

## *Yen continues to weaken*

Japanese tourists who travel abroad these days are guaranteed to find prices surprisingly high wherever they go. This is because the yen is grossly undervalued against many other currencies. The yen has weakened above 120 to the dollar and is now at a record low of over 160 against the euro.

The yen's real effective exchange rate, or its inflation-adjusted, trade-weighted value, in June fell to a level below where it was at the time of the Plaza Accord, an agreement in 1985 among the five richest nations to drive down the value of the dollar, which was then seen as overvalued against the yen and other major currencies.

The dollar has actually weakened against many other currencies in recent years, but the yen has fallen even against the greenback.

The findings of the Bank of Japan's Tankan business sentiment survey in June, released Monday, portrayed an economy in fine shape, at least as a whole. But the survey results nevertheless reflected the effects of the yen's extraordinary weakness. Business confidence has picked up further in export-oriented industries, such as electric machinery, shipbuilding and heavy machinery. A weak yen lifts the price competitiveness of their exports.

But the confidence indexes for materials industries, like pulp and paper, nonferrous metals and steel, have deteriorated amid concerns about higher prices of imported materials due to the yen's decline.

A bill now winding through U.S. Congress would introduce trade sanctions, including anti-dumping duties, against countries that are found to keep their currencies artificially cheap to help their exports. The bill is clearly aimed at China, but there is also a behind-the-scenes political move in Congress to target the Japanese currency for the sake of the struggling U.S. auto industry.

A recent Asahi Shimbun business survey of 100 major companies found that 31 of the responding firms regard the yen as too undervalued, up sharply

from the previous survey in November last year. Cash-flush foreign investment funds are snapping up Japanese stocks. Japanese companies apparently fear that the yen's weakness, which makes Japanese stocks cheap for foreign investors, will only fuel the buying binge by foreign funds.

In Japan, businesses traditionally tend to show little concern about a weak yen while reacting nervously to a stronger yen. But the slide of the currency's value is beginning to make many companies uneasy.

Why is the yen so undervalued when Japan's current-account surplus is running at the highest levels on record thanks to its strong trade performance and huge profits from overseas investments? The principal reason is that interest rates are far lower in Japan than in most other countries.

In the past, the currency of a country with strong economic fundamentals, especially a big current-account surplus, was usually given high valuation.

Amid a global glut of liquidity, however, capital has been flowing more and more into high-interest-rate currencies in recent years. This trend has been calling the tune on the currency market for some time.

If the yen continues to be so out of alignment with Japan's economic fundamentals, the situation could eventually start causing distorting effects on the economy.

Fortunately, the results of the Tankan survey suggest the economy is still on track to grow at a moderate pace for the time being. Consumer prices are still moving slightly below year-earlier levels, but this is not working to slow down the economy.

Considering both the domestic economic conditions and the yen's unreasonable cheapness, it is a fair bet that the BOJ will find an increasingly conducive environment for raising interest rates from their extremely low levels in summer or autumn.