



IS A CRISIS BREWING IN JAPAN?

The Macro Mixtape Series

August 2026

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The Macro Mixtape series is a curated collection of capital market insights told through songs that help define the moment. Consider this your essential playlist for understanding and navigating market dynamics.

Track: **In Too Deep – Sum 41**

THE SOUND BITE

On paper, Japan is striking all the right notes this year: local equity markets are at all-time highs, the current account surplus remains large, and the Bank of Japan (BoJ) finally upped the tempo by hiking its policy rate to 1%- its highest level since 1995¹.

But behind this upbeat melody, structural issues continue to hum, drowning out any positive momentum for the Japanese yen. Despite repeated massive foreign exchange interventions, the yen continues to hover near multi-decade lows, begging the questions: is Japan in too deep? Should it change its tune?

THE MAIN STAGE

Foreign exchange markets recently hit a crescendo with the yen surpassing ¥160, hitting its weakest level versus the U.S. dollar since 1986². This level, widely viewed as a psychological threshold, has evolved into a policy boundary that could trigger “yenterventions”, or direct currency purchases authorized by the Ministry of Finance to shore up the sliding currency.

Japanese policymakers have already pumped up the volume this year, blasting 11.7 trillion yen—roughly \$73.6 billion—into the market in April and May². This move sparked a multi-day rally before the currency reverted to its pre-intervention level.

Adding a rare collaboration to the mix, the BoJ and the U.S. Treasury launched a joint intervention in August, marking the first coordinated U.S.-yen buying action since 1998. While this provided an immediate boost—driving the U.S. dollar-yen exchange rate to ¥155 and fueling the yen’s strongest weekly advance against the U.S. dollar in nearly two years—it appears to be just another short-term win with the exchange rate currently hovering around ¥159.²

This has investors wondering: if this level of intervention doesn’t reverse the downward slide of the yen, what will?

The core issue facing policymakers is the underlying capital flows that continue to apply selling pressure, reinforcing the currency’s structural weakness. Even with the BoJ’s historic rate hike, a wide interest rate gap persists between Japan and the U.S. In fact, this gap has further widened in recent weeks amid a hawkish shift in market expectations for Fed policy – reinforcing the yen’s role as a funding currency.

1. Bank of Japan, FactSet as of August 11, 2026

2. FactSet as of August 11, 2026

Meanwhile, bond market vigilantes have taken the stage to express growing anxiety over the country's fiscal trajectory with Prime Minister Takaichi's expansive, multi-year spending plans with a sovereign debt load that already exceeds 200% of GDP³.

This dynamic leaves Japan trapped in a vicious feedback loop: a weak yen boosts domestic inflation by increasing the cost of imported food and energy, effectively taxing consumers already impacted by higher costs fueled by the conflict in Iran.

While economic theory suggests the remedy for the situation is tighter monetary policy, the BoJ sits in a difficult position as it risks pushing the government's borrowing costs to unmanageable levels if the central bank hikes interest rates rapidly or ramps up quantitative tightening to defend the currency.

That said, since the BoJ owns most of its own sovereign debt, the central bank holds the unorthodox option to monetize the debt – a highly theoretical monetary policy tool that results in an instant wiping out of the debt and a rapid expansion of the money supply. This possibility will likely cause speculators to continue pushing on the yen as any debt monetization efforts would artificially suppress real yields while diluting the currency's value.

Typically, when a country faces severe currency pressure, interest rates are aggressively raised to curb selling pressure and limit capital flight. However, doing so results in higher borrowing costs, oftentimes triggering a sharp recession in response. Still, in Japan's case, domestic yields remain suppressed, exacerbating the ongoing currency depreciation. To engineer a durable recovery in the yen, monetary and fiscal policies, and capital flows must sing the same song – a harmony that appears difficult to reach today.

This backdrop may also have implications for global yields given Japan's large investment positions abroad. If domestic Japanese rates become competitive with other bond markets, it can incentivize a repatriation of capital, potentially reducing demand for foreign debt and pushing yields higher elsewhere.

In addition, Japan is the largest foreign holder of U.S. Treasuries. In the event that Japan needs to liquidate a portion of its Treasury holdings to finance further currency interventions, U.S. yields may feel pressure as the market absorbs the Treasury supply.

Ultimately, Japan controls the soundboard and holds enough dry powder to keep the music playing, but outside noise can still interrupt the set. We continue to monitor the situation, and believe this serves as a reminder to investors to ensure they have adequate portfolio liquidity to help mitigate the impact of any potential beat drops that might be on the horizon.

Bonus Tracks: Items to Monitor

- **Geopolitics:** Coordinated currency interventions and recent language from U.S. Treasury leadership underscore a shared desire for strategic alignment between the U.S. and Japan with the mutual goal of managing currency dynamics to ensure global financial stability.
- **Japanese exports:** While a weak currency ignites concerns around domestic inflation, export volumes are likely to benefit as Japanese goods become more affordable to foreign buyers. Exporters with heavy overseas revenue will benefit from currency translation as a depreciating yen boosts profits, all else equal.

3. Japan Ministry of Finance, FactSet as of August 11, 2026

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