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Japan’s Nikkei Suffers Worst Day Since 1987, Hit by U.S. Concerns

Poor American economic data and yen’s surge hit stock prices, raising memories of Black Monday

By Kosaku Narioka Follow *and Rebecca Feng* Follow

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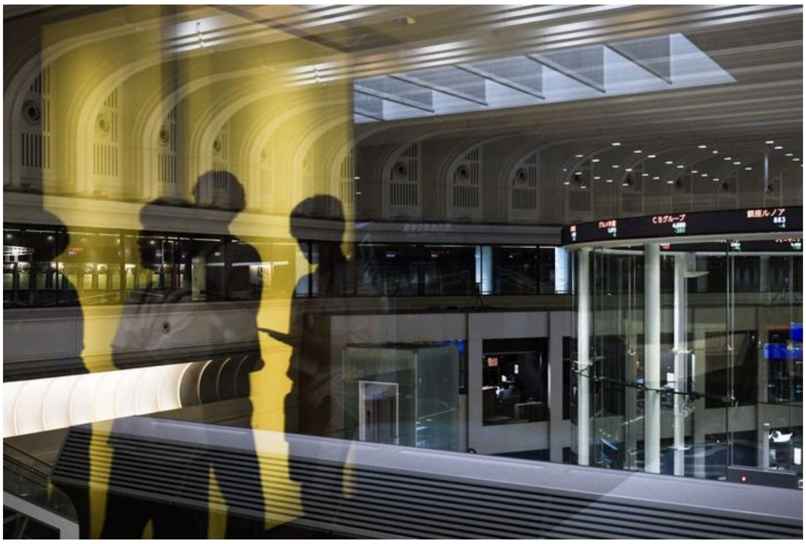

An electronic ticker at the Tokyo Stock Exchange on Monday, when shares plunged. PHOTO: NORIKO HAYASHI/BLOOMBERG NEWS

Japan’s Nikkei Stock Average had its worst day since 1987, falling 12.4% in a frenzy of selling triggered by disappointing economic data in the U.S. and a surge in the Japanese yen.

Other Asian markets also fell, with benchmark indexes in South Korea and Taiwan both down more than 8%. S&P 500 futures fell by more than 2% in Asia as U.S. markets prepared to open the week.

In the space of less than four weeks, the Nikkei has fallen more than 25% after hitting an all-time high on July 11. Over the same period, the yen has strengthened to trade around 142 to the dollar, compared with about 161 to the dollar in early July.

Market movements that normally take months or years have happened over a few days as investors reacted to developments particularly in the U.S. and Japan.

The U.S. economy appears to be slowing and the Federal Reserve is poised to start cutting interest rates in September, while the Bank of Japan raised rates on July 31 and hinted it was ready to keep doing so.

After dropping Friday and Monday morning, the Nikkei on Monday afternoon tumbled into a once-in-a-generation free fall. Investors rushing out of their positions to stanch losses led others to rush out too.

It was the worst single-day percentage drop for the Nikkei since Oct. 20, 1987. That was the Tuesday after Black Monday in the U.S., when the Dow Jones Industrial Average fell 22.6%.

While interest rates are still higher in the U.S., the narrowing gap makes the yen relatively more attractive.

For years, global investors snapped up riskier assets, such as U.S. stocks, and funded those trades with the Japanese yen, thanks to ultralow interest rates in Japan. Until recently, many hedge funds and asset managers expected that rates would remain low and the yen would remain weak.

Known as the carry trade, this strategy was yielding money for investors. Then the BOJ raised rates, causing the yen to appreciate about 7.6% against the U.S. dollar over the past week.

The rising yen fed on itself on Monday because of a squeeze on the carry trade, said strategists and traders. Investors who had borrowed yen were hit with margin calls as the currency jumped, meaning their bankers were insisting on more collateral. Those investors were forced to buy yen to cover their previous positions, pushing the currency higher and triggering still-further margin calls.

"Investors started to unwind positions at the end of last week, but as the yen strengthened and the Nikkei fell, more and more were forced to close the trade and sell into a one-way market today," said Ben Bennett, head of investment strategy for Asia at European asset manager Legal & General Investment Management.

Trading volume in Tokyo on Monday was more than double the daily average over the past year.

Amid a flight to safety, the yield on Japan's 10-year government bond fell to 0.75%. The yield had been above 1% as recently as last week. Bond prices rise when yields fall.

The stronger yen undercuts one reason for buying stocks, because Japanese exporters are less competitive when the currency strengthens and earn less in yen terms on the dollars they bring in overseas. Weak demand in the U.S. would also hit Japanese companies by reducing demand for cars, electronic parts and other Japanese goods.

And financial stocks in Japan were particularly hard-hit because the decline in long-term interest rates means they can't profit so easily on the spread between short-term and long-term rates.

"We've seen moves like this before, but only during major market events like Covid or the start of large economic downturns like the 2008 financial crisis. It'll be very important how markets trade in the coming days to see if they can recover their poise," said Bennett of Legal & General Investment Management.

Japanese stocks were hit by the unwinding of big positions that some investors had been building until recently in global markets, said Mitsushige Akino, president of Ichiyoshi Asset Management. Money had flooded into big U.S. technology stocks, which spilled over into the Asian markets because of the critical role of Taiwanese, South Korean and Japanese companies in the global tech supply chain.

The flood's direction has reversed. Tokyo Electron, a maker of machines used in semiconductor manufacturing, fell 18% on Monday and is down 46% since its peak in April.

Still, analysts said this fall was different from the one in early 1990 when the Nikkei plunged after reaching what was then a record high at the end of 1989.

At the time, Japanese stocks were trading at unusually high levels relative to corporate profits, driven by enthusiasm about what seemed to be the country's unstoppable rise, and real-estate prices were in a bubble that was about to burst. It took the Nikkei more than 34 years to reach a new record.

Trading volume in Tokyo on Monday was more than double the daily average over the past year.
PHOTO: RICHARD A. BROOKS/AGENCE FRANCE-PRESSE/GETTY IMAGES

Naoki Fujiwara, senior fund manager at Shinkin Asset Management, said Tokyo stock prices were looking attractive, although investors would likely wait until they see more stability in markets at home and overseas.

"At these levels, you can try to catch a falling knife, if you're sure you can hold on to it for the mid to long term," he said.

Marcella Chow, global market strategist at J.P. Morgan Asset Management, said markets were likely to focus on Fed policy in the U.S., which will influence the dollar-yen exchange rate and stocks.

In Japan, policymakers may step in to support markets.

Akino said the Nikkei’s plunge would likely put the brakes on the Bank of Japan’s plans. “They’re not going to raise rates,” he said. “They can’t.”

Write to Kosaku Narioka at kosaku.narioka@wsj.com

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