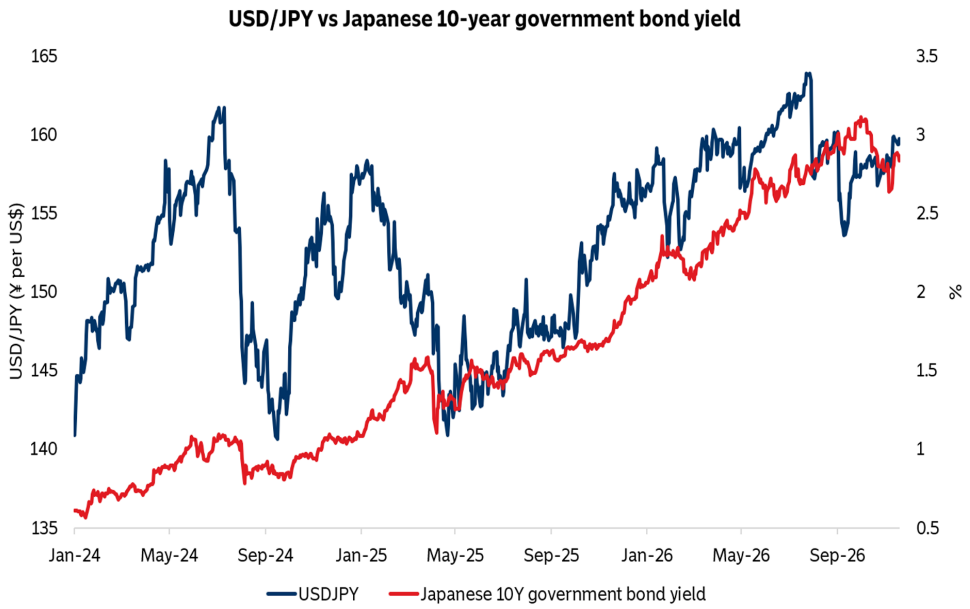
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Why isn't the yen stronger?

Gabby Byron



Source: Momentum Global Investment Management, Bloomberg Finance L.P. Data to 19 November 2026.

What does the chart show?

For much of the past few years, the weakness of the Japanese yen had a relatively straightforward explanation: interest rates in Japan were exceptionally low while rates elsewhere rose sharply. That left Japanese assets offering comparatively little income and encouraged capital to move overseas.

The explanation has become less straightforward. Japanese government bond yields have risen materially as inflation has become more established and monetary policy has begun to normalise. Yet the yen has remained weak, with USD/JPY recently trading around ¥159 to the dollar.

The chart illustrates this disconnect. While higher domestic yields might ordinarily make Japanese assets more attractive, the yen has struggled to gain meaningful ground. This suggests that the currency is being influenced by more than just the direction of Japanese interest rates.

Why this is important

The answer lies partly in the fact that currencies respond to relative interest rates, rather than rates in isolation. Japanese yields have risen, but US yields have also moved higher. The US 10-year Treasury yield is currently above 5%, compared with approximately 2.8% for the Japanese equivalent, leaving a substantial yield differential between the two markets.

This rate differential helps explain the continued attractiveness of the so-called carry trade, whereby investors borrow in lower-yielding currencies such as the yen to invest in higher-yielding alternatives. Although Japanese monetary policy is normalising, the interest rate advantage of holding dollars remains substantial, helping to sustain demand for higher-yielding overseas assets.

Currency markets are also forward-looking. What matters is not simply that Japanese interest rates are rising, but whether investors believe they will rise sufficiently, and quickly enough, to narrow the gap with other major economies. Expectations around future monetary policy, inflation and economic growth can therefore be just as important as current interest rate levels.

The weak currency itself creates an increasingly difficult balancing act for Japanese policymakers. A weaker yen can support exporters and boost the value of overseas earnings when translated back into yen, but it also raises the cost of imported goods and energy. That can add to domestic inflationary pressure and squeeze household purchasing power.

For investors in Japanese equities, the distinction matters too. A weaker yen can benefit internationally focused businesses by making exports more competitive and increasing the translated value of overseas earnings. Conversely, companies reliant on domestic consumption or imported inputs may face higher costs and pressure on margins. The impact of yen weakness is therefore far from uniform across the Japanese equity market.

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