FX Global

FX Insight

Playing the JPY Game

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JPY Can See Strengthening Under Various Outcomes

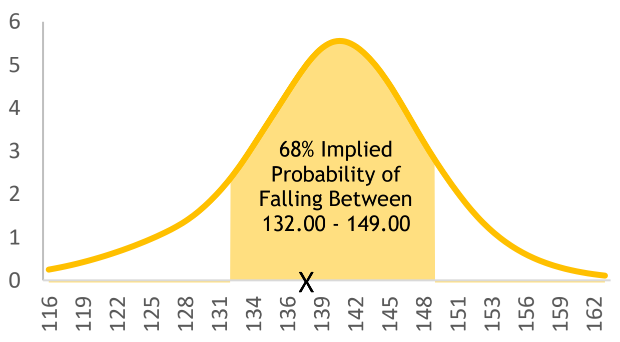
Over the last few years, the JPY has been among the worse hit of the G10 currencies as it bore the brunt of the high rates environment. That though looks to have turned as the JPY has performed strongly over the last few months with the macro environment looking to make a turn to one of easing. The JPY is very much a yield play game and both falling Fed rates and BOJ tightening allow for yield differentials between the US and Japan to narrow, supporting JPY appreciation. US data has been softening, which permits Fed easing whilst domestic Japanese economic data points towards a virtuous wage-price cycle forming, supporting BOJ tightening. The possibility of more unwind of JPY positioning and repatriation can also go some way to help stronger JPY appreciation.

In various scenarios – whether it be a soft landing or recession, we see the possibility that the USDJPY can move down quite substantially. In the latter scenario, there could be more strengthening. With regards to the US election outcome, a Harris win is unlikely to alter our view on a downward trend for USDJPY given her policies are somewhat less likely to result in an inflationary environment. In the case of a Trump victory, we still expect the declining path to continue albeit we note of some upside risk given the inflationary conditions his policies can create. Overall, we stick to our forecasts, which is based on a soft – landing outcome. We recommend going short USDJPY over the medium term. Near term, we do expect some rebound in USDJPY as the Fed we believe would cut by 25bps later and that can somewhat disappoint investors given that markets lean towards expectations of a 50bps cut. As a note, the 1M ATM implied vol shows a 68% implied probability of the USDJPY falling between 136.00 -147.00.

USDJPY Forecasts

Forecast	3Q 2024	4Q 2024	1Q 2025	2Q 2025
USDJPY	145.00 (-)	138.00 (-)	130.00 (-)	120.00 (-)

Probability Density Function of USDJPY Values for 3M Implied Vols

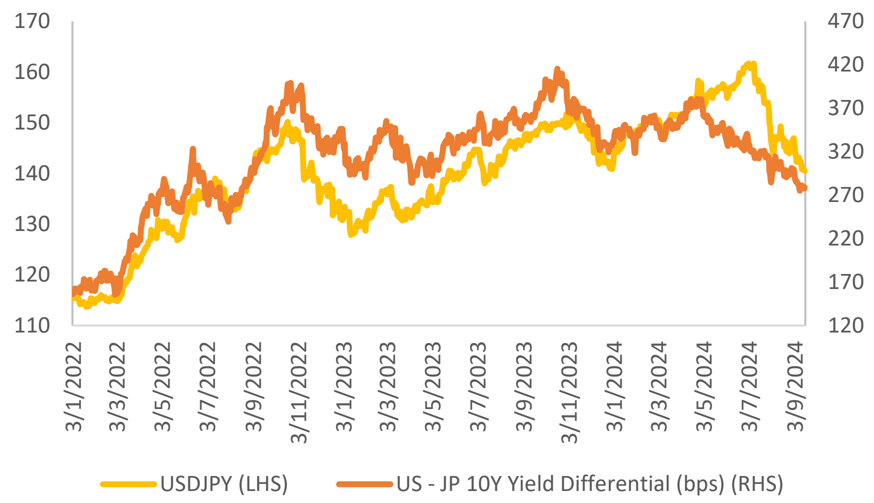


Source: Bloomberg, Maybank FX Research & Strategy
Note: 1) X shows where Maybank FX forecast is at for end Q4 2024
2) Probability density function is as of 18 Sep 2024

