Global Markets Comment: A Few Follow-Up Questions on Yen Intervention

We address a few common questions in response to our Q&A on Yen Intervention. We are skeptical of arguments that this is negative for the Dollar's reserve status, and we think the FIMA facility can be useful for both sides and actually helps reinforce the Dollar's appeal. We expect temporary and limited effects from FIMA facility usage on broader markets, but all else equal it should support easier USD funding conditions on the margin. And while it is impossible to say for sure, we think we are still in the same dynamic as in February following the last round of coordinated action, where a weaker Yen is a prerequisite for much faster rate hikes, so there is a tension between the current value of the Yen and market pricing for the next few BoJ meetings.

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Q1: Can Treasury's actions undermine the appeal of Dollar reserves?

Some commentators have argued that the US administration's more activist and enterprising approach to prevent unwanted volatility in the Treasury market could undermine confidence in holding Dollar reserve assets. While we certainly share the view that policy uncertainty and unconventional institutional actions can weigh on the Dollar's global role, and this was a central feature of our bearish Dollar view in 2025, we think applying that argument in this circumstance is a stretch.

At its core, this view relies on an assumption that Treasury's willingness to *help* Japan facilitate Treasury sales right now implies that it might be willing to *hinder* a reserve manager from making similar sales in the future. This seems like quite a leap.

Other than some special considerations due to its size, Japan's recent ability to access its Dollar reserves is not unique. For example, in March of this year, even when there were signs of strain in markets, a range of reserve managers sold significant quantities of Treasuries in order to support their currencies, and Treasury did not publicly object. We think episodes like this of forced sales actually help reinforce the Dollar's role over time.

We are also far from persuaded that Treasury's intervention signals new fragilities in the Treasury market relative to before. As we noted in our original piece, we think it simply shows that this administration is more willing to intervene than in the recent past. But willingness does not equate to necessity. Market functioning metrics have all been normal, higher oil prices and more dovish FOMC risks were responsible for recent weakness in the back end of the Treasury curve, and there are no signs that the safe-haven appeal of Dollar assets has changed in a structural way in global bouts of risk-off. Some of last year's Dollar depreciation can be attributed to other types of investors hedging the portfolio risk that arose from shifting Dollar correlations, but that has stopped and the story for reserve managers is more nuanced. And we think it is important to keep in mind that US Treasury officials used

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to be much more hands-on prior to the late 1990s. The Dollar has maintained its status through both types of management.

If anything, Japan's ability to access the Fed's FIMA facility to help ensure smoother sales at a large scale, if necessary, highlights a key structural advantage of Dollar reserves. Having facilities like this, even if not originally intended for this purpose, is unique to the US Dollar—depth of capital markets that allows for *reserve accumulation* in calm markets, and liquidity assistance in the capital markets that allows for *reserve access* in times of stress.

Japan is seeing some benefits to holding its reserves largely in Dollar assets. In contrast, some other reserve managers like Turkiye have recently faced operational hurdles after diversifying holdings into less-liquid, volatile assets like gold. When it comes time to intervene, most central banks still need Dollars, and these times are often associated with challenging valuations and liquidity conditions in other assets which makes it an inopportune time for a reserve manager to need to raise cash.

There are a number of risks to Dollar dominance, and those risks are amplified when there is uncertainty around how US institutions may act in the future. In our view, the part of this that relates to Japan and the current situation is that there are parallels between the US and Japan in terms of maintaining an unsustainable policy mix while sometimes treating the symptoms rather than the cause. This can and probably will eventually erode the Dollar's position as a credible reserve currency without significant changes. But that is a separate issue from equating coordination on selling with potentially being an unreliable partner for another reserve manager in a similar position. We believe Treasury's actions and the availability and utility of the FIMA facility help demonstrate that no one else can come close to competing with the US Dollar's usefulness, network effects, and supporting infrastructure right now.

Q2: Why would Japan want to use the FIMA facility?

We noted that the FIMA facility was not *built* for this purpose, but it is in many ways *fit* for this purpose. As we discussed in our original piece, the Foreign and International Monetary Authorities repo facility allows central banks to temporarily raise Dollar cash by selling US Treasuries to the Fed and agreeing to buy them back later. It has only been used in size once: in a more textbook use of the facility, the Swiss National Bank raised Dollar cash to provide any necessary liquidity assistance during the emergency takeover of Credit Suisse in 2023. It subsequently wound down its usage of the facility over the course of a month. This allowed the SNB to maintain its holdings of somewhat less-liquid securities while still having a ready-to-use cash buffer.

While not necessarily its originally intended purpose, using the facility around potential intervention would have some benefits for Japan (and possibly other central banks in the future). It can quickly borrow cash against less liquid parts of its portfolio, which avoids unnecessary disruption to its broader investment strategy and could also deter market participants from doubting their available resources to intervene. There would be some associated reduction in carry on the portfolio (more on this in Q3), but it should be minimal and commensurate with the increased flexibility from a reserve portfolio management perspective where capital preservation and access are the primary considerations. Assessments that Japan would either be just doing the US a favor or paying some sort of "exit fee" ignore these benefits and exaggerate the costs, in our view.

