

Credit Suisse Economics

Japan Economic Adviser: Are the US rate hikes in the pipeline responsible for weakening of the JPY?

- The JPY has depreciated sharply since 11 March, having declined below 120 against the USD on 22 March (Figure 1). Remaining dovishness of the BoJ in contrast with the Fed, which has leaned toward a more hawkish bias, seems the main driver for the recent depreciation.
- Still, the weakening of the JPY, as represented by the fact that the real effective JPY now stands at a lowest level since 1972 (Figure 2), can be hardly explained by the ongoing widening of interest rate differentials between Japan and the US. Simply, we believe that structural forces are primarily responsible for the weakening JPY, and any monetary policy efforts to reduce JPY liquidity by the BoJ would not be so successful in reversing the trend.
- In our [Japan Economic Analysis No. 99](#), we estimated the structural trade balance, which excluded contributions from demand cycle factors, and found that structural deterioration in the terms of trade and fading benefits from globalization had resulted in a large trade deficit in structural terms.

CONTRIBUTORS

Hiromichi Shirakawa

81 3 4550 7117

hiromichi.shirakawa@credit-suisse.com

Takashi Shiono

81 3 4550 7189

takashi.shiono@credit-suisse.com

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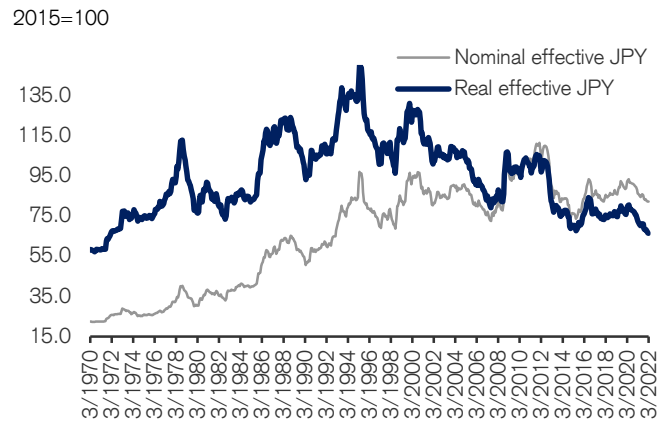
A weaker JPY appears to reflect a deteriorating trade position of the country

In our [Japan Economic Analysis No. 99](#), we estimated the structural trade balance, which excluded contributions from demand cycle factors, and found that structural deterioration in the terms of trade (Figure 3) and fading benefits from globalization had resulted in a large trade deficit in structural terms.

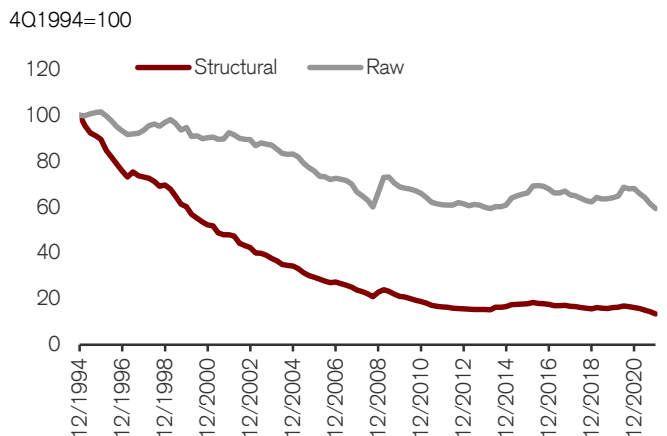
- Persistent reluctance to hike wages by Japanese firms may suggest a lack of pricing power among Japanese manufacturers. The key background seems that competitive pricing or discounting has long been the main tool for exporters to maintain global market shares, as they have lagged in upgrading their product values by innovation.
- According to results of our empirical analysis, price elasticity of Japanese major export products has increased, while that of Japanese imports declined, suggesting the decreasing pricing power of the country's manufacturers on both export and import sides.
- In other words, growth in Japanese export volume appears to have become increasingly reliant on price cuts, whereas import volume remains elevated even as prices continue to rise in line with global inflation. The net upshot has been "structural" downward pressures on Japan's trade balance through this supply-side channel (Figure 4).
- Japan might soon reach a point where discount-driven export drives are no longer capable of compensating for the domestic economy's secular stagnation. There would be limits to the extent to which manufacturers lower export prices in the face of growing domestic worker shortages. Important as well, the recent deterioration of "structural" real trade balance seems to imply that global supply-chain disruptions have started to function as a headwind.
- Given the lack of pricing power, it seems difficult to envisage a scenario in which the terms of trade actually start to recover due to improving capability of manufacturers to raise their export prices. A likely outcome would be a structural decline in the export volume and secular deterioration in the trade balance, unless Japanese manufactured products enjoy a major upshift in values added through innovation.

