

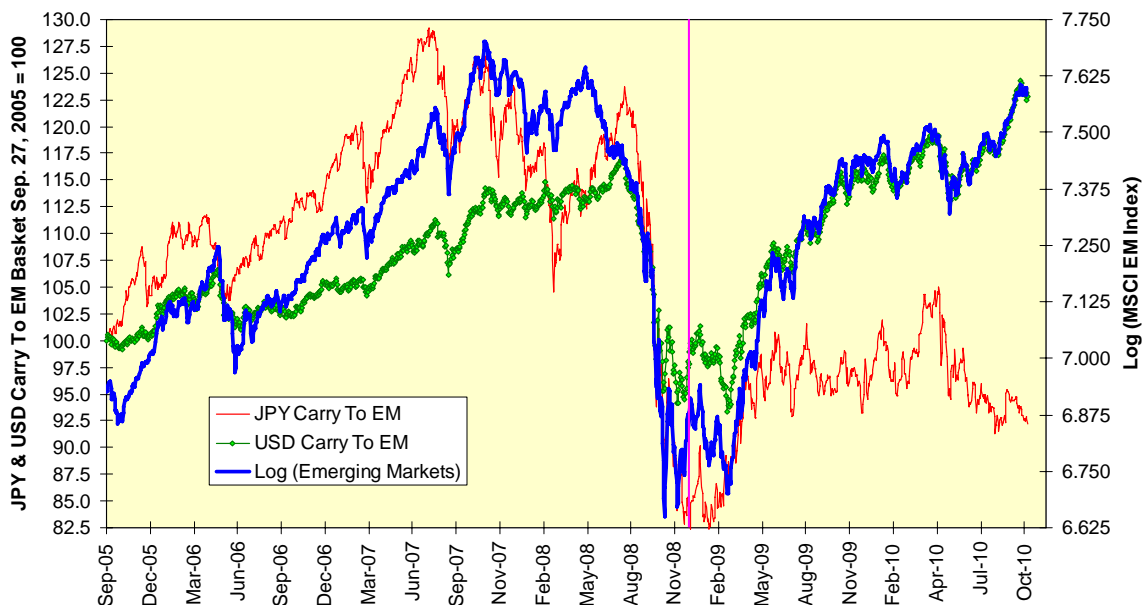
Yen Carry Trade, RIP

Once upon a time there was a land of magic that produced cars and stereos and cameras and VCRs and where all the happy people gathered in the morning to sing the company song and where Theory Z and quality circles and the concept of business as war was going to take all of our stupid American heads and, as the political fashion of the day goes, shove them into a destination unknown.

And that happy, bubbly land went ka-poof, and all the leaders of the famous group-oriented culture agreed that spending money wildly and printing more and lowering interest rates to 0% and printing more money would be a good thing and there could be no such thing as a Lost Decade, and even if there was, it could not last for two decades without getting a special legal exemption from the authorities.

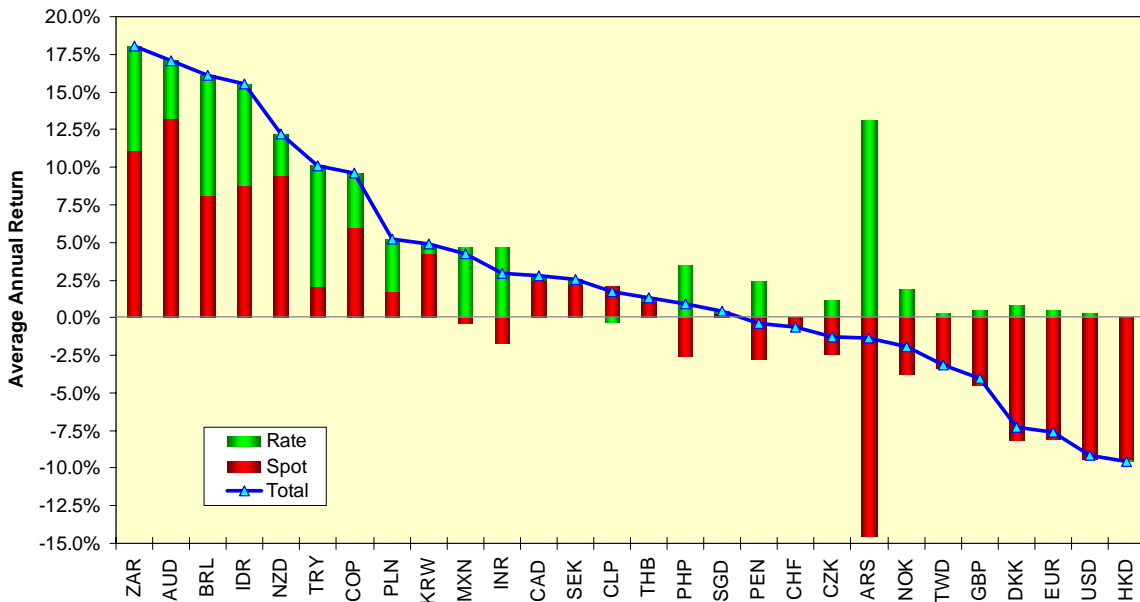
And all that money was borrowed by residents of the rest of the world and it financed their happy, bubbly habits and it was good. Then they went ka-poof, too, and they adopted the policies of the Happy Land and did so in size. And size mattered: For by March 2009, the when the unhappy land began printing its money, the excess carry return of borrowing the U.S. dollar and lending into a weighted basket of emerging market currencies began to match the logarithm of the total return of the MSCI-Barra Emerging Market Free index so closely you would think they were one and the same and that all of the emerging market miracle was nothing other than a gusher of free money fleeing the U.S. as it had fled the happy land fifteen years earlier.

USD Carry Into EM Currencies More Important After 2008



And the carry from the happy land into the EM basket became unimportant. And all of the free money from the happy land could not compete with all of the free money from the unhappy land to the extent that the carry from the Japanese yen into 28 other currencies after March 2009 became negative. The interest rate spread between the JPY and these currencies, depicted in green columns, had disappeared.

Decomposing The Yen Carry Trade March 2009 Onwards



And to make matters worse for the happy land, the yen started to strengthen against many of these currencies as no one needed to borrow it to finance themselves anymore when the unhappy land, always the Arsenal of Democracy, had so many helicopters available. And the leaders of the happy land became unhappy as all of their years of export-led growth and mercantilist surpluses and self-serving proclamations of a better way had come a-cropper and its big neighbor across the sea was eating its lunch by sending all sorts of gizmos to the unhappy land and buying Treasury bonds with all of the money and doing all of the things the happy land used to do.

Was this a scary fairy tale a few days late for Halloween? I wish; it is a deadly true story about what happens when countries think they can get something for nothing. The only thing you can get for nothing is nothing, and there is a lesson for us all here.