



Macro View

A New Risk of Yen Depreciation?

Structural Yen-Depreciation Risk Arising From Changes in the Auto Industry Environment

- Even yen-buying intervention by the government and the Bank of Japan has failed to reverse the trend of yen depreciation. Behind this lies not only capital outflows driven by corporate overseas investment and household investment in foreign equities, but also structural changes that make yen selling more likely in underlying commercial flows, including the risk of a worsening trade balance as higher energy prices lift import costs.
- The automobile industry has been a core pillar supporting Japan's trade surplus. It is now, however, facing multiple headwinds: intensifying global competition in electric vehicles, production constraints associated with domestic labor shortages, and trade-policy pressure from the US and Europe to shift production to local markets. These developments raise concerns about a contraction in domestic production and a decline in exports.
- Profits earned by companies' overseas subsidiaries are often reinvested locally and therefore are less likely to be converted into yen in the FX market. By contrast, export proceeds generated through domestic production are more likely to create yen-buying demand, since they are used to pay domestic wages, fund capital expenditure, and cover other domestic costs. Accordingly, a decline in auto exports and a narrowing of the trade surplus would reduce direct, real-economy demand for yen in the foreign-exchange market.
- A contraction of the highly productive auto industry within Japan would imply a deterioration in the economy's overall earning power. Through the Balassa-Samuelson effect, this could create structural depreciation pressure on Japan's real exchange rate over the medium to long term.

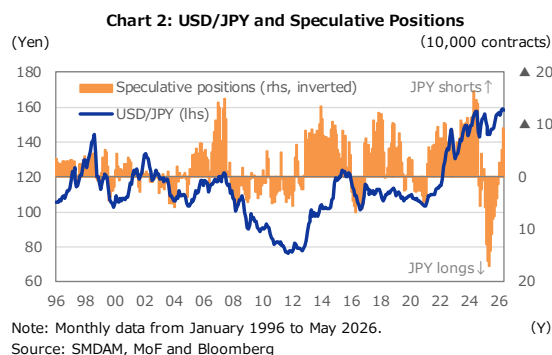
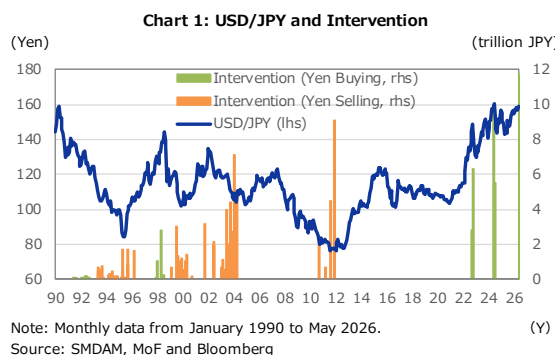
The Yen's Weakening Trend Has Not Reversed Despite Massive Intervention

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. Compared with past episodes, this intervention can be said to have had only limited effect in terms of reversing the trend of yen depreciation (Chart 1).

Speculative investors have once again built up large yen short positions, so part of the explanation may be that efforts to contain speculative yen selling were not especially successful. More fundamentally, however, changes in underlying commercial flows and in the balance of payments may mean that intervention alone cannot easily reverse the yen's weakening bias.



Japan may be moving toward an economic structure in which depreciation pressure tends to persist because yen-selling pressure remains embedded in real-economy flows (Chart 2).