It is true that the current $60bn counterparty limit would reduce the facility's effectiveness in this case because Japanese interventions can exceed that amount in a single day. However, this limit could in theory be raised quite quickly if it became necessary. The FOMC has designated that authority to the Foreign Currency Subcommittee, which consists of the FOMC Chairman, the FOMC Vice Chairman, and the Board Vice Chairman (Warsh, Williams and Jefferson). Those three can adjust the limit by notation vote (that is to say, the meeting can be an email) and there is no requirement to act on the regular cadence of FOMC meetings. That is not our expectation; the Committee initially established this facility by notation vote as part of the Covid response outside of the meeting schedule, but made more routine adjustments (keeping the facility in place and eventually making it permanent) at FOMC meetings—likely both out of convenience and to allow for broader deliberation if required. Under the terms of the permanent facility, the FOMC delegated operational details including counterparty limits to the three-person subcommittee. Governor Bowman objected to making the facility permanent as she felt it should be kept in reserve for emergencies, and there could be some other resistance as increased counterparty limits would only be relevant to a handful of reserve managers. But ultimately this is the type of decision where the FOMC typically defers to Treasury's discretion on currency policy.

Q3: What are the implications of FIMA usage for USD funding markets, and what are the associated costs for Japan with using the facility?

Greater FIMA usage would temporarily expand the Fed's balance sheet and likely boost reserves, all else equal supporting easier USD funding conditions. However, assuming aggregate usage remains limited to the $50-to-100bn range, we think the extent of impact would likely be relatively modest—for context weekly standard deviation in reserves has been about $85bn year-to-date, and we estimate that Japan purchased about $85bn from July 30-31—the largest 2-day operation since 2011. Secretary Bessent has proposed upsizing FIMA, which currently has a limit of $60bn per counterparty, to allow Japan to intervene in greater size. Beyond the direct impact on market liquidity, relying on FIMA to raise dollar liquidity also helps avoid pressure on intermediation capacity/demand for repo funding that could arise in the event of concentrated selling by an unlevered investor.

Previous interventions have had a larger impact on the Treasury market, particularly in Sep. 2022, when it appears that the BoJ sold longer-term USTs to fund JPY purchases. This resulted in a sharp tightening in swap spreads. Interventions since then have been more concentrated in short-term Treasuries, suggesting that the MoF may have subsequently shifted how it conducts interventions to limit the Treasury market impact.

The current cost of borrowing Dollars via the FIMA facility overnight is the upper limit of the Fed's target range for the funds rate, 3.75%. The FIMA facility also offers term repo for 7 days, where the cost is OIS plus 25bps. However, the MoF would still earn the yield on the Treasuries pledged—relative to the alternative of selling USTs outright, the net cost of using the facility approximates to the difference between the facility's rate and the yield on the underlying securities.

Ultimately, we believe the FIMA facility can be a helpful way to avoid the funding and spread pressures associated with large, sudden sales of US Treasuries. If the Treasury recognizes that Japan would like to continue intervention to ensure credible Yen strength and wants to prevent a destabilizing force in the market, the FIMA facility can smooth the impact on the market. Crucially though, while using FIMA buys time, it does not prevent Japan's sales of US Treasuries. Eventually, the MoF will have to sell Treasuries and/or let enough securities roll off its balance sheet to fund the intervention. We do not see Secretary Bessent's request that the MoF intervene using FIMA as an attempt to prevent Japan or other reserve managers from selling Treasuries. It is primarily a way to smooth the potential impacts from large-scale FX intervention, which could have disruptive effects on the Treasury market.

Q4: How does intervention effectiveness impact the outlook for the BoJ?

While this is a subject of considerable debate, our working assumption is that if intervention successfully keeps the currency roughly stable around current levels, it would diminish the likelihood of substantially faster or earlier BoJ rate hikes to an extent that it would shift the emphasis of policy support for the exchange rate and long-end of the curve to higher short-term real rates. This is intrinsically linked to our view that the US Treasury's involvement is not a harbinger of more significant domestic policy shifts or a sign of a working agreement between US and Japanese officials.

We see a number of parallels to periods earlier this year, when markets similarly raised the prospect of a sharp change in policy direction. At the time, we argued that we were likely to still be in a dynamic where a weaker Yen was a prerequisite for much faster rate hikes, in part because officials can argue that a stable exchange rate no longer presented an inflationary risk. With market pricing today showing a strong likelihood of a BoJ rate hike in September, we think we are back in a similar position, and see a tension between the value of the Yen and pricing for the next few BoJ meetings.

Investors have challenged that this is circular, and we agree. That is in some ways a necessary feature of an unstable equilibrium, and it will require either a shift in global conditions or a policy surprise to break it.

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