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The nominal effect of exchange rate and the variant of Carry trade - lessons from experience in the beginning of the ABE administration

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Abstract(1)

Considering on the effect of the nominal fluctuation effect under the "unprecedented monetary easing" by the Bank of Japan adapted according to an intention of the Abe administration in April 2014.

(Economic background)
Depreciation of the currency of a country should lead to increasing both volume of its exports and profits of its export industries theoretically. However, the increasing of exports volume index in Japanese wasn't observed, but the enlarging profit of export industries.

Abstract(2)

From this fact, I would like to point out two points

First, the profit of exports industries is net inflow of profit from abroad, but income redistribution in a country.

Second, this fluctuation of exchange rate is a kind of one. This paper will also explain the difference between real and nominal exchange rate. A variant of carry trade occurred by unprecedented monetary easing. By the unprecedented monetary easing, the Tokyo stock market price skyrocketed since 2012, because foreign investor increased buying in the market. It should have been a factor of appreciation of Yen. As it was, Yen rate depreciated rapidly. What are there behind this superficial fact? In the paper I will try to unravel both internal and external path of redistribution of income.

the Abenomics and the unprecedented monetary easing of the BoJ

Abe administration started from Dec. 2012. The Prime Minister designated Haruhiko Kuroda as the president of the Bank of Japan (the BoJ) in March 2013. Kudora adapted “unprecedented monetary easing” immediately after he took office (April).

(Content of the unprecedented monetary easing)

The BoJ made a “commitment to maintain the current quantitative easing framework until the year-on-year change in the consumer price index registers zero percent or higher on a sustainable basis”.

1. The BoJ doubles the quantity of fund supply
2. The BoJ aims to achieve the percentage increase in the Consumer Price Index 2% which is set as the target of stable prices.

Result of the unprecedented monetary easing of the BoJ

Monetary Base and CPI

To doubles the quantity of fund supply

Distorted the assent structure of the BoJ

Stock Price

Stock price soared

Funds of foreign investor flow in the market

Exchange Rate

Yen depreciated against Dollar

Trade balance

Trade Balance

Quantum indices in Trade Statistics

Corporate Earnings

Export Industry

Import industry

Superficial and nominal effect

Unprecedented easing policy had some effects on the stock market and the exchange rate

- Stock market price quicky responded and jumped up.
- Since early 2013, the exchange rate of Yen depreciated against Dollar.

Unprecedented easing policy seemed to have a effect on the trade balance and corporate profits

- Since March 2015 trade balance (goods and services) changed for the better.
- And the corporate performance (especially export industry) improved.
- Generally speaking, the exchange rate has real effect to trade balance and corporate performance.

However, export volume index shows us a different implication

Not react to the fluctuation of exchange rate

- Since before the Abe administration, export volume index has not reacted to the depreciation of Yen

The nominal effect of the exchange rate

- Generally speaking, exchange rate influences volume of trade export or import (the real movement of exchange rate).
- However, it doesn’t have any effects on the real trade, when it adjusts the gap of depreciating value between two currencies (the nominal movement of exchange rate)
- Under the Abe administration, depreciating of Yen against Dollar seems to be the same nominal effect to the international trade of Japan as the above despite of lower inflation rate of Yen rather than Dollar.

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Marx, K '*Capital Vol. III*' (Electric Book Company),2000, P.796

The foreign rates of exchange can change:
1) In consequence of the immediate balance of payments, no matter what the cause—a purely mercantile one, or capital investment abroad, or government expenditures for wars, etc., in so far as cash payments thereby are made to foreign countries.
2) In consequence of money depreciation—whether metal or paper—in a particular country. This is purely nominal. If £1 should represent only half as much money as formerly, it would naturally be counted as 12.5 francs instead of 25 francs

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W. Blake, "Observations on the Principles which regulate the Course of Exchange: Present Depreciated State of the Currency, London",1810 in McCulloch (ed.)" *A Select Collection of Scarce and Valuable Tracts and other Publications on Paper Currency and Banking*, 1857

The computed exchange is determined by the fluctuations of the price which is foreign bill bear in the market (P.531)

The market price of a foreign bill has been stated to depend upon two circumstances: first, on the scarcity of bills in the market compared with the demand for them; and secondly , on the value of the coin or currency in which they are to be paid, compared with the value of the coin or currency with which they are bought. (p.499)

The first, arising from the abundance or scarcity of bills in the market, is foundation of what may be called the real exchange.......
The second, arising from alterations in the value of the nominal exchanges, which has no reference whatever to the state of debt and credit of the country. And...the effects, which the real and nominal exchange have upon the general dealings and commerce of country, are distinct as their causes...(p.481)

The real exchange has an immediate effect upon the exports and imports.
The nominal exchange, whether favourable or unfavourable, has no effect whatever upon expots and imports.(p.530)

Why did the exchange rate fluctuation have the nominal effect since the Abe administration?

The depreciation of Yen has been the real exchange movement.

- A factor of depreciation of Yen has been the gap of interest rate between Japan and the United States
- Another factor of the depreciation was the worsening the trade balance
- These factors arise from the fluctuation of real exchange.
- Inflation rate of US

Despite of the factors of real exchange, the effect to trade has been nominal

- Export trade volume index has not reacted to the depreciation of Yen since 2012
- The points of problem:
  - Why hasn’t real exchange influenced the volume of trade (Why does it seem to cause the nominal effect?)
  - Where does the profit of export industry come from?

Why hasn’t real exchange influenced the volume of trade (Why does it seem to cause the nominal effect?)

Hollowing out of industry

- The domestic investment has deceased
- The direct investment has increased
- Expanding internal reserve = less domestic investment

Financialization and Unconventional Monetary Policy

- Two kinds of Carry Trade
  - Investment abroad of monied capital funded in Japan
  - Remittance of capital gain by monied capital funded in Japan to abroad

Where does the profit of export industry?

Redistribution from domestic household

Thank you

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