
# Is the wait over for a yen catalyst?

## Japan Macro Commentary - July 2026

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Following the major announcement by the Japanese government on 10 July, we review the recent arguments about structural weakness of the yen and consider whether this could be about to change.

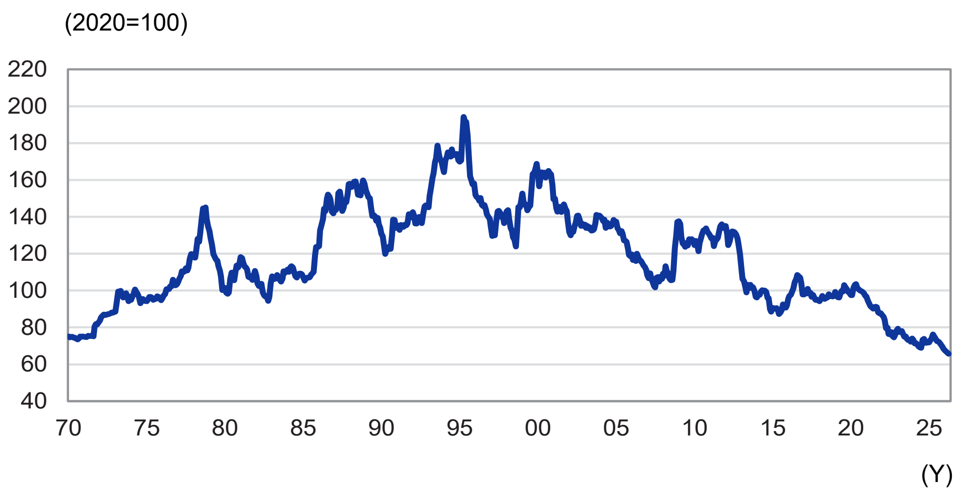
### To hedge or not to hedge? Is that still the question?

Global investors allocating to Japan have always faced an FX issue that other developed markets have not presented. The yen's persistent if fluctuating tendency to weaken versus the dollar has meant whatever level of investment returns are achieved on a local currency basis, the risk was always present that these would be eaten away by currency depreciation.

This looked like it might be starting to change, however, with the election of Sanae Takaichi last year. Her pro-investment fiscal stimulus approach was heralded as adding more fuel to the fire that was propelling the Japanese market to new heights, and the expectations that the strong rally of recent years could continue were high.

However, the mixed fortunes of the Japanese market and currency since the outbreak of war in the Middle East have cast doubt on this rosy picture into doubt. As the chart below shows, when viewing in historical context the downward glide path of the yen has been  as yet relatively unaffected by Takaichi's reforms.

**JPY real effective exchange rate**




Note: Monthly data from January 1970 to April 2026. -  Source: SMDAM and BoJ

## Is the cycle turning?

What the chart above brings to mind though, is a form of long-wave cycle theory. Whilst Kondratiev and other economists interested in identifying and analysing trends running over multiple decades haven't focused exclusively on FX rates, the trend of the yen strengthening during the decades in which the Japanese market boomed is clear to see.

Likewise, the general downward trend that set in from the mid-1990s onwards can be identified relatively easily from the chart. It is interesting however, that the upward trend peaked several years after the bubble burst, implying a lagged trend that might be relevant again now that the yen has sunk to levels not seen in decades.

### 1. Bad news for the real exchange rate

Even large government interventions haven't stopped the yen falling. The deeper reason is that the real economy is creating more natural pressure to sell yen than to buy it.

### 2. Capital outflows

Japanese companies are investing more overseas, and households are buying more foreign assets. At the same time, higher energy prices mean Japan has to import more, which increases demand for foreign currencies and weakens the yen.

