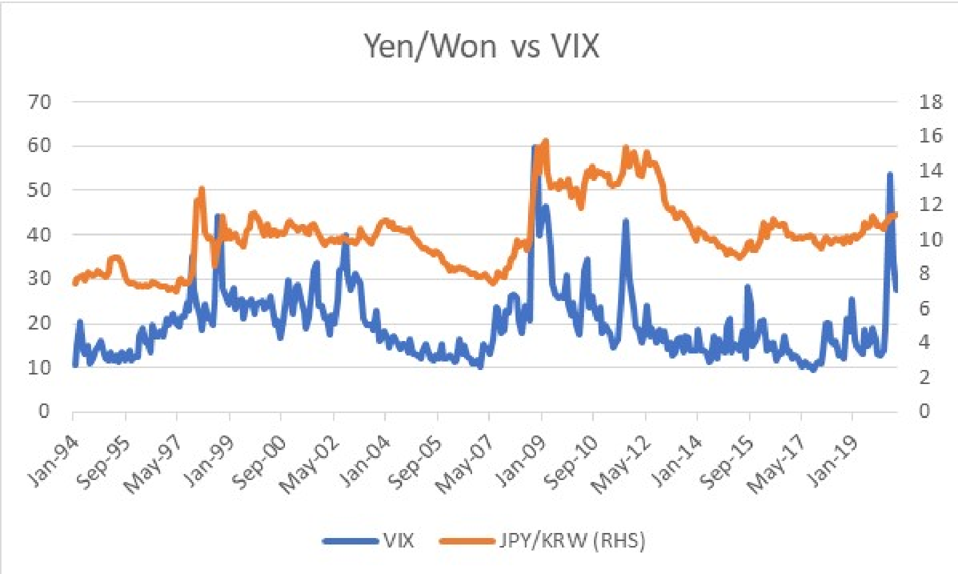
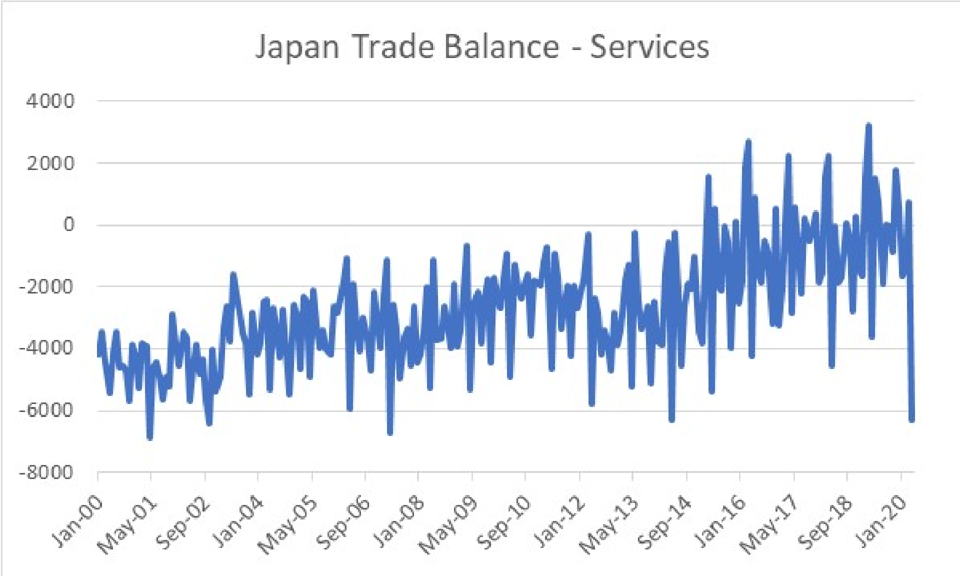
WHY IS THE YEN NO LONGER A GOOD HEDGE?

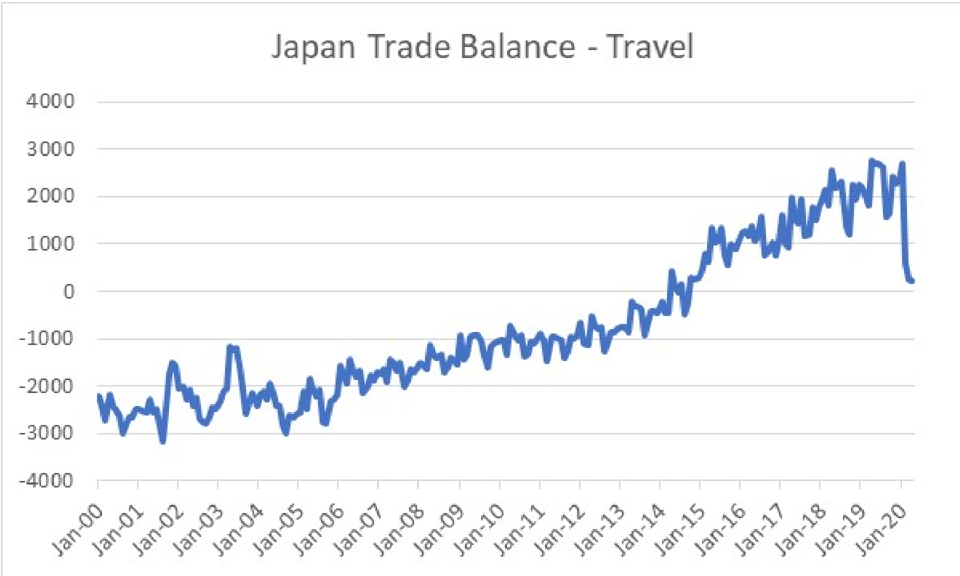
For most of the last twenty years, Japanese Yen has acted as a good hedge against rising market volatility. Perhaps the clearest manifestation of this relationship has been the Yen/Korean Won exchange rate, which has tended to see the Yen appreciate and the Won weaken when volatility spikes. The Covid-19 spike in volatility has not led to any conspicuous Yen strength.