Favorable Yield Differentials Supporting JPY

After having taken much of a hit over the last couple of years, the JPY has now recently been seeing some exuberance. Between its high on 3rd Jul 2024 to the 16 Sep 2024, the USDJPY has fallen by around 13.2%, making the JPY by far the best performing currency in the G10 space. Regionally in Asia, it also stands as the strongest performer. The JPY is very much strongly a yield play game and the easing rates environment that is now looking to become more entrenched has benefited the currency greatly. We believe that this appreciation trend is sustainable over the medium term and in this piece, we look to lay out our reasoning on how we mainly believe that the yield differentials would keep staying favorable especially under various scenarios.

Chart 1: Yield Differentials Remain the Main Driver of the USDJPY



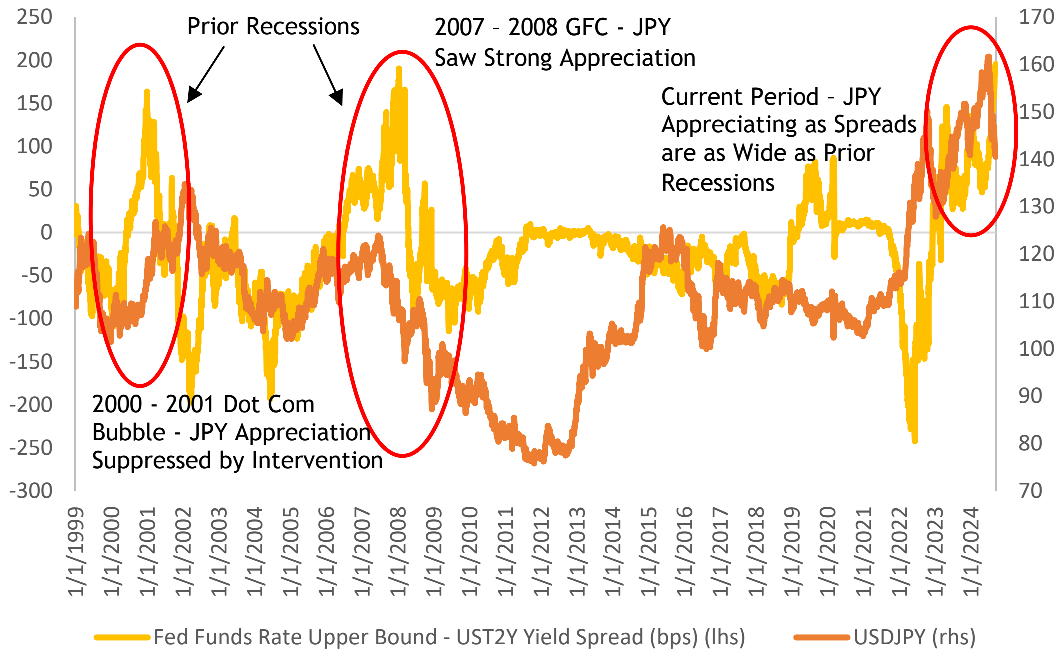
Source: Bloomberg, Maybank FX Research & Strategy

Fed Easing Cycle to Become More Entrenched and JPY to be Beneficiary of Various Scenarios in this Cycle

By this point, the Fed easing cycle looks very much to become entrenched with the focus now increasingly shifting on determining the pace of which this loosening would occur by. A reacceleration in inflation is looking less likely to occur whilst jobs data has already been showing substantial weakness. Regarding the latter, jobs opening have been falling whilst NFP has already missed on two occasions alone. The downward path on inflation may look to be bumpy and transitory factors can impact the reading occasionally (such as the China deflation readings). Regardless, the downward trend is intact. Our base case is that the Fed would gradually ease with a cumulative total of 50bps this year with the first 25bps cut coming at the Sep meeting. Into 2025, we see that there could be 100bps of rate cuts. Our in-house economists are also seeing that soft landing for the US would likely play out. The path of falling Fed rates in these conditions are likely to work to provide support for the JPY.

