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Japan | Japan

Tokyo Exchanges: Yen, Rates, Geopolitics and AI

Tokyo clients this month kept circling back to the same questions: how do you view JPY; what is really moving yields; whether Xi's visit changes anything; and how long the AI spending boom can last — and, ultimately, who it is all for.

Key Takeaways

- BoJ & FX: USD/JPY fair value remains around 167; FX is driving BoJ hike expectations rather than the reverse, limiting the impact of BoJ tightening on JPY.
- US Rates: Treasury yields are oil- and Fed reaction function-driven, not IG supply.
- US-China: Sep 24 confirms stabilization, not normalization; real risk is Nov 10 — Section 301, BIS Rule, and rare earth controls all expire.
- AI Capex: Hyperscaler capex-to-revenue has surpassed the dot-com peak; ROI evidence is building — overinvestment risk is medium-term, not near-term.
- AI & Society: AI is lifting output-led productivity; but abundance vs. inequality hinges on policy — the range of outcomes across scenarios is wide.

This report is the first in a series designed to capture the key issues on the minds of Japanese investors and corporate leaders, and to present Morgan Stanley's House View in response.

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For analyst certification and other important disclosures, refer to the Disclosure Section, located at the end of this report.

Q1. BoJ & FX: BoJ is leaning toward rate hikes — how do you view JPY?

From whom: FID > Corporates (Manufacturing) > HF · LO

Answer

Our Strategy team believes that BoJ rate hike expectations alone are unlikely to generate sustained yen appreciation. A durable decline in USD/JPY would require both lower US rates and a meaningfully more aggressive BoJ tightening cycle. Despite the recent volatility in FX markets, we continue to believe that a sustained appreciation of the yen ultimately requires a narrowing of US-Japan rate differentials, and our broader USD/JPY view remains unchanged.

Rationale

Recent FX market volatility has reinforced market focus on downside risks to USD/JPY, but our teams do not view recent developments as sufficient to alter the fundamental outlook. Our Japan Macro Strategy team views USD/JPY fair value at around 167 even after the coordinated US-Japan FX intervention on July 30 and concludes that two to three BoJ rate hikes alone would not materially move USD/JPY. Recent market moves have inverted the usual JPY-yield relationship, with the yen weakening even as JGB yields have risen. As long as markets perceive a risk that the BoJ remains behind the curve, the rates market is likely to take its cue from FX developments when assessing the future path of BoJ tightening, rather than the reverse. This helps explain why rising BoJ rate expectations have not translated into a materially stronger yen. Our Japan Economics team expects the BoJ to hike in September 2026 (to 1.25%) and again in January 2027 (to 1.5%). Sustained yen appreciation ultimately requires lower US rates, which would allow USD/JPY to trend toward the low-to-mid 150s over the medium term.

Risk

Our US Economics team does not expect the Fed to hike in 2026; however, if US inflation re-accelerates and the Fed pivots to tightening, the US-Japan rate differential would widen further, intensifying yen depreciation pressure.

Exhibit 1: USD/JPY versus fair value

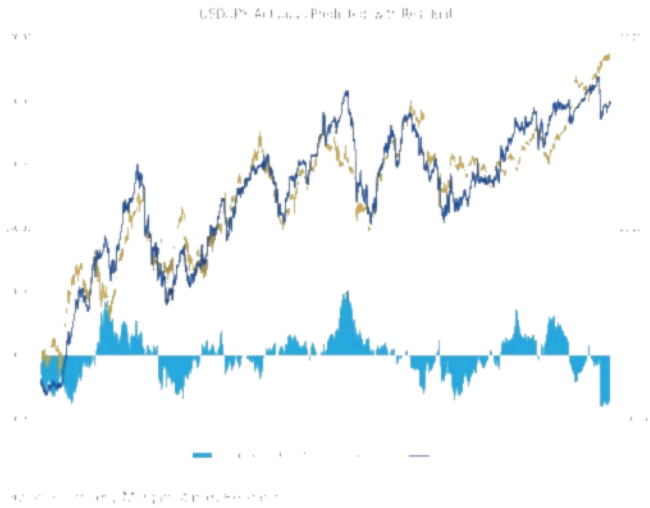
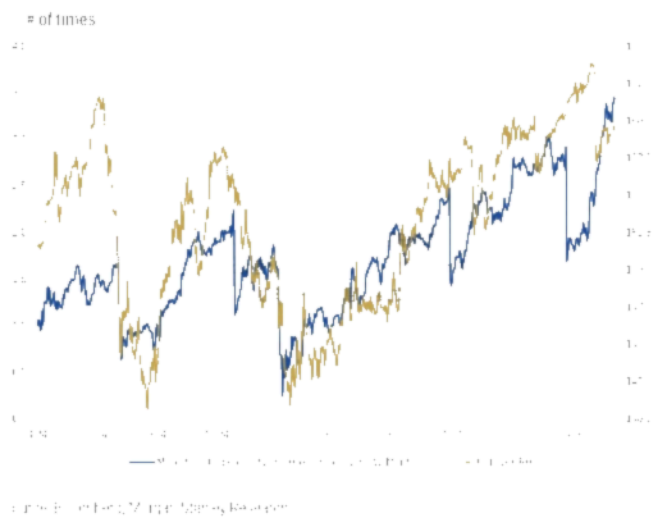


