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FX Flash

A "Normal" BOJ as USDJPY Elevated Near Term

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BOJ "Normal" With No Clear Tightening Cycle Hints

The BOJ made the decision to exit NIRP today together with the ending of YCC and ETF purchases. However, they decided to continue to maintain JGB purchases at broadly the same amount as before. The move was expected by markets given hints dropped by several media outlets over the last couple of days that included Jiji and Nikkei. Additionally, the Rengo wage negotiation results were strong at 5.28%, which was much higher than that of last year at 3.6% and also analyst expectations at more than 4%. However, building up to it, focus was less on the actual decision that was going to be done and instead more on whether Governor Ueda would indicate a beginning of a tightening cycle.

Ueda though today in our view appeared rather "neutral". The BOJ's own statement released earlier in the day just after the decision had stated "given the current outlook for economic activity and prices, the Bank anticipates that accommodative financial conditions will be maintained for the time being". The statement itself had also recognized that QQE with YCC and NIRP had "fulfilled their roles". Ueda at the press conference later called his own era "normal" compared to his predecessor but then did not at the same time define "normalization". His other comments also did not clearly point to any further tightening as he stated there was still "some distance" between inflation expectations and the 2% level whilst also noting that achieving a stable 2% inflation is "not 100% yet". He additionally noted that accommodative conditions would be maintained as long as price trends are below the 2% target. He did describe the JGBs and ETFs on the BOJ balance sheet as "legacy" and did not give any clue if there would be a planned offloading of those assets. He ultimately did mention that a bigger spike in prices could prompt the BOJ to raise rates further.

Whilst the BOJ is now back to almost behaving like a normal central bank, the BOJ is still not giving the impression that they are embarking on any aggressive or structured tightening cycle soon. The BOJ's words seem to imply today's actions are just about ending the usage of extraordinary monetary policy tools as they are not required anymore given inflation is higher than prior years and wages have risen at higher levels. However, the BOJ is still facing a fragile economy where domestic consumption has been struggling and a strong export performance (which in turn also induces more business investment) is doing a lot of the heavy lifting. Inflation is also at the same time softening and looks like it could do so for the rest of 2024.

We See More BOJ Tightening on Rising Confidence that Inflation Can Meet Target

Regardless, we do sense that the BOJ does seem to be expressing increasing confidence about inflation meeting the target. After all, the BOJ statement did make mention that “the BOJ assessed the virtuous cycle between wages and price, and judged it came in sight that the price stability target of 2 percent would be achieved in a sustainable and stable manner towards the end of the projection period of the January 2024 Outlook Report”. (Note: projection period is to fiscal 2025). Hence, we do think they will undertake another 25bps hike in Oct 2024 with another 25bps to come possibly in June 2025. The move would be spaced out so that the BOJ can assess the economic data and inflation progress in between. OIS are also implying some element of a hike this year.

USDJPY to Stay Elevated as it Remains Subjected to the Whimsical of UST Yields Near Term

The immediate implication of the outcome of today’s meeting for the USDJPY is that the pair is likely to stay elevated for the near term as UST yields movement remain the biggest driver for it and we still expect it to be high. BOJ did not give any clear sign of further hikes and in addition, the pledge to maintain pace of JGB purchases likely weighed on the JPY. USDJPY climbed post the decision as we had called for although we are a little wary on the extent of the upside from here. Above the 150.00 level, there is the rising risk of intervention from the BOJ and we crucially watch the next level of resistance at 152.00. However, we think it unlikely that the BOJ would come in at that level. There could though be substantial jawboning at that mark. More likely, the BOJ would come in at 155.00 which in itself marks the next level of resistance.

A major driver though of where the USDJPY heads to near term would be the outcome of tomorrow’s FOMC and particular regarding where the dot plots would stand. If there is a revision in the dot plots from 75bps of cuts to 50bps, this could push the USDJPY pair higher but we also have to be aware that rapid increases in the pair can prompt government/BOJ intervention. Profit taking could occur at 152.00. If the momentum is stronger, another round of profit taking could happen at 155.00, which is another potential level where the BOJ could intervene. This means we stick to our view that upside is limited near term even in this scenario. However, if the dot plots are not adjusted tomorrow, the USDJPY could continue trading in a range about 146.00 – 152.00, which also similarly implies limited upside. As a note, our house view still continues to see a 100bps of rate cuts this year by the Fed.

Meanwhile, we do not believe that the ending of ETF purchases would on net result in less appetite for Japanese equities. Foreign interest in Japanese equities could still remain strong given other favourable factors such as inflation and the economy picking up and continued corporate governance reforms. Therefore, we do not think the JPY could be negatively affected by this move.

