Weekly CIO Letter

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The Hidden Balance Sheet Behind the Yen Rescue

Washington's first yen-buying intervention since 1998 was officially about disorderly currency markets. The deeper concern was what a destabilized yen could force investors — and Japan itself — to sell.

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Executive Summary

On July 31, the United States joined Japan in the foreign-exchange market to buy yen.

The intervention was exceptional.

It was the first U.S. foreign-exchange intervention since 2011 and the first American operation specifically buying yen since 1998.

Japan subsequently disclosed approximately ¥15.4 trillion of intervention between July 30 and August 26 — larger than either of its major intervention episodes in 2024.

Officially, both governments described the operation as a response to excessive volatility and disorderly currency movements.

That explanation is correct, but incomplete.

Treasury Secretary Scott Bessent later argued that disorderly yen moves could force investors to unwind positions, destabilize global markets and ultimately raise financing costs for American households and businesses.

This points to a broader objective: limiting the risk that instability in the yen would spill into U.S. Treasuries, dollar liquidity and leveraged global portfolios.

Japan remains the largest foreign holder of Treasury securities, with approximately US$1.12 trillion as of June.

At the same time, the yen is one of the world's principal funding currencies.

- A severe currency dislocation can therefore transmit through two channels:
- Japan may require large amounts of dollar liquidity to support its currency.

Leveraged investors financed in yen may be forced to liquidate assets when the currency moves abruptly.

The intervention should therefore be understood not simply as support for the yen.

It was also a form of financial-system risk management.

1. When Currency Intervention Becomes a Balance-Sheet Problem

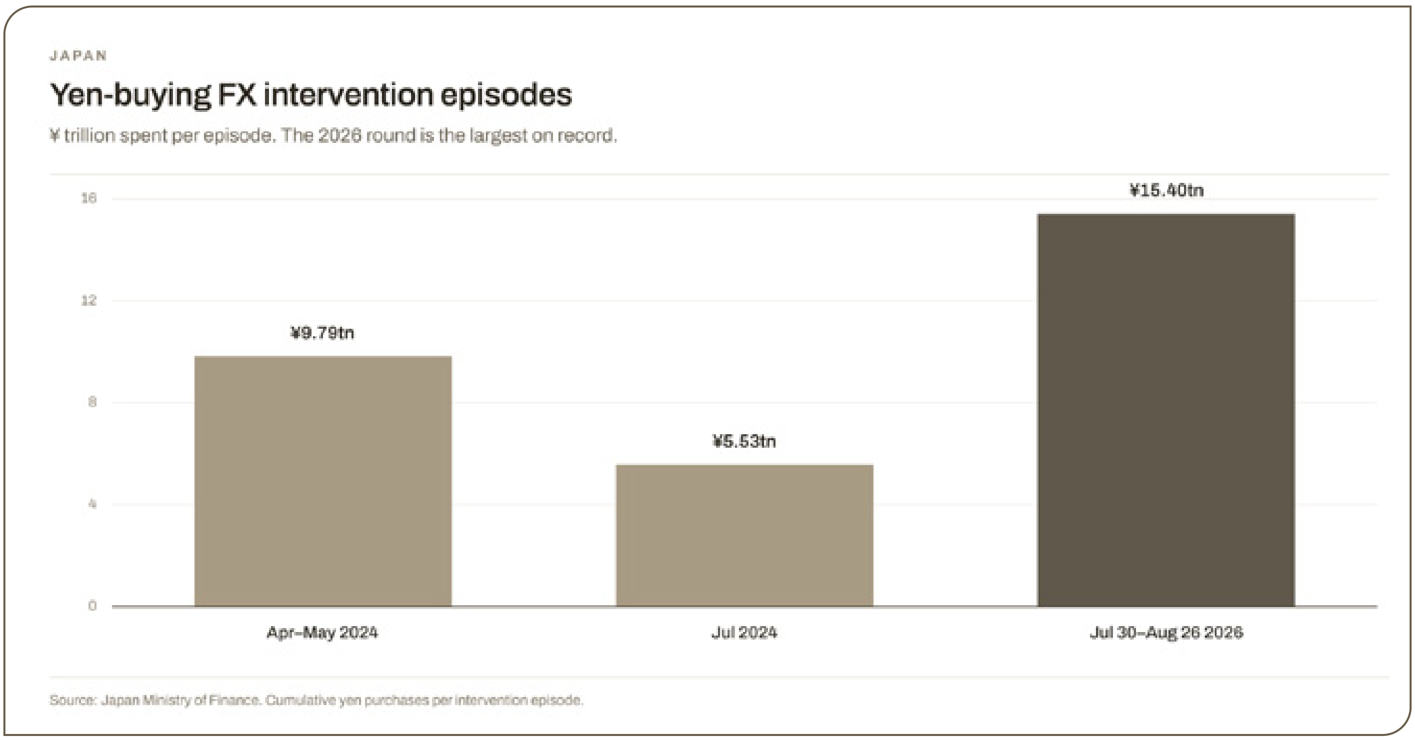
The distinction between manufacturing-led and service-led growth deserves attention.

