Mizuho Chart Speak: JPY

Economics & Strategy | Asia ex-Japan

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Post JPY Intervention (Part 2): Unintended Consequences

"Be careful not to choke on your ambitions." – **Darth Vader, Star Wars**

Figure 1: JGB Risk/Term Premium Rise with BoJ Hikes

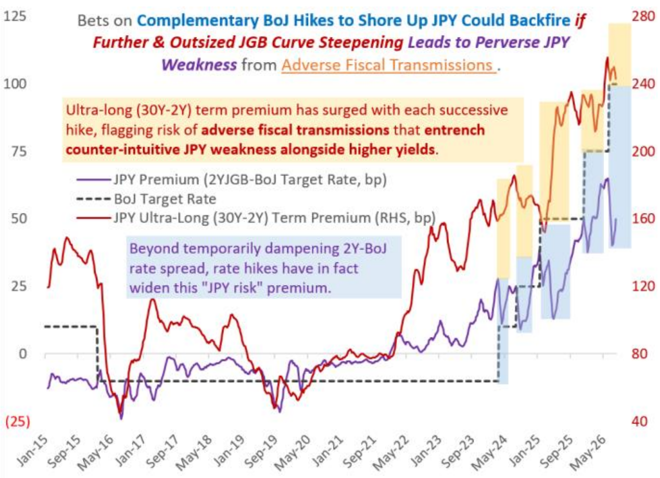

Figure 2: Inextricably Linked Fiscal-JPY Loop

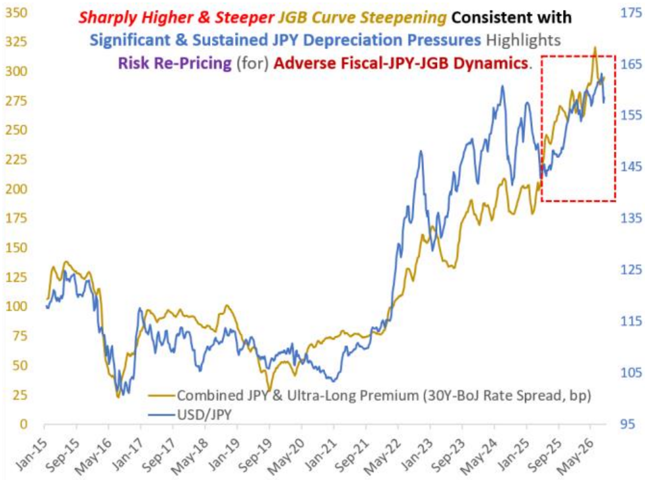

Figure 3: Negative JPY-Nikkei Correlation

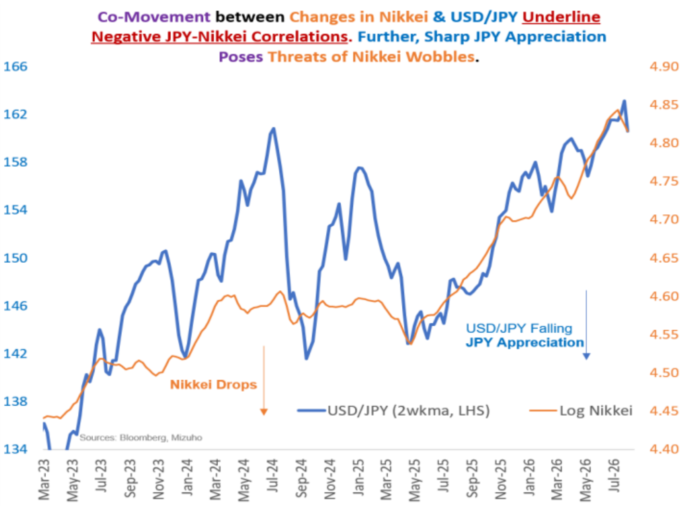

Figure 4: *Short-run* Dynamics of JPY Driving Nikkei

Summary: Granger Causality Results

Direction	F-statistic	P-value	α=0.05	Result
Log Nikkei → USD/JPY	3.0001	0.0505	3.0108	Not Significant
USD/JPY → Log Nikkei	4.0256	0.0183	3.0108	Significant

