Yen Leaps Over Milestone

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Japan scored a victory in its decadelong battle against falling prices known as deflation, as the yen tumbled to trade at 100 to the dollar for the first time in four years.

The milestone comes five weeks after the Bank of Japan surprised investors with an aggressive course of monetary easing that aims to stoke economic growth by, among other things, reducing the value of the currency, making goods manufactured in Japan more competitive on global markets. The bank's move has since prompted a host of other nations to loosen their own monetary policies, notably Australia and South Korea.

The U.S. currency rallied against its Japanese counterpart Thursday following a government report showing fewer Americans filed for unemployment last week than economists expected. A pickup in U.S. economic growth could mean the Federal Reserve will wind up its extraordinary stimulus measures well before other central banks do.

The Yen’s New Weakness

The yen has been sliding against the dollar since November, when then-candidate Shinzo Abe declared that as prime minister he’d push the Bank of Japan to be more aggressive.

Reuters
Investors and traders had been anticipating the dollar's breach of ¥100 since last year, when calls for bigger stimulus measures grew louder. The yen has weakened 16% against the dollar this year and more than 20% since last fall.

"There is this belief that the U.S., in terms of its growth cycle, is a little bit ahead of the curve of the rest of the world," which is being reflected in the dollar's strength, said Matthew Alexy, director of global foreign exchange at TD Securities.

Some big-name hedge-fund managers have profited handsomely from the dollar's rally against the yen. At one point, George Soros has scored gains of more than $1 billion by betting against the yen. Others reaping big gains have been David Einhorn's Greenlight Capital, Daniel Loeb's Third Point LLC and Kyle Bass's Hayman Capital Management LP.

Many have also bet big on Japan's stock market. The rationale: The weaker yen makes Japan's exporters more competitive, revving up their profits and bolstering the country's economic growth. The Nikkei Stock Average has climbed to its highest levels since July 2008.

Japan's rebound is just in its "second inning," Mr. Loeb said Thursday. "People think they're late" to the turnaround story, but the runup in Japanese stocks will continue, he added.

Mr. Loeb said Japanese stocks remain cheap, trading at about 13 to 14 times earnings, below the multiple of U.S. stocks.

Toyota Motor Corp. 7203.TO +5.03% this week said its net profit tripled in the last fiscal year and forecast profit growth of 42% this year. Many analysts saw the results as evidence of the benefits of a weaker yen.

For much of the past five years, as the yen strengthened amid financial-market turmoil, the currency dragged down earnings of Toyota and other Japanese industrial exporters. In response, many continued to shift manufacturing overseas, worsening a "hollowing out" that has plagued the domestic economy over the past 20 years. That in turn has kept wages under pressure, further adding to deflationary pressures.

While the yen's fall is expected to help exporters, there are also considerable downsides for Japan, notably in terms of sharply higher energy import costs.

The quick drop in the yen may be a sign that central banks are succeeding, five years after the financial crisis, in finally pushing investors out of safe havens such as the yen and into riskier assets such as stocks and some bonds.
Just as the yen's sudden strengthening in 2007 signaled a rush into safe havens ahead of world market volatility, the currency's recent drop may bode well for broader financial markets, heralding more appetite for risk. U.S. stock indexes have broken records this year and numerous classes of risky assets, such as so-called junk bonds issued by lower-rated companies, have benefited from substantial investor flows.

The dollar shot up above ¥100 in afternoon trading in New York, causing a domino effect in other markets. The dollar gained against the Australian dollar and euro, and the Dow Jones Industrial Average turned positive after trading much of the day in the red.

The dollar didn't stop its charge once it hit ¥100, quickly surging as high as ¥100.79. The sharp move set off a scramble to buy the dollar against currencies including the Australian dollar, which fell to its lowest since June 2012.

The dollar had traded within a few yen of 100 since April 4, when Japan's central bank unveiled an aggressive plan to add money to its economy in a bid to jump-start growth. It was the first time a dollar bought more than ¥100 since April 14, 2009.

The dollar's fast rise has prompted many brokerage houses to raise their forecasts for the dollar, and the view is increasing that the greenback may reach ¥110, or even higher, by the end of this year.

"What's the next stop? I heard someone say ¥120, and that looks feasible to me over the next few months," said George Dowd, who heads Newedge USA's foreign-exchange trading desk in Chicago.

The dollar's break above the ¥100 level is the latest indication of the dramatic turnaround in sentiment from last November when Japanese Prime Minister Shinzo Abe, then running for office, said he wanted to see more aggressive quantitative easing by Japan's central bank to help end Japan's long-running deflationary pressures.

New Bank of Japan Gov. Haruhiko Kuroda responded with a program that he described as including "all the policy measures imaginable at this point."

At the core is a plan to purchase more than ¥100 trillion of Japanese government bonds and other assets by the end of 2014. That's a never-before-seen doubling of the monetary base over a period of two years. The monetary base is the core figure for the money supply. Increasing the amount of money in the economy tends to push the value of the currency lower.

"It is the first time I can remember Japanese policy makers truly and positively surprising markets for a long time, perhaps even ever in my 32 years of work," said Jim O'Neill, chairman of Goldman Sachs.

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