Japan has supported the yen before.

The current operation stands out because of its scale.

Japan spent approximately:

- ¥9.79 trillion in April–May 2024;
- ¥5.53 trillion in July 2024;
- ¥15.40 trillion between July 30 and August 26, 2026.



The size matters because currency intervention requires funding.

To buy yen, Japan must provide foreign currency — primarily dollars or other reserve assets.

Japan does not hold its foreign reserves simply as cash. Like other major reserve managers, it holds large portfolios of liquid foreign securities, including U.S. Treasuries.

This creates a direct connection between the foreign-exchange market and the Treasury market.

If repeated yen intervention required Japan to raise large quantities of dollars through outright asset sales, Treasuries would represent one possible source of liquidity.

That does not imply a Japanese Treasury fire sale was imminent.

It explains why Washington had an incentive to prevent the risk from developing.

The FIMA solution

Japan has also indicated that it intends to make use of the Federal Reserve's FIMA Repo Facility.

FIMA allows approved foreign monetary authorities to temporarily exchange Treasury securities for dollars rather than selling those Treasuries in the open market.

The mechanics matter:

Treasuries → Federal Reserve → dollar liquidity → FX intervention

instead of:

Treasuries → market sale → dollar liquidity → FX intervention

FIMA therefore allows Japan to mobilize its reserve portfolio while reducing the risk that currency intervention itself creates unwanted selling pressure in the Treasury market.

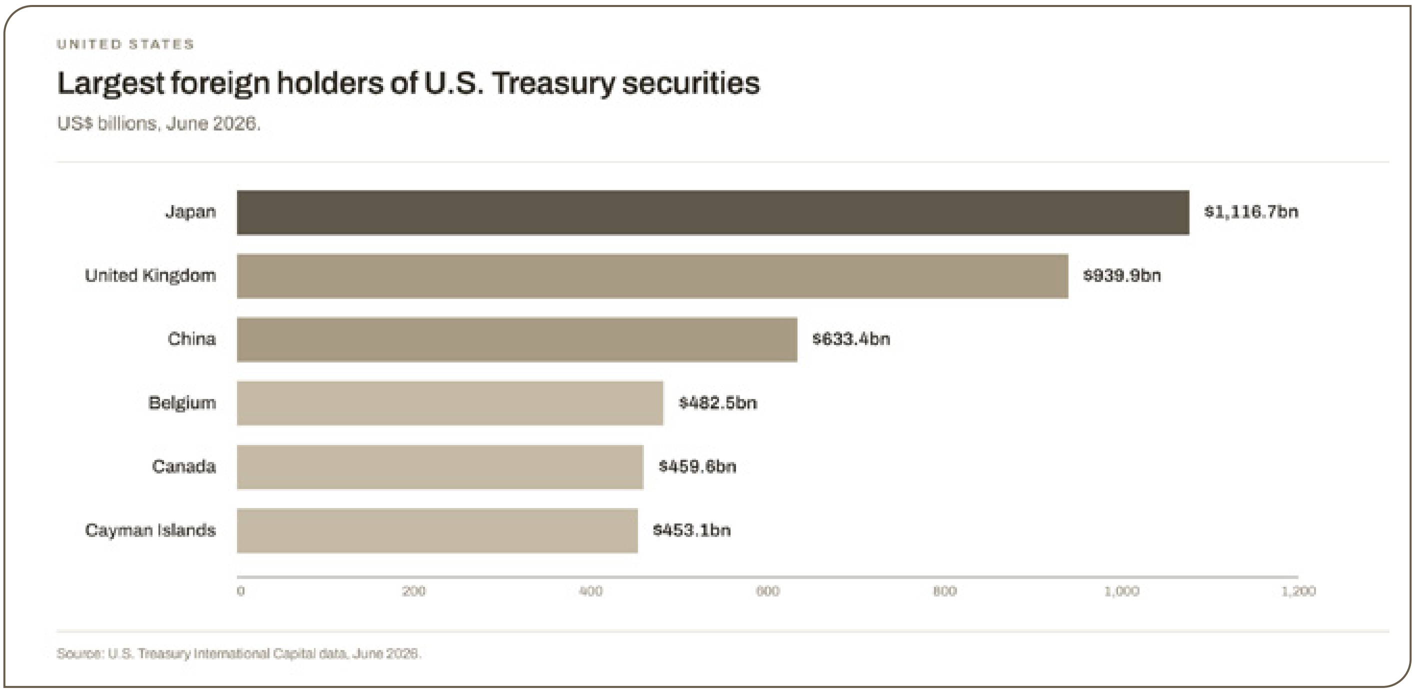
That makes the U.S. response easier to understand.