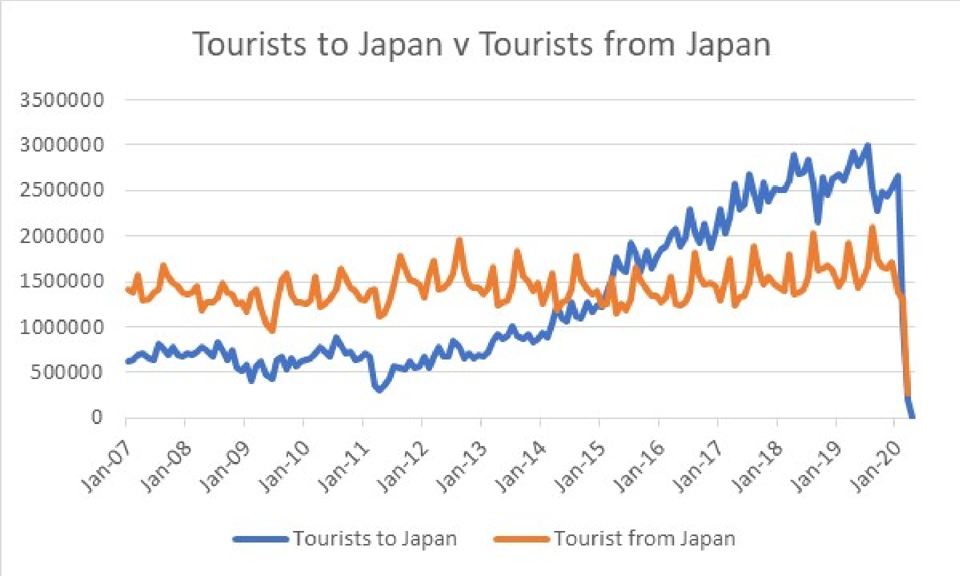
Market commentators have numerous reasons for why this could be, ranging from FX swap lines set up by the Federal Reserve, to large unhedged purchase of US assets made by various Japanese financial institutions. However, if we look at Japanese trade data and current account data, it has changed in recent years. Japan traditionally runs a surplus in the trade of goods, but a deficit in terms of services. Japan now runs a services surplus.



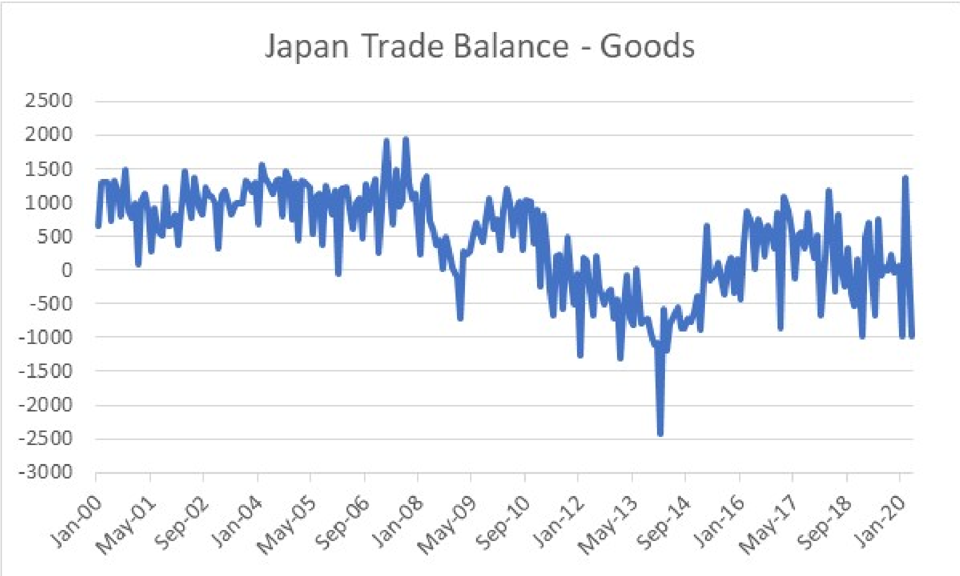
The change in the services trade balance has been almost exclusively driven by a huge change in the trade balance of travel.



A large part of this change in the travel trade balance is driven by the large increase in tourism to Japan, with the number of tourists visiting Japan overtaking outbound tourists in 2015. With Covid-19, both inbound and outbound travel and tourism has collapsed.



As can be seen from above, travel to and from Japan has been relatively stable, and much more stable than its trade balance in goods, which had tended to fluctuate wildly with the movement in the Yen, oil and economic cycles.



If the trade balance in services, and in travel is now much more important to Japan than previously, then the sudden stop in tourism to Japan is likely to be a currency weakening event. While Chinese travel to Japan has boomed in recent years, one distinctive feature of Japanese tourism is that it has largely catered to Chinese and Korean visitors, with a combined share of over 50% in recent years.

This leads to the unusual conclusion that the drop off in tourism from China is a currency weakening event for Japan. The observation then would be if that Chinese tourism recovers, and Japan is seen as a safe place to travel, then we may well see Yen strengthen if and when Covid-19 comes under control.

INFORMATION

Issue Date: 18 June 2020
Source: Bloomberg, unless otherwise stated
Investor Relations: Samantha Dunn
Email: info@russellclarkim.com
Telephone: +44 (0)20 7838 7580
Website: www.russellclarkim.com

Business and registered address: Russell Clark Investment Management Limited, 9 Chester Close, London SW1X 7BE, United Kingdom. Registered in England and Wales - Company number: 04034280

DISCLAIMER