Exhibit 2: USD/JPY vs. BoJ hikes priced by the market



Reference Reports: Morgan Stanley Global Macro Forum: Yen Intervention, the US Employment Data – Implications for Policy and Markets (August 10, 2026) / Tweaking Our BoJ Outlook (Sep 2, 2026)

Q2. US Rates & Credit: Are rising US Treasury yields driven by the surge in investment-grade corporate bond issuance?

From whom: FID > LO > HF

Answer

We do not think so. Our US Rates Strategy team concludes that the primary driver of higher Treasury yields is not IG supply, but rather the rise in oil prices following the Middle East conflict and the market's interpretation of the Fed's reaction function turning more hawkish — with real yields as the key transmission mechanism.

Rationale

Our US Rates Strategy team finds that while excess IG supply has widened credit spreads, the increase in dealer inventory was too small to explain the weakness in Treasuries. Corporate bond supply has little explanatory power for the move in UST yields. The move in Treasury yields has been driven by real rates, not breakevens (inflation expectations). Since the Middle East conflict began, oil prices, Fed policy pricing, and 10-year Treasury yields have moved in lockstep. Investors have internalized the view that "higher oil = more hawkish FOMC; lower oil = less hawkish FOMC," and as long as this interpretation holds, real yield dynamics will continue to dominate the bond market. It is worth noting that AI-related corporate bond issuance has reached a record pace (YTD through July, up +29% YoY), but this is a driver of wider credit spreads, not higher Treasury yields. Our US Rates Strategy team maintains its year-end target of 4.25% for the 10-year yield.

Risk

Re-escalation of Middle East tensions pushing oil prices higher would cause the market to re-price a more hawkish Fed, driving real yields higher again. If the perception that the Fed's reaction function has become "oil-linked" becomes entrenched, front-end volatility could remain elevated and credit spread widening could persist.

Exhibit 3: 2026 investment grade issuance YTD vs. 2023-25 avg. and YTD change in IG AI/data center 10y spreads

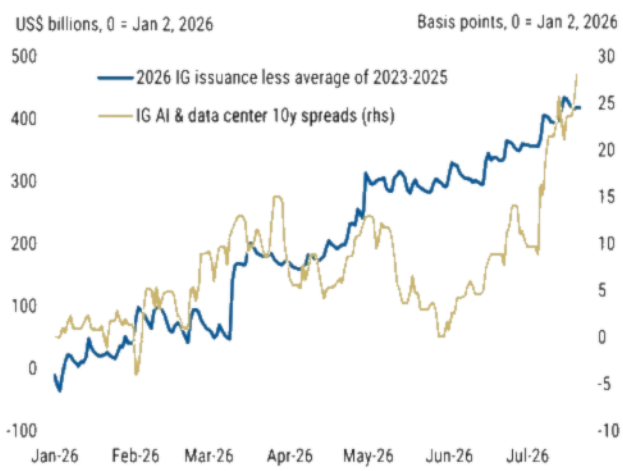
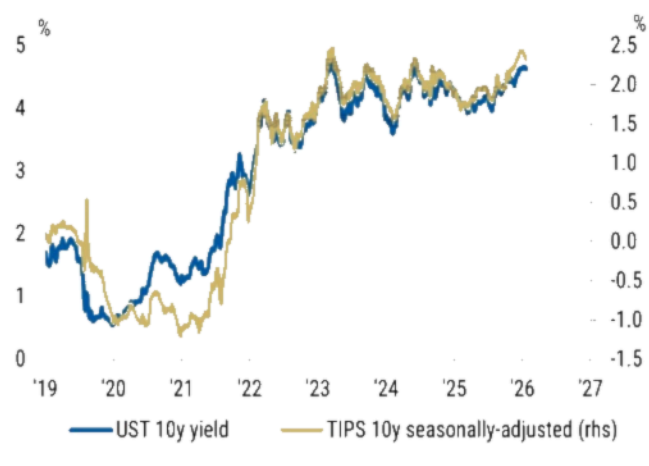