2. Japan Is Not a Marginal Treasury Investor

Japan remains the largest foreign holder of U.S. Treasury securities.

As of June 2026:

- Japan: US$1.117 trillion
- United Kingdom: US$939.9 billion
- China: US$633.4 billion
- Belgium: US$482.5 billion
- Canada: US$459.6 billion
- Cayman Islands: US$453.1 billion



Japan therefore occupies an unusual position.

It is simultaneously:

a major U.S. ally;

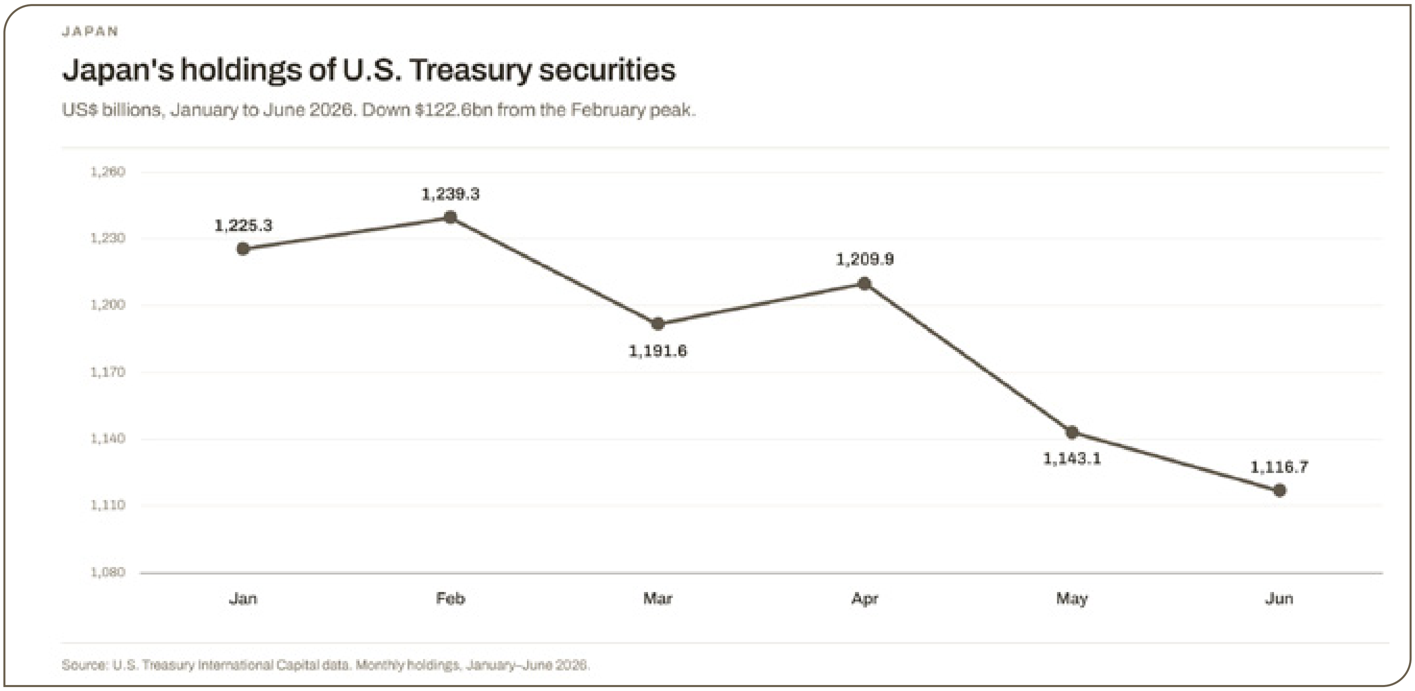
the issuer of one of the world's principal funding currencies;