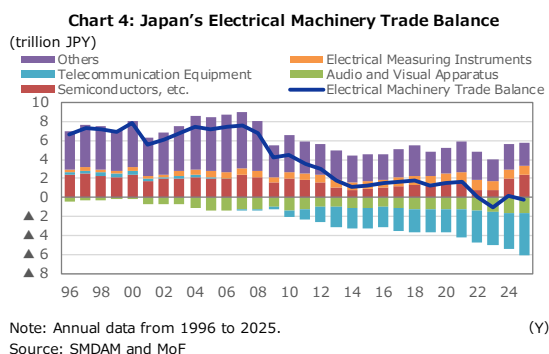
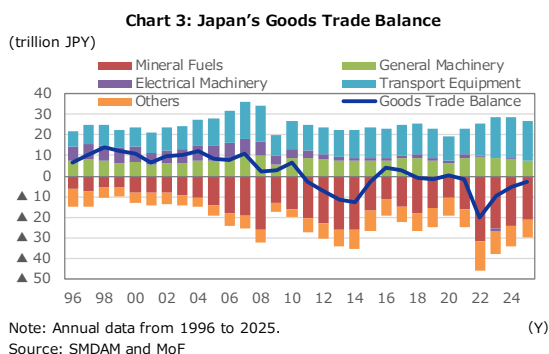


Capital Outflows and Higher Resource Prices Are Reinforcing Yen-Selling Pressure

Capital outflows from Japan are expanding, strengthening depreciation pressure on the yen. Corporate overseas M&A is increasing, and household investment in foreign equities is also growing. In addition, elevated energy prices resulting from tensions in the Middle East are swelling import values, raising the risk of increased underlying demand for dollars. Furthermore, if crude oil inventories previously drawn down by the public and private sectors are rebuilt, that would become another factor pushing import values still higher.

A new source of yen-depreciation risk may now be added to this picture: the risk of a contraction in domestic production and a decline in exports in the auto sector.

Manufacturing is the core sector underpinning Japan's trade surplus. Historically, its three pillars were electrical machinery, automobiles, and general machinery. Since the mid-2000s, however, the electrical machinery sector has suffered a major decline in international competitiveness, especially in finished products. The sector's trade balance, which recorded a surplus of nearly ¥8 trillion in 2000, is now roughly in balance. The reason it has not turned into deficit is that Japanese firms still retain competitiveness in areas such as electronic components. Even so, viewed as a whole, electrical machinery is no longer the sector it once was in generating foreign currency through trade surpluses (Charts 3 and 4).



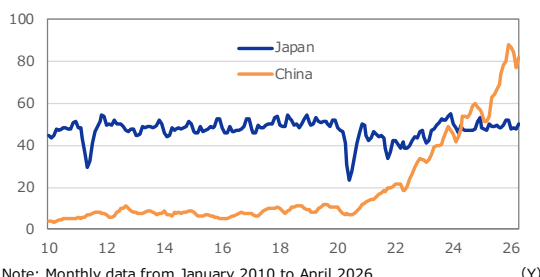
The Auto Sector Is the Main Pillar of Japan's Trade Surplus

Since then, the auto sector, together with general machinery, has become a pillar supporting 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.

The Rise of Chinese Firms in Global EV Competition

The problem is that Japan's auto industry is now facing headwinds. First, the global competitive environment, especially in EVs, is changing dramatically. In battery electric vehicles, US pure-play EV makers and major Chinese manufacturers are in the lead. Chinese firms in particular are gaining ground through in-house battery production, price competitiveness, software capabilities, and speed of product rollout, and 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 (Charts 5 and 6).

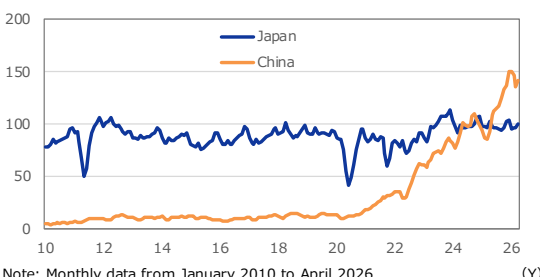
Chart 5: Japan and China Auto Exports (Volume, 3MMA)
(10,000 units)



Note: Monthly data from January 2010 to April 2026.

Source: SMDAM, MOF and CEIC

Chart 6: Japan and China Auto Exports (Value, 3MMA)
(USD 100 million)



Note: Monthly data from January 2010 to April 2026.

