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FX

Global

FX Insight

JPY - Room To Move Lower

JPY Rally Unlikely To Continue Unabated

Since the start of the year, the JPY has been among the best performers in Asia against the USD. We do not expect the JPY rally to continue unabated as the monetary policy divergence between BOJ and the Fed remains intact and weigh on the JPY against the USD. In addition, there could be even more room for UST yields to go higher as US nominal rates accelerates in the event US inflation picks up faster than expected. This is especially if Trump's planned expansionary fiscal stimulus materializes in 2017, which could manifest in even greater USD strength and in turn, lift the USDJPY even higher. The ultra-loose monetary policy is expected to continue in 2017, though the focus now centered on controlling the yield curve. There is room though for the BOJ to still cut interest rate, possibly to -0.3% from -0.1% currently, to provide further impetus for inflation and which could provide the USDJPY with further upward momentum. We continue to look for the USDJPY to head higher to the 118-levels and 125 by end-1Q and end-2017. Meanwhile, we expect the JPYSGD and the JPYMYR to trend lower and end-1Q at 1.1864 and 3.56 respectively before slipping even lower to 1.1360 and 3.36 by end 2017. Our technicals suggest that the USDJPY could hover with 112-115.20, and the JPYSGD and JPYMYR around 1.2425-1.2672 and 3.8380-3.9760.

Upside Risks To USDJPY…

USDJPY is back above the 113-levels, underpinned by firmer USD as UST yields rose after Trump pledged to move forward on tax reform. The Abe-Trump summit over the next two days (10-11 Feb) will be closely watched for any hints of protectionist implications that could stall the pair's climb higher. We also watch 4Q16 GDP print on Mon (13 Feb) and US Fed Chair Yellen's semi-annual testimony that could provide the pair with another leg up. Pair has lost its bearish momentum on the daily chart and stochastics is tentatively climbing higher from oversold conditions. A weekly close above the 21DMA could see further upside towards 115.20 (50DMA). Support at 112.00 (38.2% fibo retracement of the Nov-Dec rally).

… But Downside Risks To JPYSGD & JPYMYR

JPYSGD is trading heavy amid the relative weakness of the JPY. This cross is at risk of breaking below the lower bound of its upward trend channel (around 1.2420-region) that began in mid-Dec 2016. A clean break below that region could see further extension towards 1.2425 (50-DMA), 1.2350 (61.80% fibo retracement of the Dec-Feb rally), 1.2274 (76.4%). Resistance at 1.2672 (Feb high) before 1.2735 (upper bound of the upward sloping trend channel). **JPYMYR** seems to have formed a double top at 3.9750/60 and is on the way lower. This cross has slipped under the 200-DMA at 3.9160 and is on its way lower towards the 3.8702 (50-DMA) before the next at 3.8380 (23.6% fibo retracement of the Nov-Dec sell off). In addition, there appears to be a bearish divergence of price action with MACD. Higher highs not matched with higher high on MACD forest. Expect some downside risks to this cross. Resistance at 3.9760.

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Still Room For Further USDJPY Upside

Since the start of the year, the JPY has been among the best performers in Asia against the USD. The JPY has so far risen by 3.4% against the USD (*Chart 1a*). Key to this gain in the JPY against the USD was the lack of action by Trump on his election pledge to stimulate the economy with infrastructure spending and tax cuts. His controversial executive order banning Muslims from entering the US did not sit well with investors, sending them to safer haven assets, including the JPY. These have resulted in the unwinding of long USD bets, helping to send the JPY higher.

We do not expect the JPY rally to continue unabated as the monetary policy divergence between BOJ and the Fed remains intact. The recovery in the US economy and concomitant uptick in inflationary pressures should keep the Fed on track to hike the fund rate by 50-75bps in 2017. On the other hand, the lack of inflationary pressures in Japan should see the BOJ maintain its ultra-loose monetary policy even as it maintains its tight control over JGB yields to lower borrowing costs and boost inflation expectations. These suggest that there is room for JGB yields to remain low and UST yields to rise further. This should drive monetary policy divergence between the BOJ and Fed and encourage greater Japanese purchases of UST for higher returns and weigh on the JPY against the USD.

In addition, there could be even more room for UST yields to go higher as US nominal rates accelerates in the event US inflation picks up faster than expected. This is especially if Trump's planned expansionary fiscal stimulus materializes in 2017, which could manifest in even greater USD strength and in turn, lift the USDJPY even higher.

