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State of exception

Key takeaways

- US Treasury Secretary Scott Bessent's warnings about speculating against the yen appear to have reversed declines in the yen and long-term Japanese government bond yields for the near term.
- Nevertheless, this rhetorical strategy appears to be more a short-term time buying exercise for both the US and Japan than a structural realignment.
- The impact of the Takaichi government's commitment to fiscal expansionism, along with other factors that have weakened the yen, will reassert themselves eventually.

In remarks at Southern Methodist University Tuesday, US Treasury Secretary Scott Bessent issued an unusual boast. Referring to his "asymmetric information" about the Japanese government's and Bank of Japan's (BOJ) intentions, he dared speculators to short the yen, declaring, "I am the house now. You can bet against me if you want."

Bessent's boast is emblematic of what is, frankly, an unusual and exceptional period for both the yen (up nearly 3% against the dollar over the past month) and Japanese government bonds (ten-year yields have declined more than 4% over the past week). The US-Japan bilateral meetings on the sidelines of the G20 Finance Ministers and Central Bankers meeting last week, the joint US-Japan intervention during the summer, and the reports about an unusual Government Pension Investment Fund (GPIF) management committee meeting seem to have abruptly arrested the decline in the yen and long-term yields.

While in the near term the "Bessent put" may make it unwise to bet against a near-term yen rally, the longer term picture has not necessarily changed. To believe Bessent's boast about "asymmetric information" about Japanese authorities' intentions, one would have to believe (a) the US and the BOJ have essentially colluded over the heads of the Takaichi government to surprise markets with a more aggressive set of rate hikes than the Takaichi government would prefer; (b) the Takaichi government is satisfied with more aggressive hikes; or (c) that the Takaichi government is, despite its rhetoric about “ending excessive austerity” and its own budget documents pointing to a large increase in spending, prepared to scale back its ambitions to satisfy the Trump administration’s desires, including giving its blessing to higher interest rates.

It is highly unlikely that the Takaichi government has either launched a stealth fiscal u-turn – the government just delivered its plan for the consumption tax cut to the Liberal Democratic Party (LDP), which to the chagrin of LDP fiscal hawks includes only vague language about finding ways of funding it – or endorsed a program of monetary tightening even as it prepares significant new outlays for 2027. Meanwhile, notwithstanding the speculation around the GPIF, the barriers to the Takaichi government reintroducing financial repression are steep. Moreover, the structural factors that have produced a weaker yen, including its digital services deficit, its demand for expensive energy imports, and its domestic investors’ search for higher real returns, remain salient. Finally, the cycle whereby Takaichi’s fiscal expansionism weakens the yen – fiscal dominance forcing the BOJ to suppress bond yields relative to Japan’s peers, resulting in yen weakness, higher inflation, and more spending – has not been fundamentally broken.

The “Bessent put” should therefore be viewed more as a short-term strategy to use rhetorical gestures and the occasional joint intervention to dampen speculative activity and avoid a selloff of US Treasuries by Japanese investors before the US midterm elections. It should not be viewed as a de facto new Plaza Accord – the demands on Japan to withdraw monetary and fiscal stimulus would, for example, do little to generate demand for imports from the US to reduce the US goods trade deficit with Japan – but as an exercise aimed at buying time for the BOJ to continue normalizing and the US to avoid the risk of a disorderly withdrawal of Japanese demand for US Treasuries and other assets. It may also work to Prime Minister Takaichi Sanae’s benefit as she looks to buy more time for her “Strong and Prosperous Japan” program to take effect, minimizing the short-term pain to households and businesses from a weaker yen (while potentially buying Takaichi more time in office). But financial markets will not be permanently suppressed, and as the Takaichi government provides more evidence in the coming months that it is still serious about its commitment to fiscal expansion and expanding the supply of Japanese government bonds – deficit bonds and otherwise – the state of exception in foreign exchange and bond markets may come to an end.

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