Exhibit 4: UST 10y yield and 10y TIPS seasonally-adjusted breakeven inflation rate



Reference Reports: Global Macro Strategy Our Views After Treasury Announced Larger Buybacks (Aug 20, 2026)

Q3. Geopolitics & US-China: Where are US-China relations headed? What will Xi Jinping's Sep 24 visit to Washington deliver?

From whom: HF > LO > FID

Answer

The September 24 summit is likely to confirm "managed stability" rather than deliver a "grand bargain"; the real focal point is the fate of three policy measures expiring simultaneously on November 10: the Section 301 exclusion list; the BIS Affiliates Rule suspension; and the pause on China's Wave 2 rare earth export controls.

Rationale

We view "stabilization, not normalization" as the most appropriate framework for understanding the US-China relationship, and see the September 24 meeting as a venue to confirm whether this framework holds, rather than a platform for major new announcements. The May summit delivered a modest set of outcomes — small measures on trade and investment and cooperation in low-sensitivity areas — but structural issues including semiconductors, rare earths, and export controls remain unresolved. Three measures expire simultaneously on November 10. China's April 2025 export controls on seven heavy rare earths have never been suspended, and US imports of yttrium (used in computer chips) are down 70% from January 2025 levels. Our China Strategy team notes that confirmation of Xi's September visit and signals of softening on tech and trade restrictions could lift risk appetite for Chinese equities, but sees scope for a relief rally rather than a fundamental rerating.

Risk

If the summit disappoints and the three measures expire without renewal on November 10, the rare earth and semiconductor equilibrium could break down, causing AI supply chain costs to spike. Additionally, China's AI chip self-sufficiency ratio is projected to reach 70% by 2030 (see Exhibit 7), meaning US export control leverage will erode over time.

Exhibit 5: Nov 10 could be the date that matters more for policy measures than Sep 24's summit

Measure	Authority / Agency	Original Enactment	Scope / Items Covered	Current Status
① Section 301 Exclusion List	U.S. Trade Representative (USTR) / Trade Act of 1974, Section 301	2018 (Wave 1 tariffs)	178 product categories (Chinese goods)	Active exclusion
② BIS Affiliates Rule Suspension	U.S. Department of Commerce, Bureau of Industry and Security (BIS)	Announced September 29, 2025; effective October 2025	Advanced semiconductor exports from U.S. companies to overseas affiliates/subsidiaries of Entity List or MEU List companies (≥50% ownership threshold)	Suspended
③ China Wave 2 Rare Earth Export Controls	China Ministry of Commerce (MOFCOM)	Announced October 9, 2025; effective November 8, 2025	Holmium (Ho), Erbium (Er), Thulium (Tm), Europium (Eu), Ytterbium (Yb) + related production equipment + technology know-how (extraterritorial application)	Suspended