Interpretation

1. Log Nikkei → USD/JPY: p = 0.0505 (marginally insignificant at α = 0.05)
   - Past Nikkei values do NOT significantly help predict future USD/JPY movements
   - However, p-value is very close to the threshold — borderline case

2. USD/JPY → Log Nikkei: p = 0.0183 (significant at α = 0.05)
   - Past USD/JPY values DO significantly help predict future Nikkei movements
   - Suggests currency movements "lead" stock market changes

Economic Implication:
The Granger causality runs primarily from USD/JPY to Nikkei. Yen movements appear to lead stock market changes, consistent with the view that currency depreciation (weaker yen) boosts export-oriented Japanese equities.

Methodology Notes:
- Granger causality tests whether lagged values of X improve prediction of Y
- Uses 2 lags (weekly data) based on standard practice for financial time series
- F-test compares restricted (AR only) vs unrestricted (AR + lagged X) models
- Sample: 604 observations (Jan 2015 - Aug 2026, adjusted for lags)
- "Granger causes" = predictive causality, not necessarily structural causality

In a Nutshell:

- Greater Threat from JPY Intervention Policy Backfire: While intervention may temporarily stabilize JPY markets, **aggressively engineering sustained and sharp JPY appreciation may backfire –** *amplifying rather than alleviating JPY and JGB sell-off, amid adverse fiscal-JGB-JPY feedback loop.*
- A Significant Macro Risks from Rates-Fiscal Feedback Loop: Especially as ***intended stabilization from* BoJ tightening perversely amplify fiscal sustainability concerns**, *triggering sharp rise in JGB risk premiums/yields*, and *ultimately weakening JPY* (on debasement risks).

- Sharp JPY Appreciation may Undermine Nikkei/Risk Sentiments: Moreover, **strong negative correlation between JPY and Nikkei** warns of *sharp intervention-driven JPY surge potentially hurting Japan's asset market stability* via exporter earnings dent and valuations.
- Intervention Buys Time, Not Fundamental Stability: *JPY intervention is best suited for damping excessive volatility*. Whereas **durably constructive JPY-JGB dynamics** require some combination of a *dovish Fed, improved Japanese fiscal credibility,* and *diminished geo-economic risks*.

- **JPY intervention** is obviously **not costless**, often involving *FX reserve depletion* and *sharp policy trade-offs.*
- ***But*** the ***greater danger is*** **not that JPY intervention is merely costly**, ***rather that it backfires***.
  1. **Rates-Fiscal Channel**: *Either* due to sharply higher long-end JGB yields, with *adverse fiscal-JGB-JPY spiral* being triggered.
  2. **Equities-Risk Channel**: *Or* from negative Nikkei-JPY correlation overwhelming to *perversely compromise* the very *JPY asset market stability* that intervention seeks to instill.
- To be sure, **measured JPY intervention thus far effectively mitigate** the **threat of adverse**, **unintended consequences** – *which typically tend to result from JPY/rates shocks of a much larger order*.
- Nonetheless, **limited success in subduing *persistent upside volatility in long-end yields*** flags the **"live" risks of further coordinated US-Japan JPY intervention**.
- The resultant *potential for outsized impact* from which flags the **dangers of inadvertently accentuating**, *rather than alleviating,* **embedded fragilities/vulnerabilities**.

1. Rates-Fiscal Channel
   - Crucially, **as JPY depreciation may persist *not despite,* but because of, surging JGB yields** amid **severe credibility deficit** – *whereby fiscal, inflation and currency risks feed off, and amplify, one another.*
   - Hence, **efforts to complement intervention with** more BoJ hikes sooner may perversely magnify *rather than mitigate* adverse fiscal-JPY-JGB pressures.
   - Especially if **JGB risk/term premium continue to push sharply higher from further hikes** [Figure 1].
   - Consequently, exacerbating acute worries of ***mounting fiscal strains,*** which in turn are ***inextricably linked to (JPY) debasement risks***.
   - Which **inevitably** *overwhelm (Mundell-Fleming) dynamics of JPY appreciation from higher JGB yields …*
   - … instead, **entrenching rising JGB yields** *(driven by risk/term premiums)* **alongside weaker JPY** via adverse fiscal-JPY-JGB feedback loop. [Figure 2].