While the ultra-loose monetary policy is expected to continue in 2017, we no longer expect the BOJ to further expand the policy. In particular, the downgrading of the monetary base as its main target does not suggest an imminent tapering. Instead the purchases of JGB would remain around the current levels of JPY80tn per annum for now.

The focus instead is now centered on controlling the yield curve both at the short-end and at the 10Y. By keeping interest low and stable especially at the short-end, this should be positive for the stock market and encourage flows into equities as investors reallocate assets away from government debt. Given the positive correlation between the USDJPY and the stock market, the flow into equity should lift the USDJPY higher as investors hedge their equity purchases by going short JPY.

There is room though for the BOJ to still cut interest rate, possibly to -0.3% from -0.1% currently, to provide further boost for inflation. Note that the dateline for achieving the 2% inflation target had been pushed back further to FY 2018 beyond BOJ governor Kuroda's term of office. Further interest rate cut by the BOJ together with further Fed rate hike adjustments in 2017 (resulting in widening yield differentials in favor of US) could provide the USDJPY with further upward momentum.

Chart 1a: JPY Strength Persist YTD…

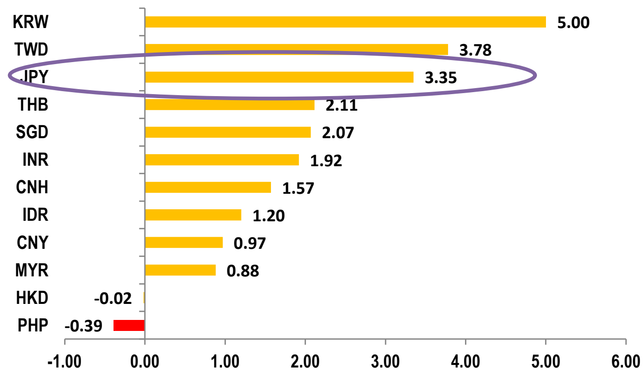
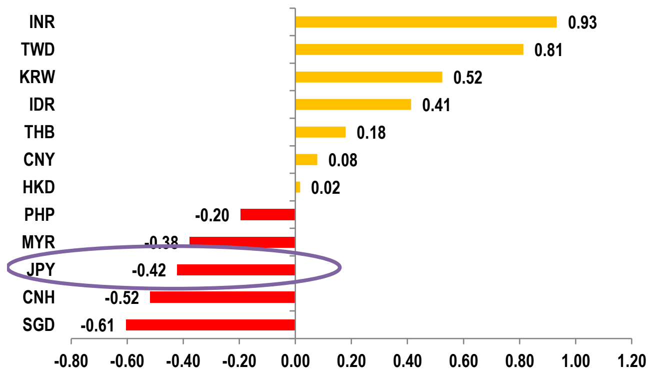


Chart 1b: … But Is Coming Off In Feb



Source: Bloomberg, Maybank FX Research

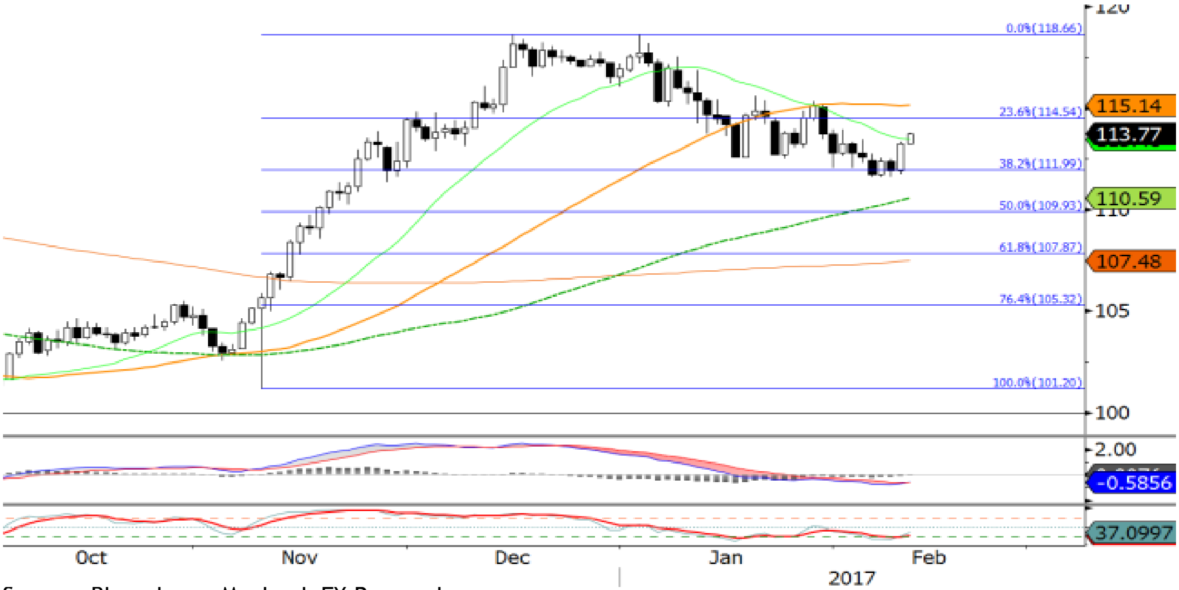
The recent pledge by Trump of a 'phenomenal' tax plan in the next few weeks have galvanized USD bulls, lifted UST yields, re-ignited long USD bets and provided the USDJPY with a leg higher. This is reflected in the 0.4% fall in the JPY against the USD so far in Feb (Chart 1b). Further rise in UST yields, and hence stronger USD, should keep the USDJPY supported.

