Trade Idea – Foreign Exchange
Yen poised for move lower
14th October 2016

**USD/JPY forms a base**

- Sentiment towards the US Dollar has turned a corner in the past ten days, after a hawkish speech from Richmond Federal Reserve (Fed) President, Jeffrey Lacker, prompted a fresh spike in rate-hike expectations. In his speech, the Fed official explained that the US policy rate should already be at 1.5% and that monetary authorities should be taking greater pre-emptive action to offset building domestic inflationary pressure. While Lacker himself is not a voting member of the Federal Open Market Committee (FOMC), his words echoed the sentiment of three members on the committee that broke ranks and voted to raise rates earlier at the September meeting. The speech combined with a strong US service sector report the following day to boost investor expectations of a December rate rise to 68% (from around 60%) and push the trade weighted dollar index up 2% to the highest level in approximately six months. The positive USD momentum has helped the USD/JPY currency pair break through its medium term downward trend line and test key resistance levels established earlier in the year. Signs of diminishing slack in the US economy and dovish Japanese monetary policy should help to boost the US-Japan real rate differential in months to come, lending strength to the USD/JPY currency pair.

![Figure 1: Real yields to support a higher USD/JPY](source: Bloomberg, ETF Securities)

**Real yield compression to reverse**

- The USD/JPY has been subject to a large 14% drop this year as the difference between US and Japanese real yields (inflation adjusted) has plunged to multi-year lows. The move comes despite the Bank of Japan (BoJ) unleashing negative rates and unprecedented levels of monetary easing. The driver of yield compression has been the sharp drop in US nominal yields as pricing of interest rate normalisation has turned dramatically more dovish over the course of the year, while Japanese inflation expectations have grinded higher. More recently, rising US nominal yields has caused this difference to trough and even start to climb (see Figure 1). As year-end draws nearer, we expect this trend to continue as healthy US inflation and labour market data (September US inflation data due on 18th October and next payroll release on November 4th) support rate hike expectations and in turn the USD/JPY.

**Watch for the break**

- In recent months, the USD/JPY currency pair has managed to form a base at the psychologically important 100 level after sustaining the large fall earlier in the year. The Lacker speech (4th October) helped to reverse the pair’s fortunes, sending it up

*All figures quoted are sourced from Bloomberg unless stated otherwise.
through its 50-day moving average (DMA) (which has been acting as a medium term downward trend line) to test resistance at 104.2. Should the pair manage to break this level then we could see it move to its high from July of 107.48. Alternatively, if the pair sunk towards the 100 level it should be viewed as an attractive buying opportunity.

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  - ETFS 3x Short JPY Long USD (SJP3)
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