We would though also like to note that in other scenarios such as a recession, the JPY can see some appreciation. At this point, there is a possibility that the market may be seeing the Fed at risk of falling behind the curve in the rate cut game and preventing a recession. If we look at the spread between the Fed upper bound target rate and the UST 2 year yields, it stands wider than in two prior recessions of the dotcom bubble 2000 -2001 and the 2007 – 2008 global financial crisis. Not surprisingly, during those two occasions, the JPY faced very strong appreciation factors (as UST yields declined heavily) such that there was even intervention by the authorities in the 2000 – 2001 period. If the Fed rate – UST 2y yield spread should be an effective indicator of a potential recession, then the upside for JPY can be substantial. As a note, we are not inclined to think that the Japanese authorities would intervene to slow JPY appreciation this time unless there is significant market disruption that arises from it. Given the relatively much weaker level of the JPY this time compared to the start of the strengthening in 2000 – 2001, it would still likely still be in their preference to allow for the appreciation.

Chart 2: Spread of Fed Rate - UST 2Y Yield is Wider than Prior Recessions



Source: Bloomberg, Maybank FX Research & Strategy

We are cognizant though of the risks that a Trump victory can risk causing disruption to the late cycle conditions that favor the JPY. His threats of tariffs can potentially result in an inflationary environment that may put pressure on the Fed to keeping rates elevated. However, that would depend also upon how global conditions actually turn out to be. A recession can actually work as a counteracting factor towards the inflation pressure placed by tariffs and Fed easing may still be able to occur. A lso, it remains uncertain what his timeline would be to implement the tariffs and whether they would only be bargaining chips for him to exert pressure on China and other countries to grant concessions to the US. As a whole though, we still think that a downward trend for the USDJPY can continue even in a Trump victory albeit we note of some upside risk.

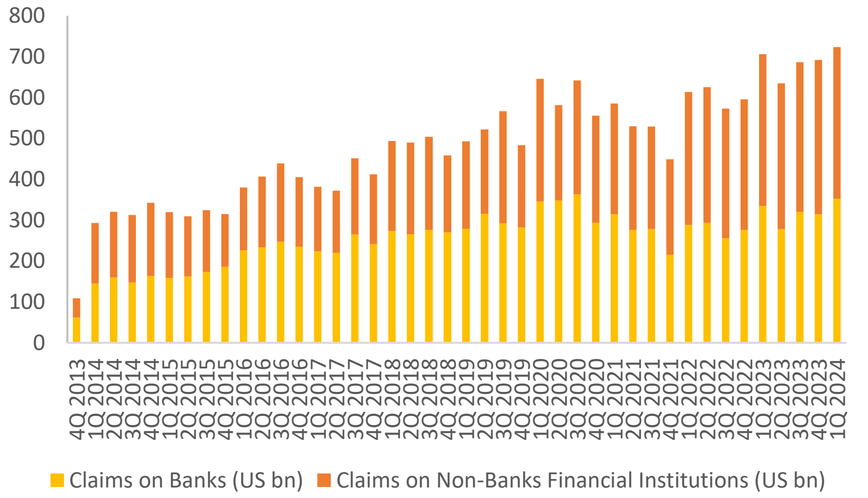
Meanwhile, in a Harris victory scenario, inflationary threat looks much less given that she is not looking to go down the path of tariffs as Trump is considering. The outcome of the JPY would therefore be more dependent on how underlying economic conditions evolve instead - whether we get a soft landing or a recession.

Overall, in this late cycle game, the number of scenarios as to which a JPY strengthening does not play out is more limited. In both a soft landing and recessionary outcome, the JPY would still see quite some appreciation. In the risk scenario of a Trump victory, a disruption to JPY strengthening may only occur under quite specific conditions but in most cases, there can still be quite some appreciation.

