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GUEST ESSAY

The Real Reason Behind Trump’s Yen Intervention

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It’s rare for the United States to intervene in another country’s currency policy. It usually happens because there is a crisis. But in recent cases involving Argentina, Japan and the United Arab Emirates, none of those countries had reached the level of emergency usually required.

In all three the Trump administration has directly supported or offered support for their currencies. Why would the administration do this? After all, it seems risky and expensive to buy another country’s currency or even offer to temporarily swap dollars for that currency, especially one whose value is falling.

None of these actions were born of benevolence. The administration has U.S. economic interests in mind but is also keen to propagate its policies and reward its allies. It has thus made currency markets instruments to overtly promote not just economic but also political and geopolitical objectives.

This administration's actions show that, as with many other interventions it has undertaken, it is willing to fight market forces if they run counter to any of these objectives. Such interventions have their limits, however, and financial markets may have the last say.

In October the administration propped up the Argentine peso, which had been sinking like a rock ahead of crucial legislative elections faced by President Javier Milei, a steadfast ideological ally of President Trump. Buying pesos was risky, since their value could have plunged further if Mr. Milei had failed to execute economic reforms, but turned out to be a good bet. U.S. support for the peso turned the elections in Mr. Milei's favor, and he soon delivered a balanced budget, ending a long run of chronic public deficits and putting public debt on a downward trajectory, which has brought down inflation and stabilized the peso.

Soon after the Iran war broke out, Washington and the Emirati government disclosed discussions of an arrangement for the Emirates to obtain dollars in exchange for dirhams. The Emirates, a close U.S. economic and security partner, has ample financial resources to deal with the conflict's repercussions, but making this discussion public sent a strong signal that it was an ally deserving of American support.

Now the Treasury is intervening in foreign exchange markets in coordination with the Japanese government, another staunch American ally, to bolster the Japanese yen. The yen fell by more than 10 percent relative to the dollar in one year before the intervention. While the coordinated purchases of yen have allowed the currency to recover some ground, success is far from assured.

Japan has good reasons to fear a falling yen. It would increase the price of imports, adding to inflation, and raise the borrowing costs on government debt if it caused foreign investors to shy away from yen-denominated assets. Prime Minister Sanae Takaichi has ambitious plans to raise government spending to amp up growth, which could eventually add to the mountain of government debt that is already more than double Japan's annual gross domestic product. Paying more interest on that debt could scupper Ms. Takaichi's plans.

What's in it for the United States? Japan is now the largest foreign holder of U.S. Treasury securities. If the Bank of Japan were to sell some of its Treasury holdings to procure dollars for purchasing yen in order to support the yen's value, interest rates on U.S. government bonds would have to rise to attract other buyers for those bonds. This would raise borrowing costs for the U.S. government and, in turn, for American businesses and consumers. Additionally, Mr. Trump's 10 to 12.5 percent tariffs on Japanese imports would fade into irrelevance if the yen kept falling, making Japanese imports cheaper.

Japan has a long history of intervening in currency markets, sometimes to prevent the yen's rapid appreciation and sometimes, as is the case now, to limit its depreciation. The U.S. Treasury's involvement is the new wild card.

Is there logic to coordinated intervention? Currency markets have a tendency to overshoot in one direction or the other when circumstances change. Smoothing out such volatility is a legitimate reason for intervention. Adding the Treasury's firepower will surely scare off speculators trying to profit off unwarranted volatility in the yen. But such interventions invariably fail to stem the tide when they are not supported by policy changes.

In fact, the yen's depreciation is hardly the result of a surge in volatility. Before the recent intervention, it had lost about a third of its value relative to the dollar since 2020. Japan is a rich country but has an aging population and a huge level of government debt. It has experienced anemic growth in recent years, and rising oil prices could increase inflation, making the yen worth less. These factors feed on themselves; a falling yen would make things worse by raising the price of imports.

By contrast, the American economy and labor market look robust. Inflation has persistently remained above the Federal Reserve's target. So the Fed is increasingly likely to raise interest rates this year, making U.S. short-term government debt more attractive to foreign investors. This is bad for the yen, given the already large differences between U.S. and Japanese interest rates, but might seem fortuitous for the United States. With no sign of any discipline on fiscal matters, it will probably result in Washington digging itself into an even deeper debt hole.

So the two economies are in different places. But they are tied together by one big problem: unsustainably high levels of government debt. Currency market intervention is a desperate attempt by Tokyo and Washington to evade the blaring warnings from financial markets. In the end, neither government is likely to outrun the discipline that market forces bring to unrestrained debt accumulation. Perhaps it's time both countries learned a lesson from Argentina.

Eswar Prasad is a professor at Cornell University and a senior fellow at the Brookings Institution. His latest book is "The Doom Loop: Why the World Economic Order Is Spiraling Into Disorder."