



A new risk of yen depreciation? Structural yen-depreciation risk arising from changes in the auto industry environment

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SMDAM

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Highlights:

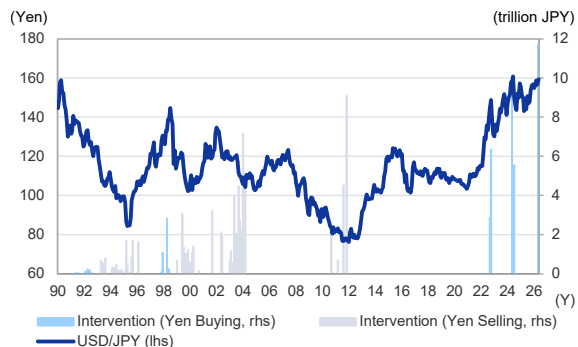
- 1 - Yen weakness is becoming structural. Despite large-scale government intervention, the yen continues to depreciate due to deeper forces such as capital outflows, rising energy import costs, and underlying trade dynamics that create persistent yen-selling pressure.
- 2 - Is the auto sector in trouble? The sector faces multiple headwinds: intense EV competition, pressure to move manufacturing abroad, labour shortages placing constraints on production, contributing to the risk of declining exports and a shrinking trade surplus.
- 3 - The broader macro implication: weaker productivity growth and exports mean less natural demand for yen, while a decline in this high-productivity industry could lower Japan's overall economic strength—leading to structural depreciation pressure on the currency over time.

1. Yen weakness is becoming structural

The depreciation of the Japanese Yen is not a new story, nor a short-term phenomenon. Downward pressure on the yen remains deeply entrenched. Between April 28 and May 27, the government and the Bank of Japan carried out ¥11.7349 trillion in yen-buying intervention, the largest monthly amount on record. Even so, the operation failed to reverse the yen's weakening trend, and the exchange rate has recently moved back close to its pre-intervention level (chart 1).

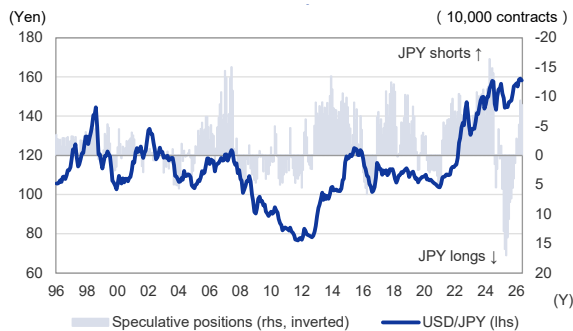
The fact is, Japan may be moving toward an economic structure in which depreciation pressure persists because yen-selling pressure remains embedded in real-economy flows (Chart 2); a narrative shaped by forces such as capital outflows, rising energy import costs, and underlying trade dynamics. Here is our view on where things are headed.

Chart 1: USD/JPY and Intervention



Note: Monthly data from January 1990 to May 2026
Source: SMDAM, MoF and Bloomberg

Chart 2: USD/JPY and Speculative positions



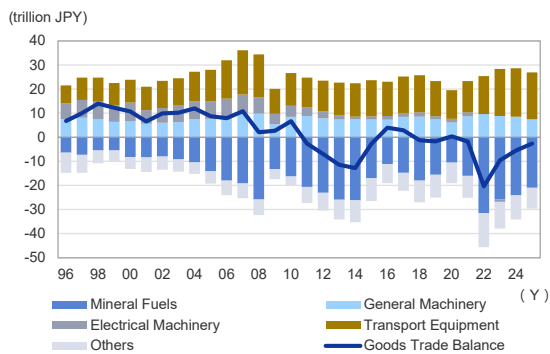
Note: Monthly data from January 1996 to May 2026
Source: SMDAM, MoF and Bloomberg

A shifting environment

Japanese firms are investing more overseas and households are buying more foreign assets, while higher energy prices due to instability in the Middle East are increasing import costs. Together, these trends are increasing demand for foreign currency and adding sustained downward pressure on the yen.

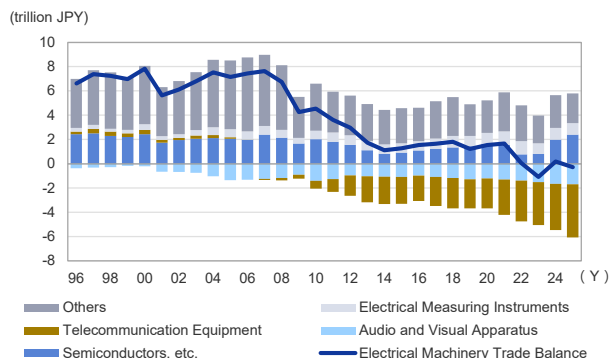
And now, a new source of risk; a contraction in domestic production and decline in auto exports.