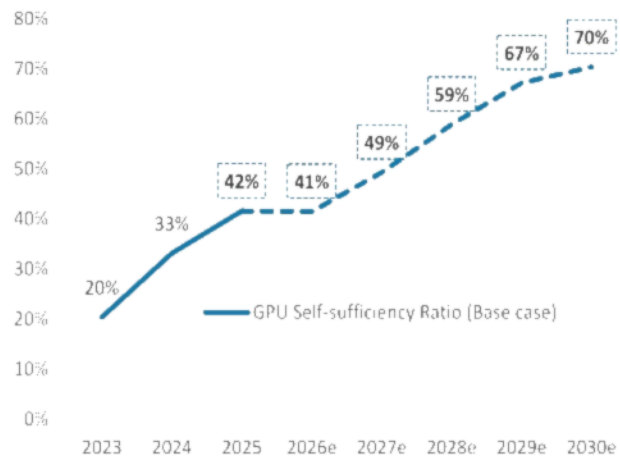
Source: White House, Federal Register, Morgan Stanley Research

Exhibit 6: US-China trade has fallen sharply and appears to be stabilizing at these levels.



Source: Morgan Stanley Research, The Weekly Worldview

Exhibit 7: US leverage in chips is not static, as China's AI chip self-sufficiency continues to rise



Source: Morgan Stanley Research, Bernstein estimates

Reference Reports: Global Economic Briefing: The Weekly Worldview: Managed Stability, Manageable? (August 24, 2026)

Q4. AI & Technology: From a macro perspective, when does AI investment become excessive?

From whom: HF > LO > Corporates (Manufacturing)

Answer

The AI capex cycle is not yet in overinvestment territory (2Q26 earnings reinforced conviction on ROI and prompted further upward revisions to capex forecasts), but hyperscaler capex-to-revenue ratios are on a trajectory to materially surpass the dot-com peak, and overinvestment risk remains a medium-term consideration that warrants continued monitoring rather than a near-term concern.

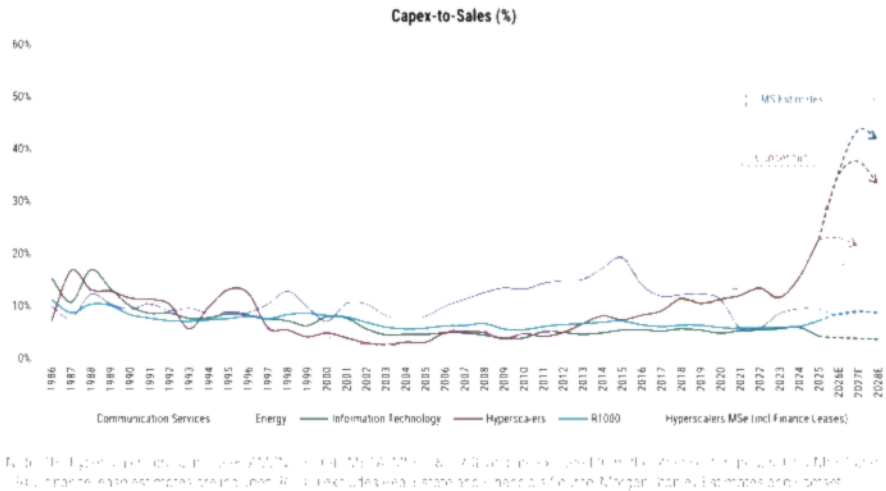
Rationale

Our Global Valuation & Accounting Strategy team maintains its view that hyperscaler cash capex-to-revenue ratios will reach 36%, 44%, and 42% (including finance leases) in 2026, 2027, and 2028, materially exceeding the dot-com peak of ~32%. The combined capex of the top-5 cloud players is now forecast at $779bn in 2026, $1.23trn in 2027, and $1.396trn in 2028; following 2Q26 earnings, the CY27 forecast was revised up a further +20% versus the July estimate, and the momentum of upward revisions continues. At the same time, 2Q26 earnings reinforced hyperscaler conviction on CY26-27 ROIC (our Internet analysts forecast the GPU leasing business generates 70% incremental margins and 30% ROIC) and evidence of ROI is accumulating. Our US Economics team explicitly states that "overinvestment risk is a medium-term consideration, not a near-term concern." Our Credit Strategy team also notes that the lag between capex deployment and monetization continues to pressure near-term cash generation — with FCF forecasts for the four hyperscalers continuing to be revised lower through 2027, widening the financing gap — reinforcing the view that AI-related credit issuance will need to remain substantial, and may need to increase further, before cash flows from these investments begin to catch up.