Positioning Looks to Support JPY Appreciation Too

JPY positioning as we see it looks like it can support further JPY appreciation. If we look at the cross border lending in JPY, it was high as of end 1Q 2024 compared to history. We do recognize that the data itself is quite dated but the high level of lending during that period still implies the possibility that there is quite some unwinding of JPY bearish positions left.

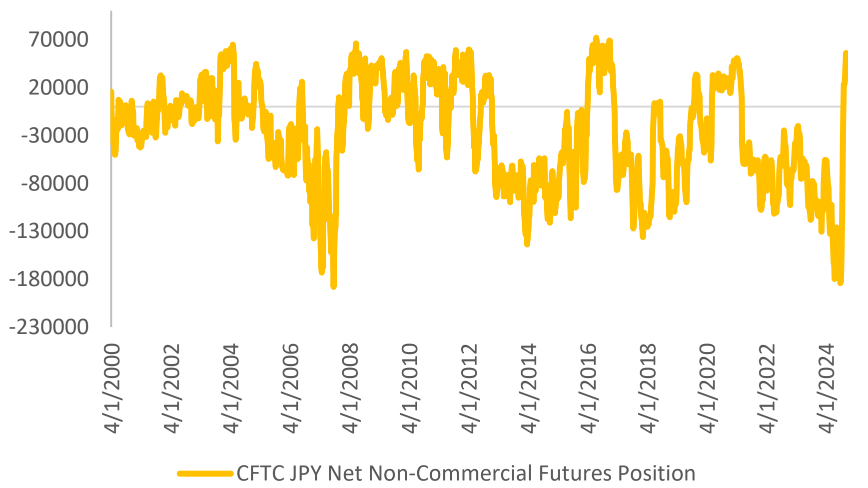
Chart 3: Cross Border JPY Bank Lending was High at End 1Q 2024 Highlighting There Can Still Be More JPY Bearish Positioning Unwind



Source: Bloomberg, Maybank FX Research & Strategy

Meanwhile, the net JPY CFTC positions (which can reflect the "fast money" part of the carry trade) is now bullish and positioning itself is around the highest levels seen over the last 20 years. Although it may appear stretched by historical standards, we do note that the JPY is still at very weak levels too and the macro situation is only turning more favorable. Therefore, such stretch positioning does not mean there would be an unwind happening so soon.

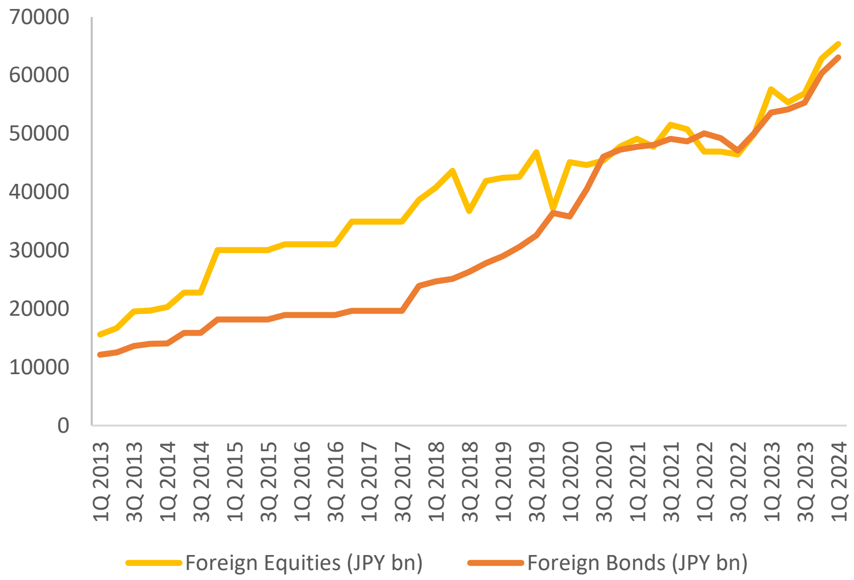
Chart 4: Net JPY CFTC Positioning is Bullish and Levels are High Compared to History But an Unwind is not Necessarily Due Given Favorable Macro Conditions