Source: SMDAM, MOF and CEIC

Deepening Domestic Labor Shortages and Production Constraints

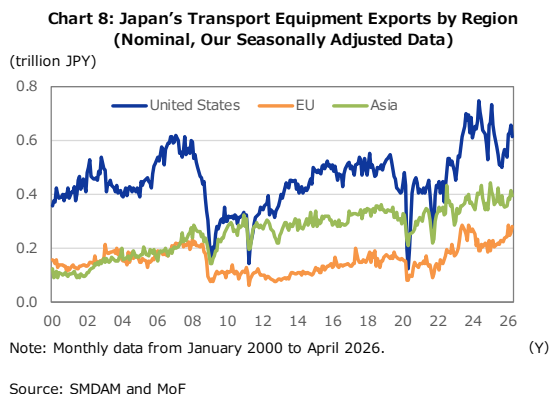
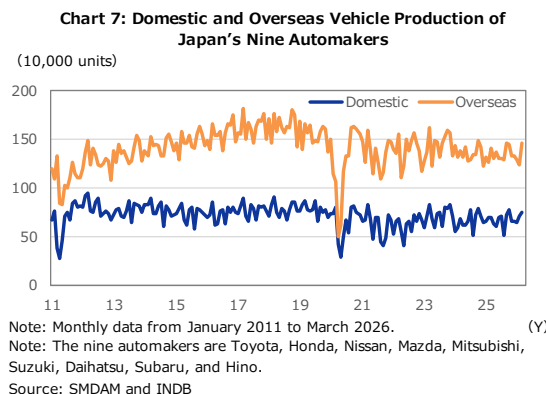
Second, there are domestic production constraints. Labor shortages in Japan are becoming increasingly severe, and constraints arising from worker shortages are intensifying at every stage of the auto supply chain, including assembly plants, parts manufacturers, and logistics. At some manufacturers, delivery 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 to re-import into Japan vehicles produced overseas is a symbolic example of this trend.

At present, this remains in part a response limited to specific firms and specific vehicle models, and it does not immediately mean that the auto industry as a whole is entering a phase of shrinking domestic production. Even so, from a macroeconomic standpoint, whether such moves spread in an environment of tightening domestic production constraints is an important issue. Value added that would otherwise have been generated in Japan is instead shifted to overseas production. Moreover, if such output is then imported into Japan, it appears in the goods trade statistics as an increase in imports. In other words, while this may be a rational response for firms seeking to ease supply constraints, at the macro level it acts to depress domestic value added and export capacity, and could become a factor restraining the auto sector's trade surplus (Chart 7).

To be sure, if a division of labor takes hold in which high-value-added models are produced and exported from Japan while lower-value-added models are re-imported, the trade surplus may not be constrained for the time being. However, if this pattern becomes entrenched, the domestic supply chain itself could gradually shrink, creating a risk of weaker export capacity over the medium to long term, including in related industries.

Trade Policy in the US and Europe and Pressure to Shift Toward Local Production

Third, there is the change in trade policy, especially in the United States. For Japanese automakers, the US is one of their largest export destinations (Chart 8). But in the US, political pressure to bring manufacturing back onshore—through higher tariffs, demands for local production, and pressure for investment in the US—has intensified, with the trend having become especially pronounced since the Trump administration took office. Producing where vehicles are sold is a rational response for avoiding tariffs and managing political risk. However, if exports from Japan are replaced by local production in the US, that would act to shrink Japan's trade surplus. In Europe as well, environmental regulation and industrial policy are reinforcing a preference for production within the region, meaning Japanese auto exports are facing a degree of localization pressure in both the US and Europe.



Why a Current Account Surplus Does Not Necessarily Lead to More Yen Buying

The key point here is that overseas earnings and the trade balance have different implications for the exchange rate.