2. Equities-Risk Channel
   - What's more, ***well-established*** **negative correlation between JPY and Nikkei** [Figure 3] *warns of adverse equities impact from sudden JPY strength.*
   - Notably, ***worst-case scenario of*** a ***sudden and sharp*** **JPY strength** [Figure 4*] **threatens to dislodge bullish momentum in Japanese equities**.
   - Specifically, if significant and sustained JPY strength from intervention results in a conspiracy of *negative exporter earnings shock* and *valuation effects**.*

- And the risk is that ***wider market confidence undermined may be to the ultimate detriment of the JPY***.
- **Inadvertent squeeze/unwind in JPY-funded carry trades** could **further dampen global market sentiments**, ***potentially cycling back to hurt JPY***.
- Especially, ***as JPY's "safe haven" status appears to be fundamentally undermined*** by Japan's vulnerabilities amid geo-political risks.

- The upshot is that **engineering sudden and sharp JPY strength**, *when pushed too far (>10% appreciation, to below 140-145),* threatens to be **counter-productive**.
- And ***even in the best case*** (in a weaker/more measured form of intervention) **JPY intervention will likely only provide limited and fleeting relief**.
- *Unless* some **JPY and JGBs are fundamentally shored up** by coincidence/combination of a *dovish Fed, improved Japanese fiscal position* and *dialed-back global geo-economic risks".*

* While longer-run models of JPY and (log of) Nikkei do not suggest stable relationship (see Appendix), Granger causality credibly establishes shorter-run negative impulse on Nikkei from JPY strength (as is applicable to post-intervention risks).

** Pertaining to JPY-denominated equities being too rich for foreign (USD-based) investors due to sudden JPY appreciation, rather than fundamental shifts.

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Statistical Appendix on Stationarity and Co-integration follow-up to Granger Causality Tests for USD/JPY & Log Nikkei:

1. JPY and (Log of) Nikkei are non-stationary and …

Stationarity Test Summary

Series	ADF Statistic	5% Critical	1% Critical	Result
USD/JPY (Level)	-0.22	-2.86	-3.43	Non-stationary
Log Nikkei (Level)	0.38	-2.86	-3.43	Non-stationary
ΔUSD/JPY (1st Diff)	-17.59	-2.86	-3.43	Stationary ✓
ΔLog Nikkei (1st Diff)	-18.41	-2.86	-3.43	Stationary ✓

Implications for Regression Analysis

Key Findings:

1. Both USD/JPY and Log Nikkei are NON-STATIONARY (have unit roots) in levels.
2. Both series become STATIONARY after first differencing → Both are I(1) processes.
3. Since both series are I(1), standard OLS regression may produce spurious results.

2. … not co-integrated, suggesting longer-run relationship that may be spurious

Cointegration Test Summary

Test Specification	ADF Statistic	5% Critical	1% Critical	Result
No intercept (standard)	-2.10	-3.34	-3.9	NOT Cointegrated
With intercept	-2.10	-3.34	-3.9	NOT Cointegrated

Interpretation and Implications

Key Finding:
USD/JPY and Log Nikkei are NOT cointegrated at conventional significance levels.

What This Means:
- The two series do NOT share a stable long-run equilibrium relationship.
- Deviations from the regression line do NOT mean-revert over time.
- The regression residuals behave like a random walk, not a stationary process.

3. Nonetheless, short-run causation dynamics are not negated

Reconciling with Earlier Analyses:

Finding: Granger causality runs from USD/JPY → Nikkei ($p = 0.018$), but NOT vice versa.
This is consistent with NO cointegration:
- Granger causality measures short-run predictive power (lagged changes).
- Cointegration measures long-run equilibrium (level relationships).
- Two I(1) series can have short-run dynamics without a long-run equilibrium.