



INTERNATIONAL FINANCE

Carry trade

Borrowing where interest is low, investing where it is high, and why a currency move can wipe out the gain

Policy rates as on 16 October 2026; exchange rates from June-August 2024

For training and education only. Not investment advice.

A carry trade collects a small, steady interest gap and takes the risk of a large, sudden currency loss.

It tends to pay while exchange rates are calm. When the borrowed currency jumps, many holders try to exit at once, and the rush to exit moves markets further.

Four terms to know first



Funding currency

The currency borrowed because its interest rate is low. In 2024 the yen was the main one.



Target currency

The currency the borrowed money is converted into and invested in, because it pays a higher rate.



Carry

The interest gap between the two: what the investment earns minus what the loan costs.



Unwind

Closing the trade: selling the target currency and buying back the funding currency to repay the loan.

The carry is set on day one at fixed rates. The exchange rate when the trade closes is not.

Source for the yen as the main funding currency: BIS Bulletin No 90, 27 Aug 2024.

A carry trade, with real arithmetic

THE SET-UP

An investor borrows ¥16,000,000 for one year at 0.5% and converts it at ¥160 per dollar into \$100,000.

The dollars earn 5% for the year.

- 1 After a year: $\$100,000 \times 1.05 = \$105,000$. The yen owed is $¥16,000,000 \times 1.005 = ¥16,080,000$.
- 2 Rate still ¥160: $\$105,000 = ¥16,800,000$. Gain ¥720,000, or 4.5% of the amount borrowed.
- 3 Yen strengthens to ¥144: $\$105,000 = ¥15,120,000$. Loss ¥960,000, or 6% of the amount borrowed.
- 4 Break-even: $¥16,080,000 \div \$105,000 = ¥153.14$. A fall in the dollar of about 4.3% wipes out the gain.

The interest gap is small and known. The currency move can be large and is unknown.

Illustration with assumed rates and an assumed exchange rate. Not a forecast.

Why hedging removes the gain

Same investor, same numbers. What happens if the currency risk is locked away on day one?

1

Agree the rate in advance

The investor contracts today to sell \$105,000 in one year at a fixed 'forward' exchange rate.

2

Forward builds in the gap

Forward = spot $\times$ (1 + yen rate) $\div$ (1 + dollar rate) = $\yen160 \times 1.005 \div 1.05 = \yen153.14$ per dollar.

3

The gain disappears

$\$105,000 \times \yen153.14 = \yen16,080,000$, exactly the yen owed. Hedged, it makes nothing before costs.

4

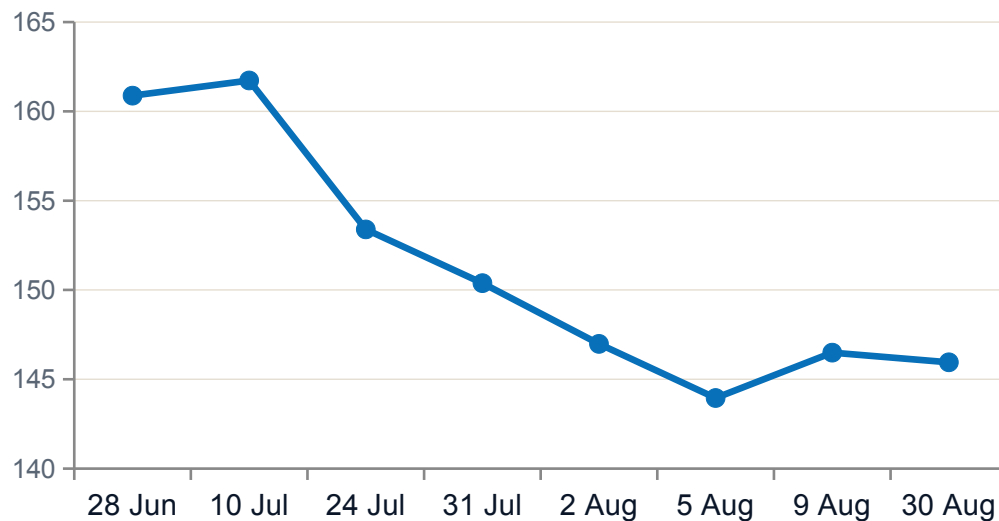
So carry is pay for risk

The interest gap is what the market pays for bearing the currency risk. Remove the risk and the pay goes too.

Illustration with assumed figures. The forward-rate formula is the standard covered interest parity relationship.

August 2024: the yen jumps

Yen per dollar, 2024 (spacing not to scale)



Read the chart

- A falling line means a stronger yen: fewer yen buy one dollar.
- From 10 July to 5 August a dollar bought about 11% fewer yen.
- For a yen-funded trade, that is a loss on the currency alone.
- Daily rates for the yen as published by the US Federal Reserve in its H.10 release.