Risk

Disappointment on ROI — if AI model capability improvements fall short of expectations and enterprise adoption lags — is the primary risk; in that scenario, hyperscalers could slam the brakes on spending, triggering a sharp selloff in semiconductors and data center-related equities. Power and grid constraints, permitting delays, and supply chain bottlenecks could also slow deployment timelines; if the lag between capex deployment and monetization widens, AI credit spreads could blow out.

Exhibit 8: Hyperscaler Capex Spending Poised to Overtake Dot-Com Peak, based on MSe



Reference Reports: Accounting & Valuation: AI Ecosystem: Charting Recent Trends (June 9, 2026) / Software Snippets: Hyperscaler Capex Forecasts Rise Further (August 9, 2026) / Sunday Start: Summer of AI Financing (August 16, 2026) / Global Cloud Capex Tracker: Spending Acceleration Continues (August 3, 2026)

Q5. AI & Society: How will AI change the world? Are we headed for broad-based "abundance" (dramatically higher productivity & living standards for all) or concentration of capital, widening inequality, and stronger redistribution?

From whom: Corporates (Non-Manufacturing) > Corporates (Manufacturing)

Answer

Our US Economics team finds that AI is laying the groundwork for broad-based productivity gains and output growth, but whether those benefits are widely distributed depends on the speed of diffusion and the policy response, making a widening-inequality, stronger-redistribution scenario equally plausible.

Rationale

Our US Economics team finds that industries with high AI exposure saw labor productivity (output per worker) accelerate above other industries in 2025, driven by faster output growth rather than labor displacement, current evidence broadly consistent with an optimistic scenario. High-AI-exposure industries accounted for 1.7pp of the 2.4pp output-per-worker growth differential in 2025. That said, the latest data (August 2026) notes that AI-driven labor disruption is becoming "increasingly visible," with high-AI-exposed occupations already showing a rising unemployment rate contribution of up to 15bp to aggregate unemployment, which signals that the transition is no longer purely an output story.

In a rapid-diffusion scenario, if task creation and wealth effects function adequately, the rise in unemployment can be contained; but if the policy response (fiscal and monetary) is delayed, a "recession-type rise in unemployment" becomes possible. The combination of diffusion speed and policy response drives a wide range of peak unemployment rate increases — from 0.2pp to 4.1pp. In the baseline scenario (diffusion at roughly twice the speed of the internet era), AI accelerates output and productivity growth without triggering a significant rise in unemployment or a recession.

Ultimately, whether the outcome is broad-based prosperity or widening inequality depends not only on what AI can do technically, but on whether its benefits are distributed broadly and reliably enough to sustain demand, with fiscal policy, automatic stabilizers, and retraining investment playing a critical role in shaping that distribution.

Risk

If AI benefits accrue disproportionately to capital owners and high-skilled workers while middle-income wages stagnate, political backlash and radical redistributive policies (wealth taxes, AI levies, etc.) could emerge. History suggests that "inequality risks are rising," and that institutions and public policy will be decisive in determining how broadly the gains are shared.

Exhibit 9: Potential labor market displacement from AI adoption depends on diffusion speed and strength of feedback effects: Slow to moderate diffusion rates produce manageable labor displacement in the presence of task creation and indirect wealth effects. If feedback effects are strong, even fast diffusion produces a more manageable economic transition.

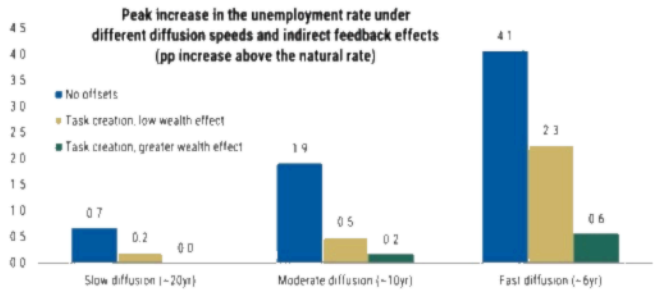


Exhibit 10: In industries with high AI exposure, output per employee rose faster in 2025, and accelerated more, than in other industries



Reference Reports: AI and Economic Transition: Expect Rhyme, Not Rupture (May 13, 2026) / AI and Economic Transition: Industries with high AI exposure are seeing labor productivity from faster output growth, not labor replacement (April 20, 2026)

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