Source: Bloomberg, Maybank FX Research & Strategy

A recent Bloomberg survey has found that almost half of the analysts polled believe that the GPIF would increase its allocation target for Japanese equities in its new asset allocation as the fund needs to earn higher returns as inflation accelerates. Nearly half the respondents were expecting a decrease in foreign bonds although actually only roughly around a third expect that they will increase their holdings in domestic bonds. Also, only around a third believe that they will reduce their allocation to foreign equities. Current GPIF asset allocation is roughly about 25% equally across domestic bonds, domestic equities, foreign bonds and foreign equities. At this point, it is still uncertain how the allocation would be rejigged but the impact of any reallocation can potentially have quite an impact on USDJPY. Whilst we do not have detailed data on the total foreign holdings of GPIF, there is available data on the total that pension funds in Japan hold. The number is high as of 1Q 2024 and has risen substantially over the years.

Chart 5: Foreign Equity and Bond Holdings of Japanese Pension Funds Stand High as of 1Q 2024



Source: Bloomberg, Maybank FX Research & Strategy

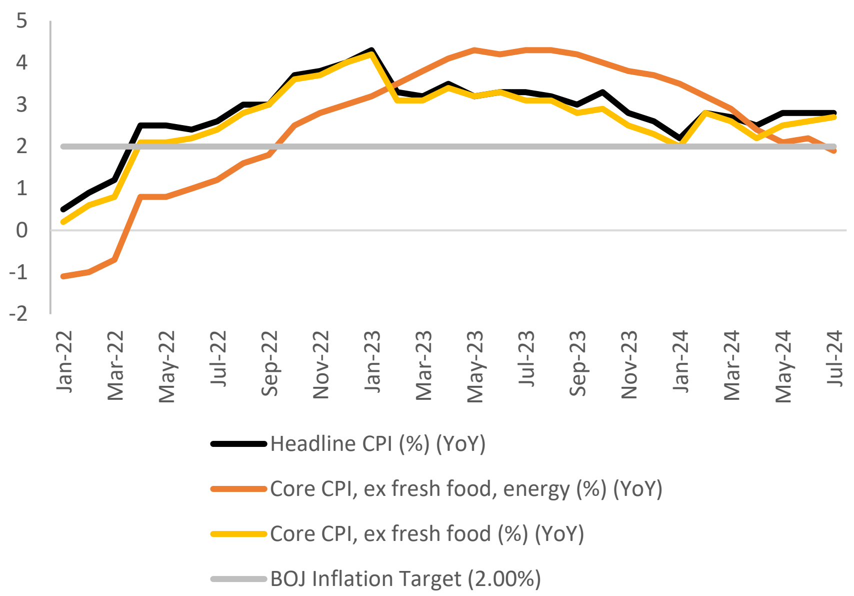
BOJ Tightening Cycle Remains Intact Albeit Gradual

BOJ tightening looks like it is very much intact as Governor Ueda has recently reiterated that “there is no change” to their basic stance that they will adjust monetary policy as they gain confidence in the likelihood of the economy achieving a stable 2% inflation. As it is, the virtuous cycle between wages and prices is looking to become more entrenched given how economic data is evolving. Real wage growth has now turned positive and it has been so for the last two months. Meanwhile, inflation looks likely that it would fall around the BOJ’s expected level of 1.9% YoY in 2024, which puts the price trend on the path to hold above the 2.00% target at the end of the forecast period in 2025 - 2026. We do note that CPI readings may slowdown in the near term amid the reintroduction of utility subsidies although it should pick-up again towards year-end as those subsidies come to an end and continued wage growth can support demand-driven inflation.