a large reserve holder;

and the largest foreign investor in U.S. government debt.

Japanese Treasury holdings have also declined materially this year.

They rose to approximately US$1.239 trillion in February, before falling to roughly US$1.117 trillion by June.



There is an important limitation.

TIC data combine official and private Japanese investors and are affected by custody and valuation effects. The decline cannot be interpreted as evidence that Japan's government itself sold the full amount.

What matters is the broader relationship.

With more than US$1 trillion of Treasury exposure associated with Japanese investors, Washington has a rational interest in ensuring that currency stress does not unnecessarily translate into Treasury-market stress.

This becomes particularly relevant when long-term Treasury yields are already elevated and the federal government continues to issue substantial amounts of debt.

3. The Larger Risk Was the Carry Trade

Japan's reserve portfolio is only one side of the story.

The yen has spent years functioning as a major global funding currency.

Investors can borrow or finance positions at relatively low Japanese interest rates and deploy that capital into higher-yielding assets elsewhere.

The strategy works while:

- Japanese funding remains inexpensive;
- the yen remains weak or stable;
- volatility remains controlled.

The risk appears when the yen moves violently.

A sudden appreciation increases the value of yen liabilities relative to foreign assets.

Leveraged investors may then be forced to cut positions.

That liquidation does not need to occur only in Japanese assets.

It can spread across:

- equities;
- corporate bonds;
- emerging-market assets;
- commodities;
- currencies;
- Treasury securities.

This is why Bessent's reference to forced unwinds is particularly important.

The intervention may have been designed to contain two opposing risks simultaneously.

A continuing yen collapse could force Japan to conduct increasingly large reserve operations.

An uncontrolled reversal could force global carry investors to deleverage.

Both routes could eventually affect Treasury-market liquidity and U.S. financial conditions.

Why the Treasury Market Matters So Much

Treasury securities are more than government bonds.

They function simultaneously as:

- federal liabilities;
- foreign-exchange reserves;
- global collateral;
- repo-market instruments;
- safe assets;
- and the foundation of dollar liquidity.

This creates unusual policy incentives.

A disruption in Treasury-market functioning affects much more than the federal government's borrowing rate.

It can influence:

- mortgage rates;
- corporate borrowing costs;
- financial leverage;
- bank collateral;
- derivatives pricing;
- global dollar funding.

That explains why Bessent linked disorderly yen moves directly to the borrowing costs faced by Americans.

The yen was the immediate market being defended.

The Treasury market was one of the markets Washington could not afford to allow it to destabilize.

Implications for Markets and Portfolios

U.S. Treasuries

The intervention reinforces the structural importance of Treasury-market liquidity.

That should not be confused with an investment recommendation on long-duration bonds.

Treasury securities have very low conventional nominal default risk, but they still carry meaningful:

- duration risk;
- inflation risk;
- term-premium risk;
- real-return risk.