Chart 3: Japan's goods trade balance



Note: Annual data from 1996 to 2025
Source: SMDAM and MoF

Chart 4: Japan's electrical machinery trade balance



Note: Annual data from 1996 to 2025
Source: SMDAM and MoF



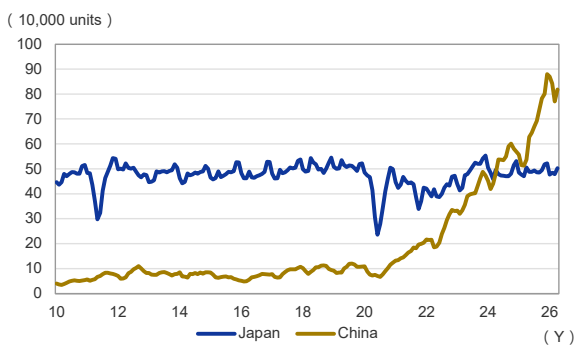
2. A key industry under pressure

The auto sector, along with electrical machinery, is the main pillar of Japan's trade surplus. The trade balance in transport equipment, which includes automobiles, saw its surplus nearly double from just under ¥10 trillion in 2000 to just under ¥20 trillion in 2025. In addition to finished-vehicle exports, the auto industry has generated high value added through a broad supply chain spanning materials, parts, machine tools, and logistics. In that sense, automobiles can be regarded as a strategic industry underpinning Japan's external balance and the yen's fundamentals.

However, now massive headwinds are threatening domestic production and exports.

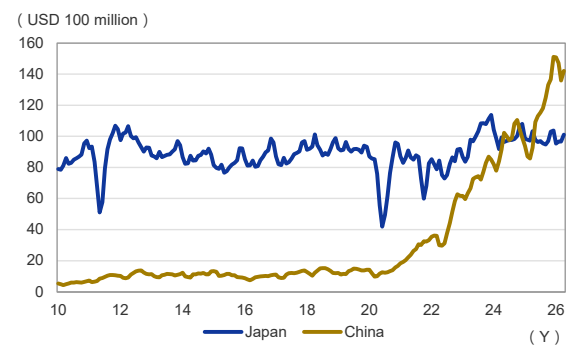
First, US pure-play EV makers and Chinese manufacturers are leading in battery electric vehicles. China, in particular, is gaining ground with their in-house battery production, price competitiveness, software capabilities, and speed of product rollout. And they are stepping up their offensive not only in China but also in Southeast Asia, a major export market for Japan. More recently, there have even been reports that Chinese players are accelerating development in all-solid-state batteries, an area Japanese automakers are pursuing as a core next-generation battery technology

Chart 5: Japan and China auto exports (Volume, 3MMA)



Note: Monthly data from January 2010 to April 2026
Source: SMDAM, MoF and CEIC

Chart 6: Japan and China auto exports (Value, 3MMA)

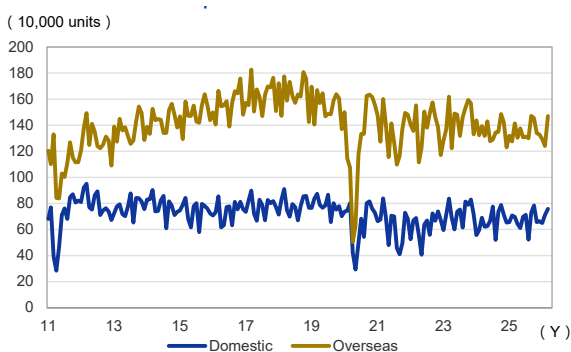


Note: Monthly data from January 2010 to April 2026
Source: SMDAM, MoF and CEIC

Second, labour shortages are intensifying and impacting every stage of the auto supply chain from parts manufacturers to assembly plants and logistics. At some manufacturers, delivery times—especially for popular models—have lengthened, and situations have emerged in which demand exists but domestic output cannot be increased sufficiently. The move by major automakers, though only specific firms and models for now, to re-import into Japan vehicles produced overseas is a symbolic example of this trend.

At the macro level, moves like this depress domestic value added and export capacity, and could become a factor restraining the auto sector's trade surplus.