Chart 6: Real Wage Growth has Turned Positive, Which Would Help Support Demand - Driven Inflation

Source: Bloomberg, Maybank FX Research & Strategy

Chart 7: Inflation Readings May Slow in the Near Term But Should Pick-Up Towards Year-End



Source: Bloomberg, Maybank FX Research & Strategy

With the more encouraging economic numbers, we therefore expect the BOJ to hike again by 25bps in Dec 2024, which brings the rates to 0.50%. The market should also be quieter during that period amid the festive season, which can reduce the likelihood of any major disruption occurring as a result of the decision. We expect them to subsequently hike again by 25bps in Jun 2025 and by the same amount in Dec 2025, which should bring the rate up to 1.00%. The BOJ's increasing hawkishness overtime should in turn be a supportive factor for JPY strengthening.

We Stay Cognizant of the LDP Leadership Election Race

The LDP presidential election is slated to be held on the 27 Sep 2024 and there are already total nine declared candidates. As it stands, current opinion polls are showing that Shigeru Ishiba - former Minister of Defense and Shinjiro Koizumi - former Minister of Environment and son of former Prime Minister Junichiro Koizumi are in the lead. Koizumi has already said that he would respect BOJ independence. Sanae Takaichi - former Minister of Internal Affairs and Communications who is seen as the favorite after those two has come up to say that it is too soon for the BOJ to move away from an ultra-easy policy. For now, we just stay cognizant of how the race would pan out.

Table 1: List of LDP Presidential Candidates

Candidate Name	Previous or Current Key Position
Shigeru Ishiba	Former Minister of Defense
Shinjiro Koizumi	Former Minister of Environment
Sanae Takaichi	Minister of State for Economic Security
Yoshimasa Hayashi	Chief Cabinet Secretary
Yoko Kamikawa	Minister of Foreign Affairs
Katsunobu Kato	Former Minister of Health, Labor and Welfare
Takayuki Kobayashi	Former Minister of State for Economic Security

Taro Kono	Minister for Digital Transformation
Toshimitsu Motegi	Secretary General of the Liberal Democratic Party

Source: Various News Websites, Maybank FX Research & Strategy

Near Term, Expect Two-Way Risks on USDJPY But to Eventually be Ranged

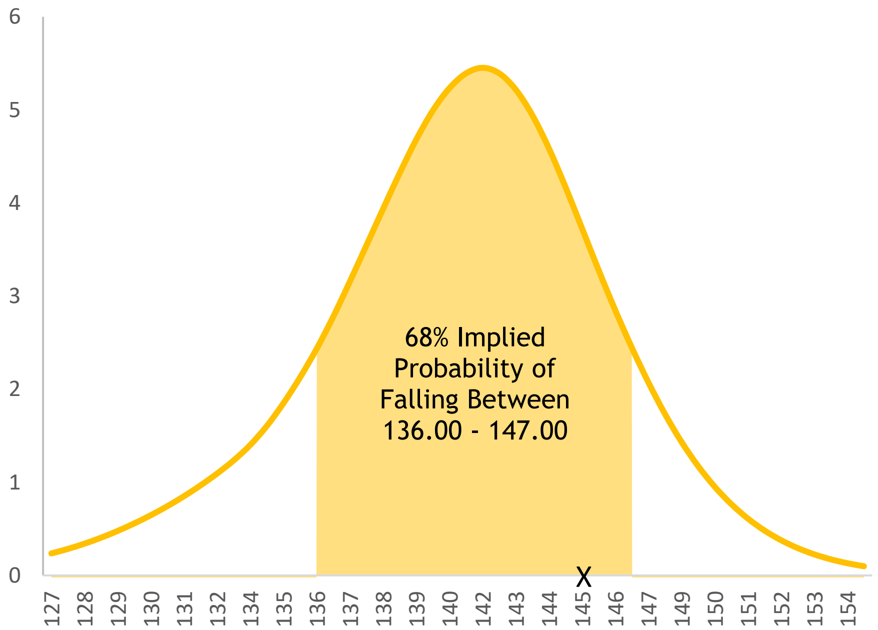
There is a BOJ decision due this coming Friday on the 20th Sep but we see the impact on the JPY to be more limited from this given that they are likely to stay on hold and Ueda would continue reiterate that a tightening remains in the game. This has likely already been priced in by markets. Focus would instead be on the FOMC and whether they would move by 25bps or 50bps in addition to their views on the economy. The Fed's actions and words remain open to interpretation by the market and that creates two-way risks for the USDJPY near term. However, if it rebounds, we expect that it would still be within a range of 140.00 - 145.00.

