FX

Global

FX Flash

JPY Support With YCC Change

- **BOJ tweaks the YCC policy through capping the JGB 10y yields at 1.00% by conducting fixed-rate purchases at that level which essentially widens the YCC band from +/- 0.50% to -0.50 - +1.00%**
- **Ueda justifies adjustment done to preemptively address risks by setting up the YCC to handle upside price pressures as it only deals with the downside**
- **They are avoiding giving a tightening perception possibly because the economic case is uncertain**
- **Regardless, market speculation on normalization is likely to rise, leading to more volatility for the USDJPY.**
- **Overtime, we see the USDJPY could grind lower as the BOJ as UST-JGB yield differentials narrow.**

The Bank of Japan (BOJ) has once again surprised the market by tweaking the yield curve control (YCC) policy despite Governor Kazuo Ueda having exhibited a dovish tone in recent times.

Previously the YCC policy had operated in a strict band of +/- 0.50% for the JGB 10y yield. Whilst the BOJ is still going to keep that band, they have now labelled it as a reference and it does not represent rigid limits. They will now cap the JGB 10Y yields by conducting fixed-rate purchase operations at 1.00%. They will also be nimbly conducting market operations at 0.50 – 1.00%.

In essence, we view their move as widening the range of the YCC to be at -0.50% to 1.00%. Effectively, it would actually be a normalization on their part but it seems from their language and actions that they have been careful not to paint this as a monetary tightening of any sort.

Furthermore, the BOJ again emphasized continuing patiently with monetary easing as the price stability target of 2% has not yet come into sight. The BOJ itself has said the move is aimed at pre-emptively addressing risks to the YCC as the YCC is mainly set up to deal with downside price pressures but not upside. However, their forecasts do not actually imply they see inflation rising sustainably. As a note, Ueda has mentioned that they are a long way off from exiting negative interest rates. They may be anxious about letting the market perceive this as a tightening given the economic case to exit a loose monetary policy stance is uncertain.

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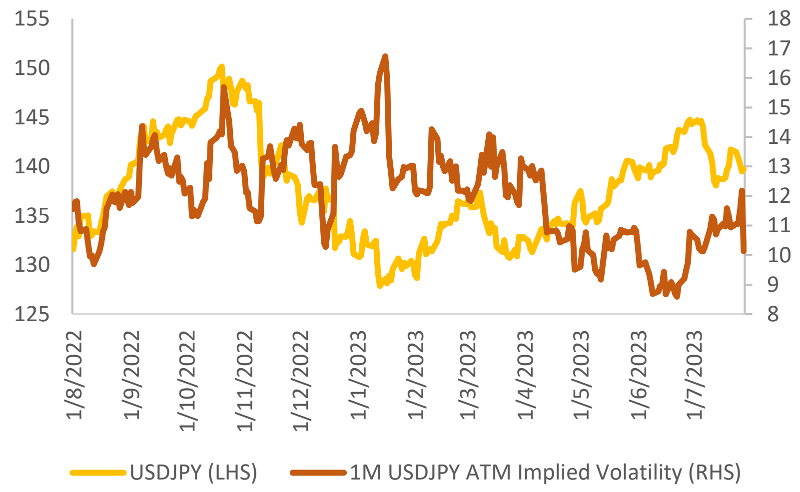
Regardless of these comments, we do though interpret this as a first early gradual move towards exiting the YCC eventually especially given their ballooning balance sheet. Despite BOJ attempts to play down a start of a normalization cycle, market speculation on monetary tightening would have risen, leading potentially to more volatility for the USDJPY in the coming future. As a note, USDJPY 1M ATM implied vols have been rising recently in line with the speculation on a BOJ move. High tightening speculation near term can risk pushing the USDJPY to 135.00, a support level we have talked about for a while. Resistance we think would cap out at 145.00.

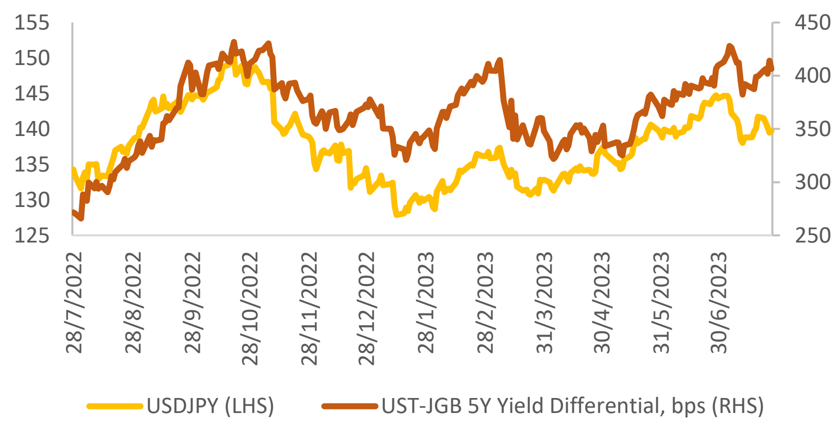
Overtime, in the medium term, regardless of BOJ's attempts to avoid giving a tightening perception, we see the USDJPY could grind gradually lower as the BOJ may struggle to stay as the last dovish holdout and UST-JGB yield differentials narrow. JGB yields could move higher on continued speculation of normalization whilst UST yields looks to fall with future Fed rate cuts potentially occurring.

Chart 1: USDJPY and 1M USDJPY ATM Implied Volatility



Source: Bloomberg, Maybank GM FX Strategy & Research

Chart 2: USDJPY and UST-JGB 5Y Yield Differentials



Source: Bloomberg, Maybank GM FX Strategy & Research

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