Source: Federal Reserve, H.10 historical rates for the Japanese yen (release of 13 Oct 2026). Axis starts at 140.

How the 2024 unwind unfolded

1

July: the trend turns

From the first half of July the yen stopped weakening, and a brief sell-off with signs of carry unwinding came on 24 July.

2

31 July: Japan raises rates

The Bank of Japan set its overnight rate target at around 0.25%, up from 0 to 0.1%. The US Fed held its rate at 5.25% to 5.50%.

3

2 August: US jobs data

A somewhat weak US labour market report led investors to reassess the risk of a US recession.

4

5 August: the peak

Japan's TOPIX index fell 12% in a day. The US VIX briefly topped 60 in off-hours trading.

5

By 9 August: calmer

The S&P 500 had regained its losses since that Monday and the TOPIX most of its losses.

Sources: BIS Bulletin No 90, 27 Aug 2024; Bank of Japan statement, 31 Jul 2024; FOMC statement, 31 Jul 2024.

Why unwinds tend to be sudden

¥40 tn



Crowded positions

BIS put FX carry trades at a rough ¥40 trillion (\$250 billion) going into August 2024, and says that may be too low.



Leverage and margin

When volatility rises, lenders ask for more margin. Holders sell to raise it, which pushes prices further and lifts volatility again.



Calm breeds risk

Long spells of low volatility draw more borrowed money into carry trades, which makes the eventual rush to exit larger.

Source: BIS Bulletin No 90, *The market turbulence and carry trade unwind of August 2024*, 27 Aug 2024.

Where policy rates stand

The gap between US and Japanese policy rates was about 5 percentage points in August 2024. It is under 3 points now.

US FEDERAL FUNDS

3.75-4%

Target range, raised by 0.25 point on 16 September 2026. It was 5.25% to 5.50% in July 2024.

BANK OF JAPAN

1.25%

Target 'around 1.25%' from 24 September 2026. It was around 0.25% from 1 August 2024.

RBI REPO RATE

5.50%

Raised from 5.25% on 7 October 2026.

Sources: FOMC statements, 31 Jul 2024 and 16 Sep 2026; Bank of Japan statements, 31 Jul 2024 and 18 Sep 2026; RBI Monetary Policy Statement, 7 Oct 2026.

If you learnt this from older material

What older decks say

- A carry trade means borrowing cash abroad and depositing it at home.
- US dollars are the usual low-rate currency to borrow.
- The risk is a gradual drift in the exchange rate.

What holds now

- Much of it runs through currency forwards, swaps and options (BIS, Aug 2024).
- In 2024 the yen was the main funding currency; US rates were 5.25% to 5.50%.
- In 2024 a dollar bought about 11% fewer yen in under four weeks.

The idea has not changed. The funding rates and the speed of the risk have.

Sources: BIS Bulletin No 90, 27 Aug 2024; FOMC statement, 31 Jul 2024; Federal Reserve H.10 yen rates.

Four things people get wrong



'The interest gap is free money.'

It is payment for taking currency risk. Hedge the currency with a forward and the gap disappears.



'Only currency traders are affected.'

On 5 August 2024 the unwind spread to shares: TOPIX fell 12% and the S&P 500 3.0%.



'A higher rate means a rising currency.'

Not necessarily. The forward rate prices the higher-rate currency at a discount, and spot rates can move either way.



'It was all about Japan's rate rise.'

BIS points to a mix: the rate rise, weak US jobs data, heavy leverage and thin August trading.

Check yourself

Q1

An investor borrows at 1% and invests in another currency at 6%. That currency falls 8% against the borrowed one over the year. Did the trade make or lose money?

Q2

Why does hedging a carry trade with a forward contract remove the gain?

Q3

Name two things that turned a modest US data surprise into a large market move in August 2024.

Sources and disclaimer

SOURCES FOR THE FIGURES IN THIS DECK

- Episode, TOPIX -12% and VIX above 60 on 5 Aug 2024, ¥40 trillion estimate: BIS Bulletin No 90, The market turbulence and carry trade unwind of August 2024, 27 Aug 2024.
- Yen per US dollar, 2024: Federal Reserve, H.10 historical rates for the Japanese yen, release of 13 Oct 2026.
- Bank of Japan: statements of 19 Mar 2024 (0 to 0.1%), 31 Jul 2024 (around 0.25%) and 18 Sep 2026 (around 1.25%, effective 24 Sep 2026).
- US federal funds target: FOMC statements of 31 Jul 2024 (5.25% to 5.50%) and 16 Sep 2026 (3.75% to 4%).
- RBI repo rate 5.50% from 7 Oct 2026: RBI Monetary Policy Statement, Press Release 2026-2027/1264.
- The investor, loan amounts and rates in the worked examples are assumptions computed exactly. They are not market quotes.

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