Trade Idea – Foreign Exchange

Greater stimulus to pressure Yen

12th August 2016

**Yen rally to end**

- In recent weeks, attempts by Japanese authorities (both fiscal and monetary) to boost economic performance have fallen short of market expectations. A surprise ¥28trn fiscal package and an expansion of the Bank of Japan’s (BoJ) ETF purchase program have both failed to convince investors that a revival in economic growth and inflation prospects is on the horizon. The disappointment saw the Yen rally 4.5%, undoing its losses from the prior week and bringing the currency’s total gain for the year to 17.1% on a trade weighted basis. However, this upward trend shouldn’t last too much longer. At its next monetary policy meeting in September, we believe that the BoJ will commit to implementing greater monetary stimulus and outline a strong resolve to do more going forward. This will be in an attempt to regain credibility and ensure the success of its three pronged easing program in restoring healthy inflation. This should help weaken the JPY, particularly against the US Dollar, a currency which we believe will benefit in coming months from growing expectations of monetary tightening.

**“Comprehensive assessment” fears overdone**

- At the BoJ’s last monetary policy meeting, it announced that it would be conducting a “comprehensive assessment” of the bank’s Quantitative and Qualitative Easing (QQE) programme. This created uncertainty and some concerns that the bank would be either; i) lowering its inflation target or ii) removing elements of its easing programme. However, in a recent speech the BoJ’s Deputy Governor, Kikuo Iwata, made it clear that negative rates had been beneficial for the economy and that the review was being conducted in order to achieve “the price stability target of 2% at the earliest possible time”. We therefore do not necessarily see the review as a means of tapering current measures, but rather an assessment of what policies would be most effective going forward. As such, we believe further stimulus will be announced in September which should allay investor concerns and place the JPY under renewed pressure.

**Figure 1: Yen remains overvalued**

![Chart showing Yen remains overvalued](image)

*Source: Bloomberg, ETF Securities*

**Retracement likely**

- Rising yields in recent weeks have supported the JPY, but we believe that the currency remains overextended against what real yields would imply on an absolute basis (see Figure 1). Net speculative positioning remains at record highs for the Yen,
but shorts have started to trough and longs decline. We believe a strong policy response in September could spur a reversal in market positioning and cause a sharp JPY retracement, particularly for the USD/JPY currency pair which has faced support at the 101.96 level, a key sticking point for the pair between December-13 to August-14 (see Figure 2).

**Figure 2: USD/JPY hits support**

![USD/JPY Rate chart](chart)

Source: Bloomberg, ETF Securities

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- ETFS 3x Long JPY Short USD (LJP3)
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