Probability Density Functions (PDF) of USDJPY Values Based on Implied Volatility

By looking at the implied vols for 1M, 3M, 6M and 12M, we see that the implied probability of the range that the USDJPY could fall in can be seen to be quite wide. Given the uncertainty that does cloud markets over the next year, we are little surprise by this wide range.

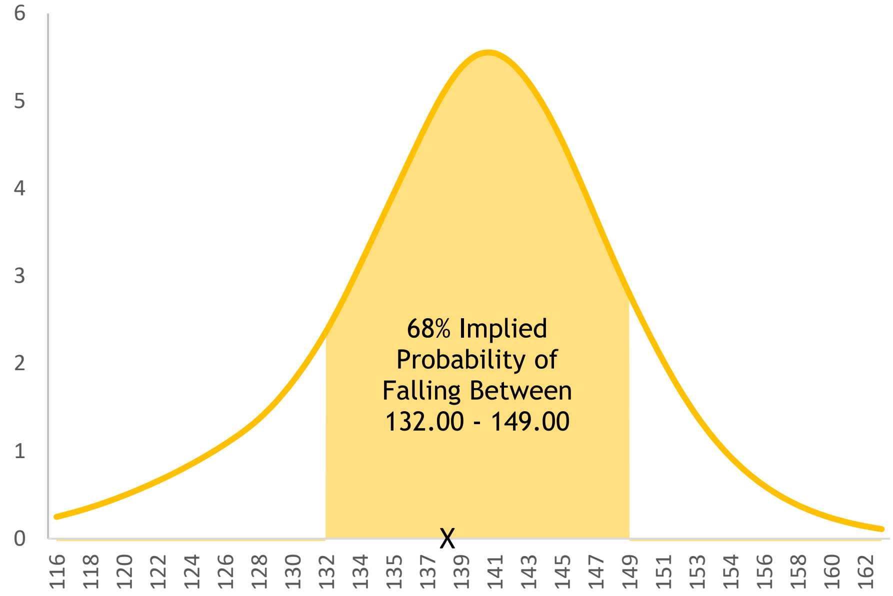
(put the forecast as an x the forecast on all the charts)

Chart 8: PDF of USDJPY Values for 1M Implied Vols



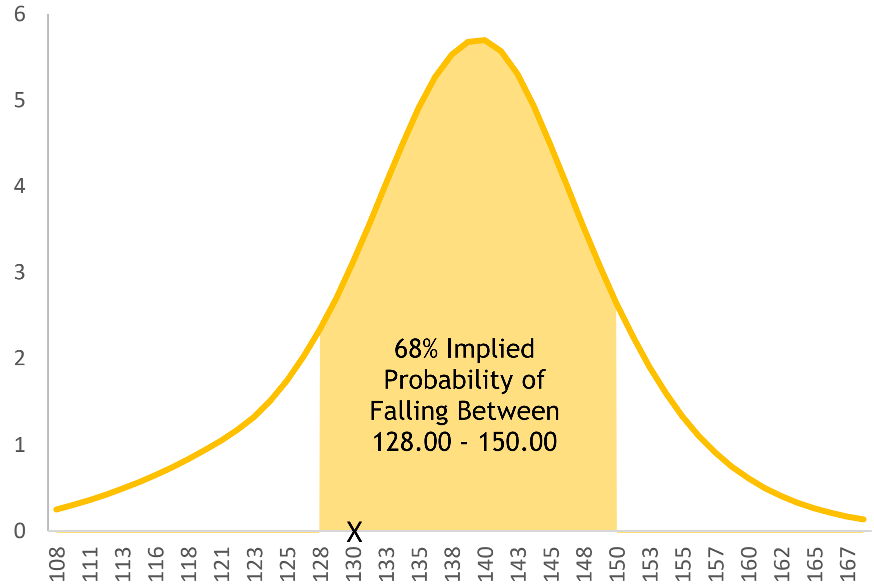
Source: Bloomberg, Maybank FX Research & Strategy
Note: 1) X shows where Maybank FX forecast is at for end Q3 2024
2) PDF is as of 18 Sep 2024

