Trade Idea – Foreign Exchange

Yen slide to continue

3rd June 2016

Abe urges coordinated response to slow growth

- At last week’s G7 summit, Japanese prime minister, Shinzo Abe, urged world leaders to take part in a coordinated fiscal response to lacklustre global growth, comparing current economic conditions to those during the 2008 financial crisis. While the speech failed to garner much support, it did highlight the willingness of Japanese authorities to do more in order to ensure growth and acted as a precursor to Abe’s decision on Wednesday to delay the proposed 2% sales tax hike by two and a half years to October 2019, a move which sent the USD/JPY falling over 1%. While we expect fiscal stimulus to continue to be an important part of achieving the nation’s economic goals, with core inflation so far from its target (2.3% below), it is highly likely that the Bank of Japan (BoJ) will implement further monetary stimulus in coming months. Further loosening should put pressure on the JPY against the US Dollar, as diverging policy paths come increasingly to the fore, making current levels an attractive point to go tactically long the USD/JPY currency pair.

BoJ unlikely to disappoint for much longer

- After the sharp JPY rally that followed the disappointment of the BoJ’s last monetary policy meeting, it is understandable that investors may be cautious about the central bank’s intentions. However, the surprising decision to maintain the status quo masked the grim economic picture that was delivered in the BoJ’s quarterly outlook report that was released simultaneously. The report revealed a deep cut to the 2016 inflation forecast and raised concerns over the impact of slowing emerging market demand on Japanese exports. Recent inflation and manufacturing data has likely added to these concerns, showing the second month of declining core consumer prices and the fastest contraction in manufacturing activity in three years (see Figure 1). Without sufficient stimulus these economic trends are likely to continue in the near term, which we will force the BoJ to ease if not at its upcoming meeting on June 15th, then in July.

Figure 1: Economy remains weak

*All figures quoted are sourced from Bloomberg unless stated otherwise.
**Positioning shifts**

- Despite widening nominal yield differentials between Japan and the US, speculative positioning has remained stubbornly JPY bullish, until now. Last week, speculative long JPY positions experienced the largest fall since November 2011, and shorts showed early signs of bottoming. A catalyst in the form of further monetary easing by the BoJ or hawkish comments during Janet Yellen’s World Affairs Council (WAC) speech (6th June) could spur an increasing shift to bearish positioning and help push the USD/JPY exchange rate higher (JPY weakening) from current depressed levels.

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