubble, and the promotion of global investment, all correspondingly led to monetary tightening and drove the dollar higher (1978-1985, 1995-2001, and after 2011). Conversely, when the domestic economy was in a slump, priority was placed on economic leverage, deflation avoidance, the strengthening of export competitiveness, with monetary easing and measures to oppose dollar appreciation being implemented (1973-1978, 1985-1995, 2001-2011). So, what is the current economic situation in the US and what are its policy priorities? It is clear that the US economy is now in a solid phase, that the risk of inflation is higher than that of deflation, and an ever-stronger emphasis is increasingly being placed on asset bubble warnings. In other words, this means that the strong dollar makes sense. The starting point of the dollar's rise this time may also be important. Between 2011 and 2014, the dollar's appreciation was merely equivalent to the dollar creeping along the bottom, and the dollar was stagnant at its historic low-price level during the period of the US's super monetary easing (QE). The rise in the dollar started in earnest in the latter half of 2014 when QE3 was over and the Fed's balance sheet expansion had ceased. It's fair to say that it has still only been over three years since the beginning of the *de facto* appreciation in the dollar, and so the theory that holds that we have already entered the long-term dollar depreciation phase cannot be said to be convincing.

Why Mr.Mnuchin prefers a weak dollar?

Rather, it seems more likely that market participants are paying attention to the fact that the US government is exacerbating trade friction and focusing on depreciation in the dollar. Treasury Secretary Mnuchin surprised the market by saying at the Davos Conference that the weakening in the dollar was desirable. As a result, the United States raced into protectionism as if it were taking the lead in a competitive currency devaluation. But is it so? The United States now imports 80 to 90% of its necessary supplies of materials. There is almost no supply capacity in the US for most of these goods. In other words, the United States is engaged in very little if any price competition with other countries. Therefore, it cannot be that currency devaluation will improve the trade balance. In the Reagan era in the 1980s, the United States produced about 60% of its necessary supplies of materials domestically, and so the role of the dollar depreciation policy in supporting domestic producers had some significance, but now the circumstances are completely different. (Although it is only trying to weakness in its currency against China (= curbing downward devaluation in the RMB), it is still the case that maintaining a strong RMB is the key in the trade friction between China and the US).

Weak dollar is only good for the repatriation tax cut

So, is not the reason that Mr. Mnuchin said that he welcomes the weakness in dollar perhaps the fact that there is a repatriation tax cut? Thanks to this tax reform, the tax rate on domestic remittances of overseas retained earnings of US companies already accumulated (estimated at about 300 trillion yen) has been lowered from 35% to 15.5%. As a result, demand for huge remittances to the United States and also demand for dollars is expected to be boosted, but at the moment it seems to have been held in check so that it would not result in excessive dollar appreciation. If the dollar rises in response to the transfer of overseas retained earnings to the United States, the US parent companies' converted dollar receipts will be depreciated, and so the US tax revenue will be reduced. It is therefore conceivable that the policy can be viewed as being a way of avoiding this outcome.

Stronger dollar is the interest of the U.S. as Mr Trump said

Leaving this point to one side, the dollar's rise is desirable for the US in almost all respects. On the day after Mr. Mnuchin's comment on the dollar's depreciation, President Trump came up with the view that 'the strength of the dollar is appropriate for the strong US economy, and a strong dollar is in the national interest of the US' (Mr. Trump's view on the exchange rate has evolved greatly in one year !!). It looks likely that this represents the true nature of the US government's attitude to the issue.

Fundamentals support strong dollar

In analyzing the economic fundamentals, almost everything is a high dollar factor. 1) The tightening of monetary policy and adoption of a fiscal expansion policy are both classically typical high currency factors, 2) in terms of interest rate and business confidence among developed countries, the US is the strongest, and so this is consistent with the dollar increase, 3) The strengthening of the global profitability of US companies tends to improve the current account balance , and 4) The nation that is most prone to monetary tightening among industrialized countries is the United States, etc.

Strong yen may be transient

As reported in Strategy Bulletin 194 on February 7, the crash in stocks in February is not due to the economic fundamentals but seems to be transient in that the causes lie in internal market factors such as supply and demand and technical considerations. Moreover, given that the sudden depreciation in the dollar against the yen also occurred at the same time as the global sell-off in stocks, it seems fair to say that the movement looks transient in our view.