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The Yen Carry Trade & August 2024 Global Market Turmoil

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In early August 2024, global financial markets witnessed a sudden and sharp downturn, sparking concerns across the economic and investment landscapes. Among the various factors contributing to this crash, the role of the Japanese yen (JPY) stood out as particularly significant. The yen, a historically important currency in global markets, not only moved sharply during this period but also exacerbated broader financial instability. Several factors, including the unwinding of yen carry trades, U.S. monetary policy risks highlighted by Federal Reserve Chair Jerome Powell in his late July address, and global macroeconomic concerns, converged to create the perfect storm.

The Japanese Yen's Importance and Carry Trade Dynamics

The Japanese yen holds a unique position in the global financial system. It is often viewed as a safe-haven currency, meaning that during times of global economic uncertainty, investors flock to the yen, pushing up its value. On the other hand, Japan's ultra-low interest rate environment—largely a result of decades of sluggish inflation and economic growth—has made the yen attractive for the carry trade.

What is the Yen Carry Trade?

The Yen carry trade is a popular strategy among investors where they borrow yen at very low interest rates and invest in higher-yielding assets in other countries, such as U.S. or emerging market bonds, to profit from the difference. This trade has been particularly attractive due to Japan's negative or near-zero interest rates, making borrowing yen virtually costless. However, the carry trade comes with risks. If the yen appreciates significantly, the value of the borrowed yen increases, making it more expensive to repay. This forces traders to unwind their positions, triggering sharp sell-offs across markets.

Country	GDP	GDP Growth	Interest Rate	Inflation Rate	Jobless Rate	Gov. Budget	Debt/GDP	Current Account	Population
United States	27361	3.00	5.50	2.90	4.30	-6.30	122.30	-3.00	335.89
China	17795	0.70	3.35	0.50	5.20	-5.80	83.60	1.50	1409.67
Euro Area	15545	0.30	4.25	2.20	6.40	-3.60	88.60	1.70	350.08
Germany	4456	-0.10	4.25	1.90	6.00	-2.50	63.60	6.30	84.70
Japan	4213	0.80	0.25	2.80	2.70	-5.50	263.90	3.60	124.30
India	3550	1.90	6.50	3.54	9.20	-5.63	86.54	-1.20	1386.18
United Kingdom	3340	0.60	5.00	2.20	4.20	-4.40	97.60	-3.30	67.79
France	3031	0.20	4.25	1.90	7.30	-5.50	110.60	-0.70	68.14
Italy	2255	0.20	4.25	1.10	6.50	-7.20	137.30	0.50	58.99
Brazil	2174	1.40	10.50	4.50	6.80	-8.90	74.42	-1.42	216.28
Canada	2140	0.50	4.25	2.50	6.40	-1.30	107.00	-0.60	40.80
Russia	2021	-0.80	18.00	9.10	2.40	-1.90	14.90	2.50	146.40

Source: <https://tradingeconomics.com/japan/indicators>

In 2024, many investors were engaged in substantial Yen carry trades due to the widening interest rate differentials between Japan and the rest of the world, particularly the United States. But as the yen appreciated during the market turmoil in early August, those carry trades quickly unwound, exacerbating volatility across asset classes.



<https://www.tradingview.com/x/RIDLOoJN>

The August 2024 Market Crash: Key Drivers

The financial market crash in early August 2024 was driven by a confluence of global economic and financial factors. Here are the key drivers:

- **U.S. Monetary Policy and Powell's Address**

On July 30, 2024, Federal Reserve Chair Jerome Powell delivered a critical address, emphasizing the "balance of risks" (Inflation Control, Economic Growth, and Financial Stability) in the U.S. economy. He highlighted the trade-off between controlling inflation, which remained above the Fed's 2% target despite moderating from its 2022-2023 peaks, and the risks posed by rising interest rates. These included the potential for a sharp economic slowdown, tightening financial conditions, and increased vulnerabilities in both domestic and global financial systems.

Powell's reference to the "balance of risks" reflected the Fed's challenge of balancing the need to keep inflation in check while avoiding tipping the economy into recession or causing financial instability. This message signaled that while the Fed might be approaching the end of its rate-hiking cycle, the path forward remained uncertain, which fueled market volatility.

Following his remarks, investors grew increasingly concerned about whether the U.S. economy could avoid a hard landing as elevated rates persisted. This uncertainty, along with global economic risks, contributed to a shift in market sentiment, driving up the value of the yen and leading to the unwinding of yen carry trades.

- **Yen Appreciation and the Yen Carry Trade Unwinding**

As global markets started showing signs of stress in early August, a flight to safety began, with investors seeking refuge in assets like gold, U.S. Treasuries, and the Japanese yen. This influx of demand for the yen caused its value to spike rapidly. The appreciation of the yen caught many investors off-guard, particularly those involved in the yen carry trade.

As the yen strengthened, traders who had borrowed yen at low interest rates and invested in higher-yielding assets suddenly faced significant losses. They were forced to unwind their positions quickly, leading to a sell-off in global equities, bonds, and other risk assets. The sharp unwinding of the yen carry trade exacerbated the market crash, as investors scrambled to cover their positions, further driving up the yen's value.

- **Global Economic Uncertainty**

Broader global economic factors also played a significant role. Rising inflationary pressures in major economies, such as the U.S. and Europe, coupled with ongoing geopolitical tensions in regions like Eastern Europe and the Middle East, fueled investor anxiety. Additionally, China's economic slowdown, characterized by weak demand and persistent property sector problems, weighed heavily on market sentiment.

All these factors converged in early August, creating an atmosphere of heightened uncertainty and triggering a broad sell-off across asset classes. The yen, as a safe-haven currency, surged in value as global risk sentiment deteriorated.

Conclusion

The financial market crash of early August 2024 was a multi-faceted event driven by global economic uncertainty, monetary policy risks, and currency market dynamics. The role of the Japanese yen, particularly through the unwinding of yen carry trades, played a crucial part in amplifying the volatility and market stress during this period.

Federal Reserve Chair Jerome Powell's July 30 address, in which he outlined the risks facing the U.S. economy, added another layer of uncertainty to the markets. Investors, grappling with concerns about inflation, interest rates, and slowing growth, sought safety in the yen, triggering a sharp appreciation and compounding the market downturn.

As global financial systems continue to evolve, the yen's dual role as both a safe-haven asset and a key currency in speculative financial strategies will remain a critical factor in times of market stress. Investors and policymakers alike must remain vigilant about the risks associated with currency movements and the interconnectedness of global financial markets.

About Samuel Lawrence

Samuel Lawrence is the founder and CEO of Schwarz Quant Investment Bank, leading the company's investment management and research activities. Since establishing Schwarz Quant Investment Bank in 2015, Samuel has spearheaded projects ranging from the development of new commodity, macro, and equity trading strategies to pioneering research in portfolio construction methods. Samuel's proficiency in quantitative analysis and risk assessment is

instrumental in ensuring the reliability and effectiveness of our investment strategies. His unmatched skills in probabilistic predictive analytics, strategic insights, and risk management are pivotal in optimizing portfolio performance.

Samuel holds a degree in Business Administration from Baden-Württemberg State University, Germany where he first discovered his passion for finance-related forecast & modeling. Prior to this, he studied Industrial & Production Engineering at the University of Ibadan, which provided him with a strong foundation in physics, mathematics and statistics.

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