

Yen Weakness Looms Large in '22

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Pluto is a planet. That was a fact as sure as night followed day when I was learning about the solar system in the 1980s. But information changed. Evidence changed. In 2006, the International Astronomical Union declared that our little friend across the Milky Way is in fact just a “dwarf planet.”

The textbooks had it wrong.

I think finance textbooks also goof up with the drivers of currency moves. The books say that if one country catches an inflation shock while another does not, the currency of the former *should* weaken.

Yet with U.S. Consumer Price Inflation (CPI) rising 6.2% in the year through October—more, notably, than the 0.2% rise in Japan’s inflation rate (figure 1)—the market has chosen to respond with dollar *strength* relative to the Japanese yen.

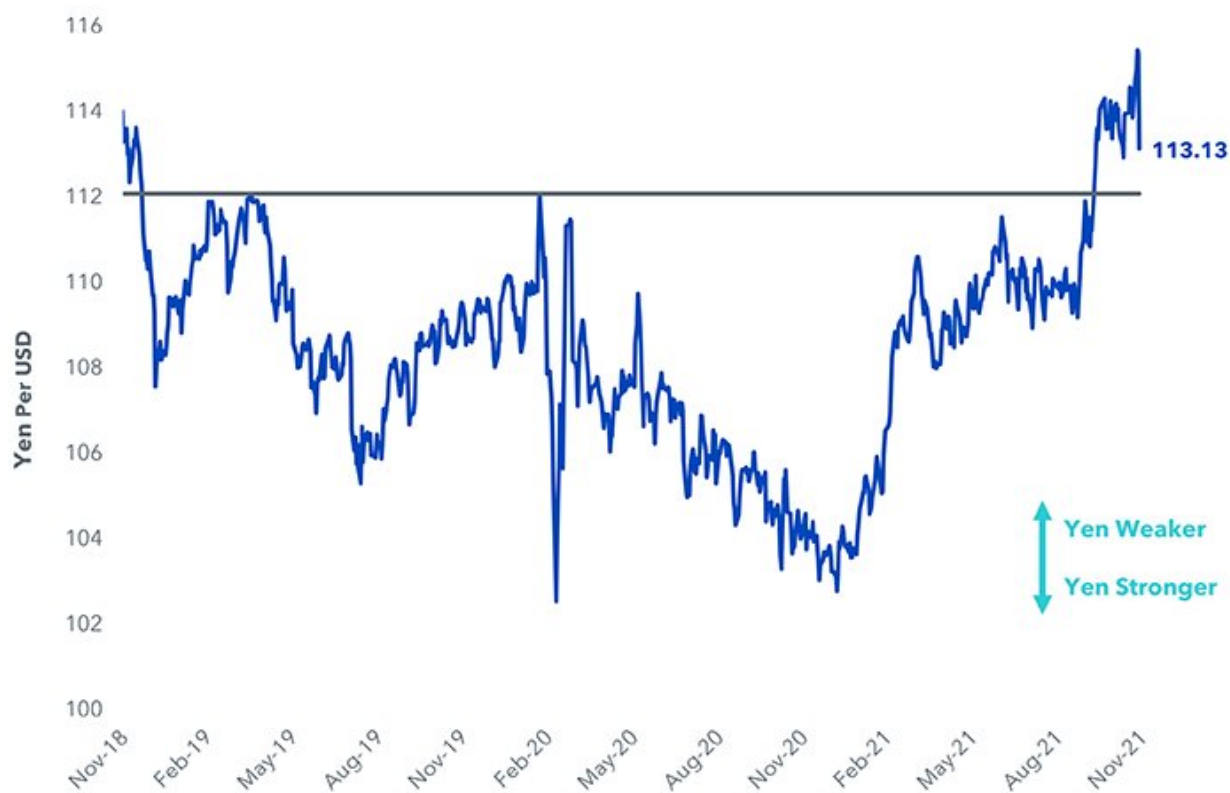
Figure 1: Year-over-Year (YoY) Consumer Price Inflation



Sources: Refinitiv, U.S. Bureau of Labor Statistics and the Statistics Bureau of the Japan Ministry of Internal Affairs & Communication, as of September 2021 for Japan and October 2021 for the U.S.

There are several explanations for the greenback's advance relative to the yen (figure 2).

Figure 2: Japanese Yen per Dollar



Source: Thomson Reuters Refinitiv, as 11/29/21. USD = U.S. dollar.

For one, if you asked almost anyone a year ago which country—the U.S. or Japan—was more likely to have a big inflation surprise, I suspect most of us would have picked the former.

Additionally, it's not like the November 10 release of the October U.S. CPI data was some new revelation; inflation has been on many minds for months. The most recent report was the sixth in a row to witness year-over-year inflation above 5%.

The dollar is rallying against the yen because the market is getting in front of a scenario that has the Fed tightening monetary policy more than Chair Jay Powell is insinuating.

Particularly noteworthy is the stark contrast between consumers' spending impulse in the U.S. versus in Japan.

The Johnson Redbook gauge of U.S. chain store retail sales jumped 15.1% from this time last October (figure 3), corroborating our view that a big U.S. [holiday shopping season looms](#). That sets up a non-zero probability that Powell will sweat an overheating economy in 2022, or at least one where inflation is smoldering to such an extent that investors are fielding rate hikes with some frequency.

Figure 3: YoY Change, Chain Store Sales



Sources: Thomson Reuters Refinitiv, Japan Chain Stores Association, Johnson Redbook.

Now think about the calculus of Haruhiko Kuroda, head of the Bank of Japan (BoJ). Inflation is nowhere near hot on the streets of Tokyo; the consumer is lethargic. A 2022 rate hike by the BoJ is about as likely as you and me going to the astronomers and successfully lobbying to get the Pluto decision overturned.

The yen isn't sitting around and waiting for U.S. monetary authorities to surprise the market with something more than just one or two rate hikes next year. It is weakening right now, busting up through the ¥112 level a few weeks ago and is currently trading around ¥115. Maybe the yen is telling us the Fed may be forced to do something like a hike at every meeting, or every other meeting. Maybe it's even something more benign—a quicker end to the Fed's \$120 billion per month bond purchase program that is currently running at "only" \$105 billion.

For more on Japan, take a look at this [piece from October](#). If you anticipate the yen chart will keep running higher as Japan's currency weakens, our two ETFs that hedge it are the [WisdomTree Japan Hedged Equity Fund \(DXJ\)](#) and the [WisdomTree Japan Hedged SmallCap Equity Fund \(DXJS\)](#).

If you disagree with me on yen weakness, we have one that doesn't hedge it. That one is the [WisdomTree Japan SmallCap Dividend Fund \(DFJ\)](#).

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