Trade Idea – Foreign Exchange
Navigating the September meetings
9th September 2016

Central bank meetings loom

- In the coming weeks nothing features so prominently in the financial calendar than the central bank meetings of the world’s first and third largest economies. Both the US Federal Reserve (Fed) and the Bank of Japan (BoJ) are scheduled to have monetary policy meetings on the 21st September and both banks look set to deliver important messages regarding their respective monetary policy programmes. In the US, the Fed will likely use the meetings as an opportunity to lay the foundation of a rate rise in December, while in Japan the BoJ’s Policy Board will likely expand its asset purchase programme in response to weak inflationary pressures. The impact of both events will be pronounced in the currency market, where a repricing of future monetary policy paths will likely lend broad support to the USD and weaken the overvalued JPY. This should help to maintain the recent upward trend of the USD/JPY and GBP/JPY currency pairs and presents a tactical opportunity for currency investors.

BoJ is not finished

- As mentioned previously (see Greater stimulus to pressure Yen), the BoJ intends to conduct a “comprehensive assessment” of its quantitative and qualitative easing (QQE) with a negative interest rate policy (NIRP) at the upcoming September meeting. A recent speech delivered by the BoJ Governor, Haruhiko Kuroda, explained that the assessment is a cost benefit analysis of incumbent measures and their impact on the wider economy. Some market participants took the Governor’s reference to the negative impact of NIRP on financial intermediaries as an indication that further easing would be off the table. However, we see the speech as a sign that further easing will take place in the form of an expansion of the BoJ’s asset purchase programme, rather than a further cut to interest rates (see BoJ unlikely to cut rates further). Therefore, we see the BoJ meeting as a catalyst for further downside for the JPY.

Hawkish comments to be reaffirmed

- Market pricing of a December rate hike rose by a half in late August to over 60% as relatively hawkish comments from the Fed’s Vice Chairman, Stanley Fischer, and the NY Fed president, William Dudley boosted expectations of upcoming tightening (see Figure 1). However since then, USD bulls have been unlucky. Yellen’s balanced speech at Jackson Hole, a subpar payroll

*All figures quoted are sourced from Bloomberg unless stated otherwise.
report and weak non-manufacturing data for August have all caused expectations to fall back down to 50% and have kept USD gains tempered. At the September meeting, we believe the Fed will begin to state more explicitly that it intends to raise rates soon, likely doing so with the standard caveat that the decision will remain data-dependent. This should help to support the USD as expectations of a December lift-off are boosted. Even larger USD moves will be expected should the next three US employment reports come in strong which should provide the Fed with justification for a December move.

Yen positioning over extended

- Speculative positioning for the JPY and GBP are extended at record levels in opposing directions (see Figure 2). If the BoJ announces further easing on September 21 then the GBP/JPY will likely see some sharp gains (Yen weakening) as positions are trimmed back to more normal levels. The currency pair also crossed above its 50 daily moving average (DMA = 135.37) on 31st August which is typically a bullish technical indicator. For the USD/JPY the recent uptrend has been less pronounced but could establish itself should the Fed start to demonstrate more hawkish behaviour. The pair has some way to go before it is likely to run into resistance at the high it reached on the 2nd Sept of 104.32, 2.7% above current levels.

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- ETFS Short JPY Long GBP (JGBP)

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- ETFS Short JPY Long USD (SJPY)

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- ETFS 3x Long JPY Short USD (LJP3)
- ETFS 3x Short JPY Long USD (SJP3)

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