Even when Japanese firms earn profits overseas, those profits are not necessarily converted into yen and repatriated to Japan. If they are reinvested abroad, they do not directly translate into yen-buying demand. In practice, Japan's current account is in substantial surplus, but much of that surplus is accounted for by the primary income balance, and a large portion of that is not readily converted into yen in the FX market because it is used, for example, for local reinvestment by overseas subsidiaries.

By contrast, foreign-currency earnings from exports are used to pay domestic wages, procure materials, pay taxes, and fund capital expenditure and other spending in Japan. Relative to profits earned by overseas subsidiaries, export proceeds are therefore more likely to generate demand for conversion into yen. Of course, not all export receipts translate into yen-buying pressure, given the presence of FX hedging and foreign-currency-denominated payments. Even so, compared with the case in which overseas subsidiary profits are reinvested locally, foreign-currency earnings generated through domestic production and exports are more likely to create yen-buying flows. Accordingly, even if automakers' global earnings remain solid, a decline in domestic production in Japan and a narrowing of the auto sector's trade surplus would reduce yen-buying pressure in the FX market from the standpoint of underlying commercial flows (Chart 9).

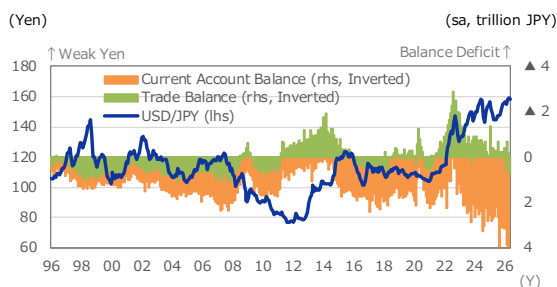
The Risk of a More Fragile Trade Structure

This point is important in considering future yen-depreciation risk. Japan's trade structure has already changed materially. After electrical machinery ceased to function as the surplus pillar it once was, automobiles and general machinery came to support the trade surplus. If the auto surplus were to shrink, Japan's goods trade would become even more dependent on general machinery. General machinery remains internationally competitive, but it would be difficult for that sector alone to sustain Japan's trade surplus. If the auto surplus thins out, Japan's trade balance would shift toward a more fragile structure.

Although this report does not explore the issue in detail, another major concern is the structural widening of the services balance deficit, especially the digital deficit. This too could make underlying yen-selling pressure more persistent. If the auto trade surplus were to shrink, Japan's capacity to offset the services deficit would also weaken, making yen-buying flows in the overall external balance even more vulnerable.

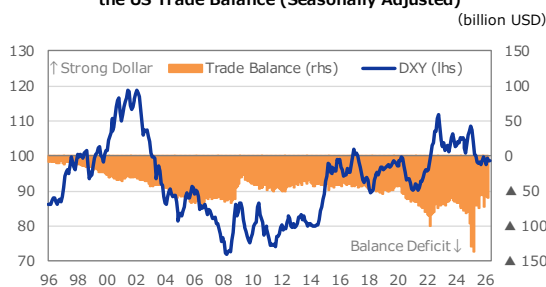
To be clear, we are not arguing that trade surpluses are inherently desirable or that trade deficits are inherently undesirable. The trade balance is determined by outcomes such as the domestic saving-investment balance and industrial structure. The United States, for example, has run trade deficits for an extended period while still attracting capital from around the world, supported by the dollar's status as the key reserve currency, deep financial markets, strong growth expectations, and competitiveness in intellectual property and services. A trade deficit therefore does not automatically mean currency weakness or a decline in national strength (Chart 10).