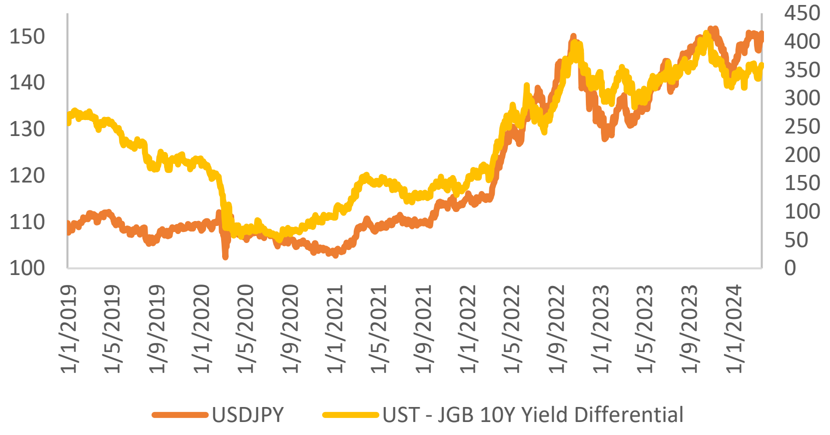
Given the upside is limited whether the Fed adjust the dot plots and the likelihood of the Fed easing this year (with our house call of 100bps of cuts) whilst the BOJ hikes, we continue to see the balance of risks of USDJPY is skewed to the downside. As US treasury yields gradually moves downwards, this should narrow the differential with the JGB yields, leading to downward pressure for the USDJPY. Therefore, we continue to stick our USDJPY forecast for this year, which shows a downward trajectory. To also mention, any accidents such as war or recession this year could result in the JPY being viewed as a safe haven, which also supports a USDJPY downward move. We continue to stick to our strategy to sell USDJPY on rallies.

Table 1: USDJPY 2024 Forecast

Forecast	1Q 2024	2Q 2024	3Q 2024	4Q 2024
USDJPY	150.00	145.00	140.00	136.00

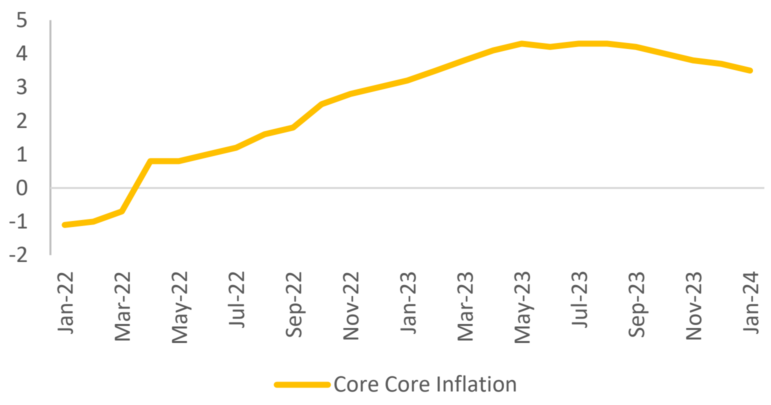
Source: Maybank FX Research & Strategy

Chart 1: UST Yield Differentials Are Going to Remain the Biggest Driver of USDJPY



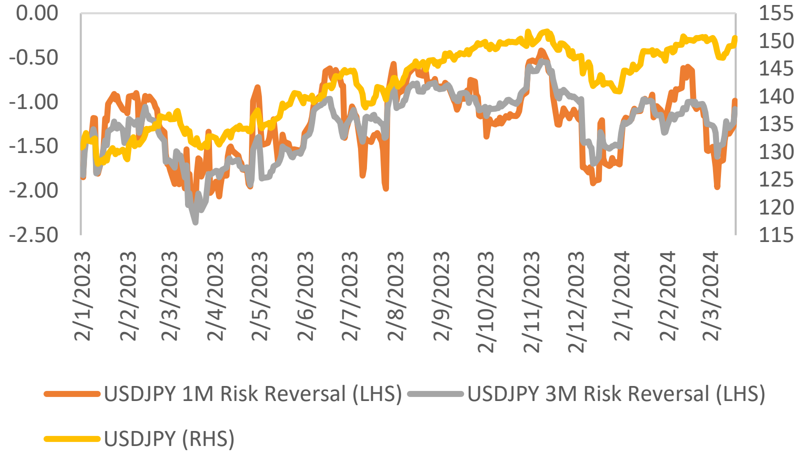
Source: Bloomberg, Maybank FX Research & Strategy

Chart 2: Inflation is Softening Although BOJ Sounds More Confident Inflation Can be at Target



Source: Bloomberg, Maybank FX Research & Strategy

Chart 3: USDJPY Risk Reversals Have Risen Recently Implying that Market Sentiment is towards a Weaker JPY



Source: Bloomberg, Maybank FX Research & Strategy

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