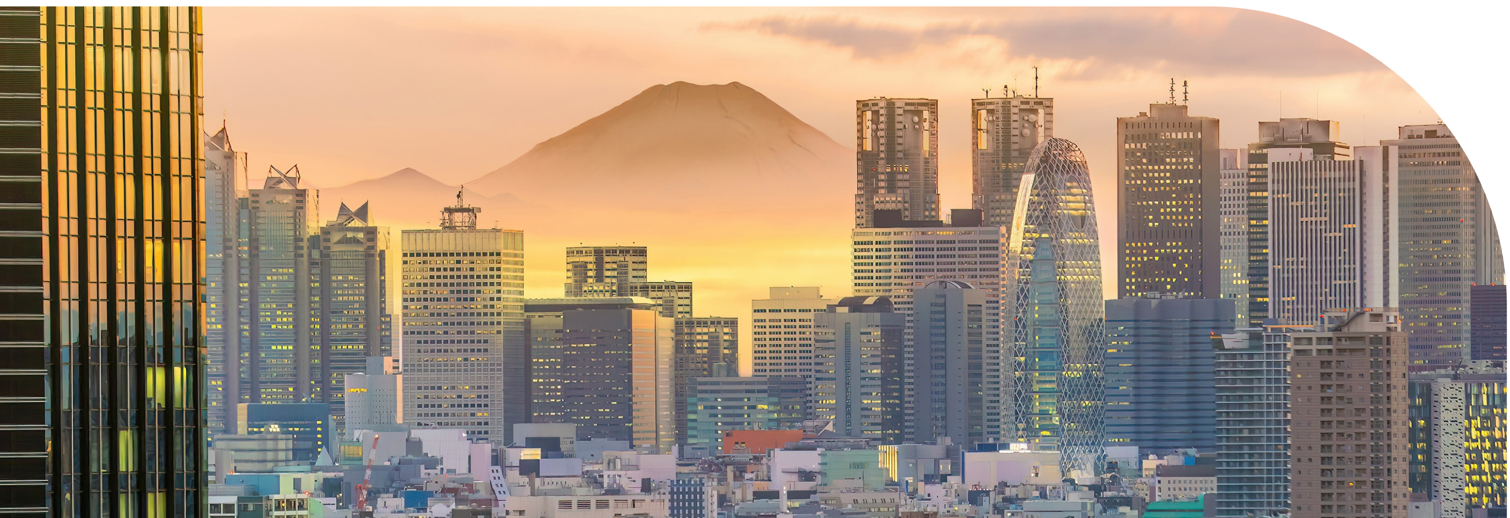
### 3. Autos are a dinosaur sector that can't revive the yen anymore

Japan's trade surplus has depended heavily on the car industry. Exporting cars brings foreign currency into Japan, which is then converted into yen and supports its value. Japanese car makers face tougher competition (especially from China in electric vehicles), labour shortages at home, and pressure from the US and Europe to produce cars locally rather than export them.

### 4. This (probably) means lower export volumes and less capital repatriation

If more cars are produced overseas instead of in Japan, exports fall. That means less foreign income is converted into yen, reducing natural demand for the currency. Even if Japanese companies earn good profits abroad, they often keep and reinvest that money overseas.

So it doesn't translate into buying yen in the currency market. Japan's trade structure is already more fragile than before. If the car industry's surplus shrinks, Japan may struggle to maintain a strong flow of export earnings to support the currency.



## Did everything change on July 10th?

Despite the above, we believe the tide could now be turning.

On the morning of the 10th, Finance Minister Katayama said the government was looking to pursue a policy to boost investments by households and pensions in Japanese assets.

This is a natural follow-on from the recently announced increase in the target level for household equity, mutual fund and bond ownership from end 2025 level of 23% to 40% of household financial assets by 2040. Household financial assets were 2.351 quadrillion yen (roughly 14tn USD) as at end of 2025, according to the Bank of Japan, more than twice Japan's GDP.

A change of 17% would be circa 400tn yen, around 30% of the market cap of the entire TOPIX Prime index. These moves could also be quite significant for Japanese equity demand, as both individuals and pensions have generally been underweight.

As such, these developments are mildly positive for the yen, because they imply more demand for Japanese assets over the longer term, but it's unclear if there will be major moves in the near term. It may relieve some pressure on the yen as speculative positioning is already significantly net short. Going forward real interest rate differentials are likely to remain a key determinant of the level of the yen versus other currencies.

Additionally, many Japanese pension funds manage their assets over the long term based on their strategic asset allocation from an ALM perspective, so it is unclear whether political leadership alone could lead them to increase their allocation to domestic assets.

At the same time, from an investment standpoint, shifts from foreign equities to domestic equities and from foreign bonds to domestic bonds are certainly possible. For equities, this could be driven by a reassessment of Japanese companies as capital efficiency improves and growth investment expands.

For bonds, higher interest rates are increasing the medium- to long-term attractiveness of domestic bonds. If these changes are seen as structural rather than temporary, higher expected returns on domestic assets could affect the asset allocation of pension funds.

There are also signs of growing interest in domestic assets. In the investment trust market, inflows into Japan-focused equity funds have increased compared with a year earlier. In fixed income, purchases of Japanese government bonds by individual investors have also risen, suggesting that JGBs are becoming a more prominent alternative to bank deposits.

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