Chart 7: Domestic and overseas vehicle production of Japan's nine automakers

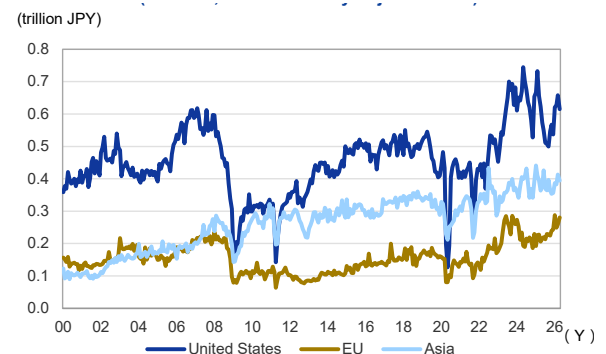


Note: Monthly data from January 2011 to March 2026.

Note: The nine automakers are Toyota, Honda, Nissan, Mazda, Mitsubishi, Suzuki, Daihatsu, Subaru, and Hino.

Source: SMDAM and INDB

Chart 8: Japan's transport equipment exports by region (Nominal, our seasonally adjust data)



Note: Monthly data from January 2000 to April 2026

Source: SMDAM and MoF

Third, calls to bring auto manufacturing back onshore in the US are becoming louder. And Trump's return to office has intensified the pressure, with higher tariffs, demand for local production, and pressure for investment in the US. Local US production is a rational response for avoiding tariffs and managing political risk, but this would certainly impact on Japan's trade surplus. A similar story is playing out in Europe, too, with environmental regulation and industrial policy reinforcing a preference for production within the region.

This shift matters because exports generated through domestic production tend to create yen-buying demand, whereas profits earned overseas are often reinvested locally and do not flow back into yen markets. As production moves abroad and export capacity weakens, the natural support for the yen from trade flows diminishes.

3. Bad news for the real exchange rate

In terms of productivity, the contraction of the auto industry poses a threat to the economy's overall income-generating capacity through wages, employment, regional economies, and the accumulation of technology.

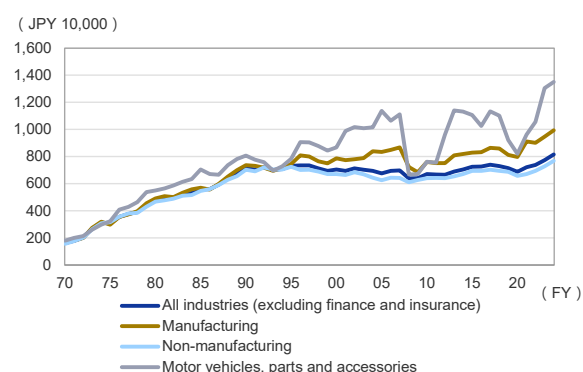
When high-productivity sectors shrink domestically and the economy's overall earning power declines, then, other things equal, the real exchange rate faces depreciation pressure via the reverse Balassa-Samuelson effect. The decline in international competitiveness seen in parts of the electrical machinery sector in the 2000s marked one turning point in the transformation of Japan's trade structure. If the domestic base of the auto industry weakens going forward, that could become another factor pushing down the real exchange rate—that is, reinforcing structural yen weakness—through slower productivity growth in the tradable goods sector (Charts 9 and 10).

Chart 9: JPY real effective exchange rate



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

Chart 10: Value added per employee



Note: FY 1970 - FY2024
Source: SMDAM and MoF

A measured outlook

That said, Japanese automobiles have held on to global brand power, sales networks, and reputation for quality. Unlike consumer electronics, automobiles have long replacement cycles and are not easily switched. In addition, governments in various countries are inclined to adopt industry-protective policies.

In the EV space, the US is reviewing emissions regulations, and Europe is also showing signs of revising policies that had focused exclusively on BEVs, with environmental regulation shifting in a more pragmatic direction. This is a mitigating factor for Japanese automakers, which have emphasised hybrids. At least in the short- to mid-term the competitiveness of Japanese firms in hybrids and high-value-added vehicles could provide support, meaning Japan's auto exports may not contract sharply.

At the same time, there is hope that the AI boom will help revive the electrical machinery sector. But, the question is how far such a revival could offset a shrinking trade surplus in autos.

The road ahead

Debate over the yen tends to focus on the Japan-US interest-rate differential and on whether intervention is taking place. Over a longer time horizon, however, the evolution of underlying flow dynamics and productivity is also critically important. If the export capacity of the domestic auto sector changes, the yen's equilibrium level itself could also change. The direction of the auto sector is therefore no longer merely an industrial issue; it is a macroeconomic issue that could shape the yen's long-term value.

Going forward, in assessing the yen, it will be important to monitor closely such indicators as auto export values, domestic vehicle production, the overseas production ratio, trends in re-imports, and changes in exports to the US and Europe.

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