Figure 1: Nominal USDJPY

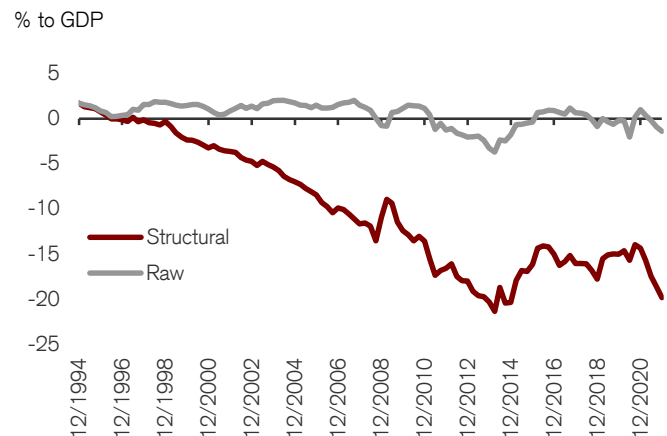
Source: Credit Suisse, Bloomberg

Figure 2: Effective exchange rates

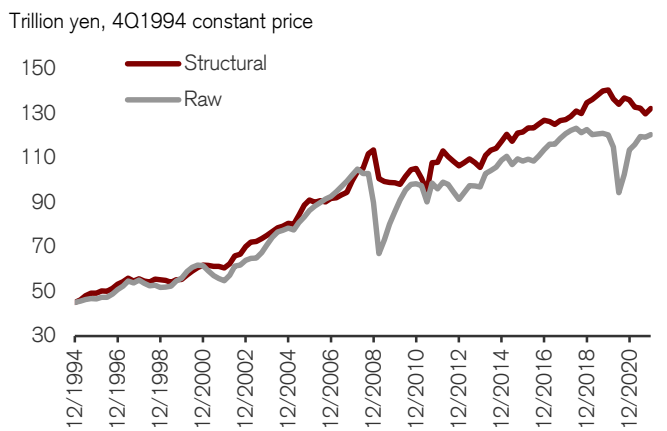
Source: Credit Suisse, BoJ

Figure 3: Structural terms of trade

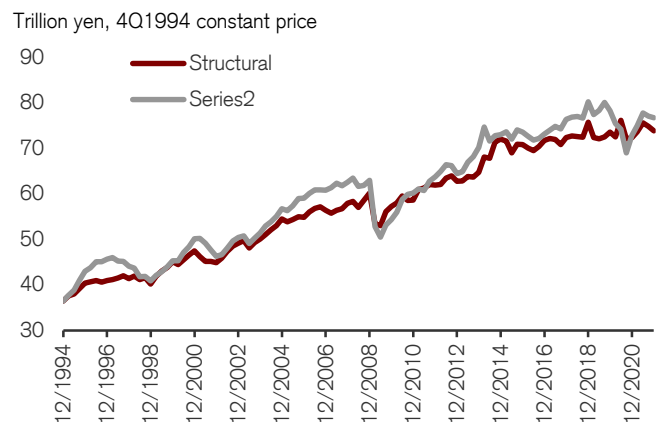
Source: Credit Suisse, Cabinet Office

Figure 4: Structural trade balance

Source: Credit Suisse, Cabinet Office

Figure 5: Structural real exports

Source: Credit Suisse, Cabinet Office

Figure 6: Structural real imports

Source: Credit Suisse, Cabinet Office

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