Chart 9: USD/JPY and External Balances (Seasonally Adjusted)



Note: Monthly data from Jan 1996–May 2026 (current account & trade to Apr). Current account shows trade balance only (income omitted).
Source: SMDAM, MoF and Bloomberg

Chart 10: US Dollar Index (DXY) and the US Trade Balance (Seasonally Adjusted)



Note: Monthly data, Jan. 1996–May 2026 (trade balance to Mar).
Source: SMDAM and U.S. Census Bureau

The Kind of Deficit Matters

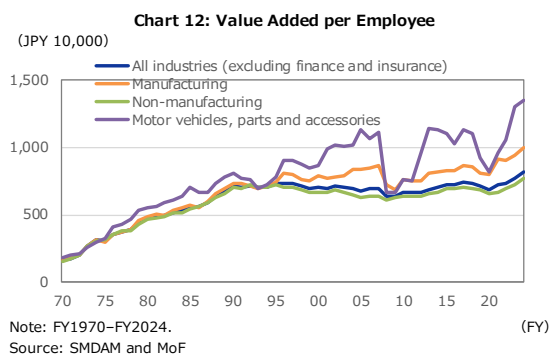
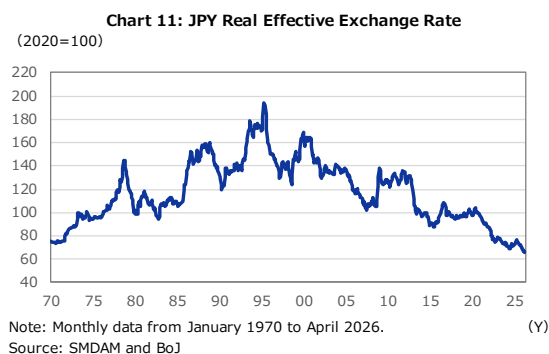
What matters is the nature of the deficit. If a deficit arises because of strong domestic demand or capital inflows into attractive domestic investment opportunities, the resulting downward pressure on the currency may be limited. But if it arises because of higher resource imports, a shrinking domestic manufacturing base, and sluggish export growth, the implications are different. In that case, yen-selling flows associated with imports continue to occur, while yen-buying pressure generated by exports weakens. In the FX market, this makes it easier for real-economy yen selling to become a persistent feature.

Structural Yen Weakness Resulting From the Shrinkage of High-Productivity Sectors

A further point is that a contraction in the domestic auto industry could also become a source of yen weakness from a productivity perspective. Automobiles are produced by a large-scale, high-productivity manufacturing industry. The sector forms an industrial cluster in which R&D, technology, parts procurement, quality control, skilled labor, and capital investment are integrated. The presence of such a high-productivity sector within Japan supports the economy's overall income-generating capacity through wages, employment, regional economies, and the accumulation of technology.

From the perspective of the Balassa-Samuelson effect, countries in which productivity in the tradable goods sector rises more rapidly relative to the non-tradable sector tend to see domestic prices pushed upward and the real exchange rate appreciate.

Put differently, if high-productivity sectors shrink domestically and the economy's overall earning power declines, then, other things equal, the real exchange rate—the real value of the currency—becomes more likely to face depreciation pressure. 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 11 and 12).



The Underlying Strength of Japanese Automobiles and Factors That Could Mitigate the Headwinds

That said, it would be premature at this stage to conclude that domestic auto production and exports are set to contract rapidly. Japanese manufacturers remain strong in hybrids, high-quality vehicles, commercial vehicles, and certain high-value-added models. Their global brand power, sales networks, and reputation for quality also remain intact. 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. Indeed, 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 emphasized hybrids.

Accordingly, while the risk of stronger competitive pressure on Japanese automakers over the long term cannot be ignored, over at least the next several years the competitiveness of Japanese firms in hybrids and high-value-added vehicles could provide support, meaning Japan's auto exports may not contract sharply.

However, as seen in the field of AI, the global competitive environment can change at extraordinary speed. As noted above, multiple headwinds are blowing at once—EVs, Chinese competition, domestic labor shortages, and trade policy in the US and Europe. In that environment, one cannot assume unconditionally that the auto trade surplus will continue to support the yen. At the same time, there may currently be hopes that the AI boom will help revive the electrical machinery sector. The question, however, is how far such a revival could offset the risk of a shrinking trade surplus in autos.

A Long-Term Macro Perspective on the Exchange Rate

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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