Chart 9: PDF of USDJPY Values for 3M Implied Vols



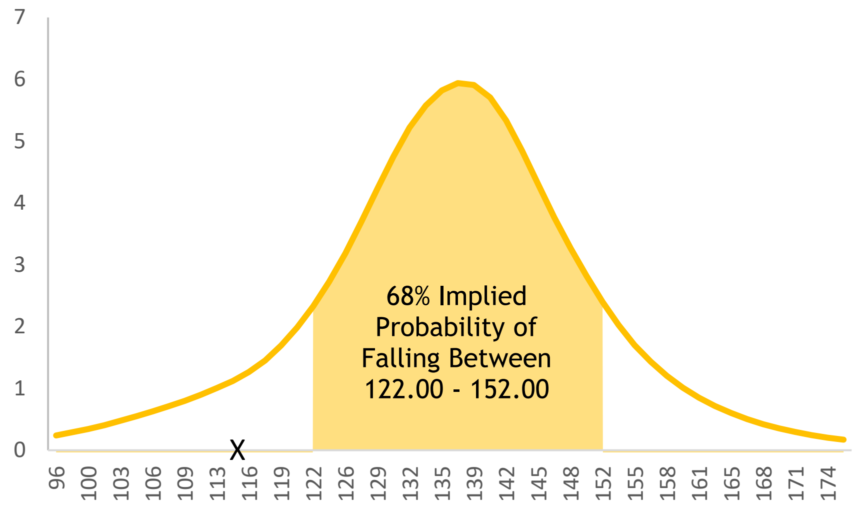
Source: Bloomberg, Maybank FX Research & Strategy
Note: 1) X shows where Maybank FX forecast is at for end Q4 2024
2) PDF is as of 18 Sep 2024

Chart 10: PDF of USDJPY Values for 6M Implied Vols



Source: Bloomberg, Maybank FX Research & Strategy
Note: 1) X shows where Maybank FX forecast is at for end Q1 2025
2) PDF is as of 18 Sep 2024

Chart 11: PDF of USDJPY Values for 12M Implied Vols



Source: Bloomberg, Maybank FX Research & Strategy
Note: 1) X shows where Maybank FX forecast is at for end Q3 2025
2) PDF is as of 18 Sep 2024

Chart 12: Two - Way Risks for USDJPY

Resistance: 145.00 and 150.00

Support: 140.00 and 135.42

Source: Bloomberg, Maybank FX Research & Strategy

Conclusion: Expect JPY to be the Resilient Play

There looks to be various factors that would support the JPY in the medium term which include the 1) falling Fed rates, 2) BOJ tightening and 3) further position unwinding and repatriation. These combined narrow yields differentials and allow for strong JPY appreciation. These factors also appear likely they can somewhat play out in various scenarios whether it is a soft landing or a recession and even in a Trump victory.

Overall, we continue to stick to our USDJPY forecast which is based on a soft landing although there is a possibility of further downside in the scenario should there be a recession. A Harris win is also unlikely to change our expectations of USDJPY. In the case of a Trump victory, we believe that our expected downward trend path to continue albeit we note of some upside risk. Therefore, we also recommend going short USDJPY over the medium term.

Near term, we do expect some rebound in USDJPY as the Fed we believe would cut by 25bps later and that can somewhat disappoint investors given that markets lean towards expectations of a 50bps cut. As a note, the 1M ATM implied vol shows a 68% implied probability of the USDJPY falling between 136.00 -147.00.

Table 2: USDJPY Forecasts

Forecast	3Q 2024	4Q 2024	1Q 2025	2Q 2025
USDJPY	145.00 (-)	138.00 (-)	130.00 (-)	120.00 (-)

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