The government does not need to default for a long Treasury position to perform poorly.

Long Duration

The long end currently faces opposing forces.

Support comes from:

- eventual monetary easing;
- safe-haven demand;
- official liquidity facilities;
- Treasury liquidity-support buybacks.

Pressure comes from:

- large fiscal issuance;
- persistent inflation risk;
- higher term premia;
- reserve diversification;
- potential Japanese capital repatriation.

Long-duration Treasuries increasingly represent both a macroeconomic trade and a fiscal-risk trade.

Investors should distinguish the two.

Japanese Yen

Intervention has established that authorities are willing to defend against disorderly depreciation.

It has not established a permanent floor for the currency.

The yen strengthened sharply following the operation but subsequently surrendered a meaningful portion of those gains.

A durable yen appreciation will probably require fundamentals to move alongside intervention — through higher Japanese rates, lower U.S. yields or both.

Carry Trades

The intervention is a useful reminder that carry is not free income.

Yield is earned gradually.

FX losses can arrive abruptly.

Leveraged carry strategies deserve particular caution when authorities have demonstrated willingness to intervene aggressively.

The relevant question is not merely how much carry a position earns.

It is whether the portfolio can survive the currency move required to collect it.

Global Portfolios

The episode reinforces the importance of liquidity and controlled leverage.

It also illustrates why currency diversification should not depend entirely on forecasting the next move in USD/JPY or the U.S. Dollar Index.

Currencies are connected to:

- monetary policy;
- sovereign balance sheets;
- collateral;
- foreign reserves;
- leveraged funding.

Multi-currency portfolios reduce dependence not only on one exchange rate, but on one financial regime.

Risks to the Central Thesis

There are several reasons not to overstate the argument.

First, Treasury-market protection was not the only objective. The official rationale remains excessive currency volatility.

Second, June data continued to show substantial foreign demand for U.S. securities. There is no evidence of an ongoing foreign buyers' strike.

Third, Japanese TIC holdings do not represent only government reserves.

Fourth, facilities such as FIMA already reduce the need for outright Treasury liquidation.

Fifth, intervention may ultimately fail to reverse the yen trend if the underlying interest-rate differential remains too wide.

The evidence supports describing the intervention as pre-emptive protection against financial contagion, not as a rescue of an already-failing Treasury market.

Our Perspective

At Astro Wallenius, we believe the most revealing aspect of this episode is not the level of the yen.

It is the architecture behind it.

Japan is the largest foreign holder of U.S. Treasuries.

The yen is a major global funding currency.

Treasuries are the primary reserve and collateral asset of the dollar system.

And the Federal Reserve operates a facility specifically designed to allow foreign monetary authorities to obtain dollars without becoming forced sellers of Treasuries.

These facts belong to the same system.

The U.S. decision to participate in yen intervention therefore makes more sense when viewed not as a bilateral currency favor, but as financial-system risk management.

The authorities were attempting to prevent a currency imbalance from becoming:

a funding imbalance;

a deleveraging event;

or ultimately a Treasury-market liquidity problem.

The episode does not imply that the dollar system is failing.

In some respects, it demonstrates the opposite.

The United States possesses the institutional infrastructure to supply dollar liquidity, coordinate with foreign reserve managers and defend the functioning of the world's largest sovereign bond market.

But it also exposes a vulnerability.

The global financial system is highly interconnected.

A disorderly move in a funding currency can reach an apparently unrelated sovereign bond market remarkably quickly.

That is why Washington intervened.

Final Thoughts

The United States had not bought yen directly since 1998.

It did so in 2026.

Japan subsequently deployed a record-scale intervention.

It signaled future use of FIMA.

And Treasury Secretary Bessent explicitly connected disorderly yen moves to forced unwinds and higher American borrowing costs.

The implication is broader than foreign exchange.

The yen rescue was also an attempt to protect the plumbing of the dollar system.

For investors, that is the central lesson:

currencies, sovereign bonds, collateral and leverage cannot be analyzed independently.

The risks often live in the connections between them.

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