Consequently as a result of Trump's signaling, the USDJPY has rallied above the 113-levels overnight and is heading back towards the 114-levels. The 10Y UST-JGB bond yield differentials has widened with 10Y JGB still below the 0.10% level to 0.098% and the 10Y UST at above 2.40% and is putting upward pressure on the pair. Still, the Abe-Trump summit starting tomorrow is eyed for possible unexpected outcomes especially if JPY manipulation is brought back to the table and this cautiousness could cap gains intraday.

While there are risks that summit could result in a surge in the JPY against the USD as it did during the Clinton-Miyazawa summit in 1993, we believe the package that PM Abe will bring to the negotiating table during his summit with Trump will ease such concerns. This package is likely to include Japanese businesses participation in infrastructure building and other projects in the US which would contribute to creating jobs there. Moreover, aides to Trump have highlighted that JPY manipulation were not a priority in the talks. However, there possible areas of conflict especially surrounding US automobile and agriculture exports to Japan that could still weigh on the USDJPY. Still, as a valued ally of the US in Asia, the US might also not want to come down too hard on Japan so long as some of the concerns of the US such as automobile exports are resolved. A 'peaceful' conclusion to the summit will be positive for the USDJPY and keep the pair supported.

We continue to look for the USDJPY to head higher to the 118-levels by end-1Q and then to 125 by end-2017.

USDJPY Daily Chart: Climbing Higher



Source: Bloomberg, Maybank FX Research

USDJPY is back above the 113-levels, underpinned by firmer USD as UST yields rose after Trump pledged to move forward on tax reform. The Abe-Trump summit over the next two days (10-11 Feb) will be closely watched for any hints of protectionist implications that could stall the pair's climb higher. We also watch 4Q16 GDP print on Mon (13 Feb) and US Fed Chair Yellen's semi-annual testimony that could provide the pair with another leg up. Pair has lost its bearish momentum on the daily chart and stochastics is tentatively climbing higher from oversold conditions. A weekly close above the 21DMA could see further upside towards 115.20 (50DMA). Support at 112.00 (38.2% fibo retracement of the Nov-Dec rally).

JPYSGD Daily Chart: Downside Risk

Source: Bloomberg, Maybank FX Research

JPYSGD is trading heavy amid the relative weakness of the JPY. This cross was last seen around 1.2510 levels. Daily momentum indicator shows waning bullish bias, while stochastic is turning lower. This cross is at risk of breaking below the lower bound of its upward trend channel (around 1.2420-region) that began in mid-Dec 2016. A clean break below that region could see further extension towards 1.2425 (50-DMA), 1.2350 (61.80% fibo retracement of the Dec-Feb rally), 1.2274 (76.4%). Resistance at 1.2672 (Feb high) before 1.2735 (upper bound of the upward sloping trend channel).

JPYMYR Daily Chart: Double-Top

Source: Bloomberg, Maybank FX Research

JPYMYR seems to have formed a double top at 3.9750/60 and is on the way lower. This cross has slipped under the 200-DMA at 3.9160 and is on its way lower towards the 3.8702 (50-DMA) before the next at 3.8380 (23.6% fibo retracement of the Nov-Dec sell off). In addition, there appears to be a bearish divergence of price action with MACD. Higher highs not matched with higher high on MACD forest. Expect some downside risks to this cross. Resistance at 3.9760.

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