

FX Insight

JPY - Losing Luster

USDJPY Forecast Revised Higher But Trajectory Maintained

We have revised our forecast for the USDJPY to take into account USD strength amid Fed rate hike expectations and trade war concerns in the near term. We expect some mild USD retracement and BOJ policy normalisation expectations to weigh on the USDJPY in the next 6 to 12-months. Accordingly, our 1-month, 3-month, 6-month and 12-month outlook for the USDJPY is 115, 115, 112 and 110 respectively. The current level of the JPY is fundamentally undervalued relative to its BEER fair value of 109. We expect the JPY to correct in the longer term.

JPY Losing Luster As Safe-Have Proxy Play For Now

In the current environment of more aggressive Fed rate hike expectations and Sino-US trade war concerns, the current strength of the USD has made the currency the more sought-after refuge in the face of global risk-off sentiments compared to JPY. Carry trades with the JPY as the funding currency for USD assets also weighs on the JPY. In addition, portfolio inflows into Japanese assets have not lifted the JPY as investors tend to hedge their asset purchases against further JPY depreciation. Recent CFTC data showed that market players are positioning for further USD strength as reflected in the increase in net-short JPY contracts in the week of 10 Jul. Expectations of USD correction from 4Q, exporter repatriation of earnings during quarter-end for book-keeping purposes and JPY seasonal strength in 4Q should be supportive of the JPY.

Upside Risks For USDJPY Near-Term; JPY Strength In The Medium Term

Technical charts suggests that the USDJPY could potentially head higher towards 118-levels should resistance level at the 114-handle be broken on a weekly close. A move towards 118 though is likely to be short-lived with a retracement likely back towards the 115-levels. Support is around 111.20-levels (38.2% fibo retracement of the Jun 2016 to Dec 2016 rally). EURJPY looks to remain supported, and AUDJPY range-bound but both have the potential to retrace in the near-term. Downside risks to both JPYSGD and JPYMYR could persist, though there could be a potential for a rebound for the JPYSGD.

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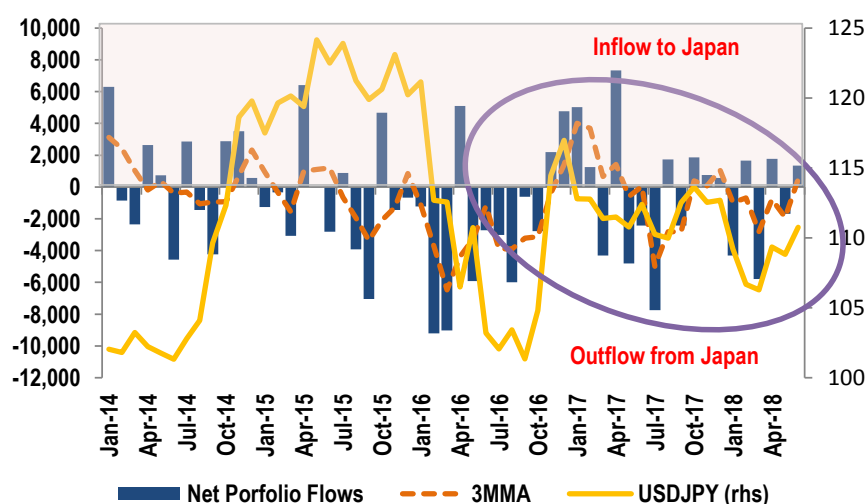
Portfolio Inflows Not Necessarily Supportive of the JPY

In an environment of uncertainty, particularly with regards to lingering trade war concerns, haven-assets are likely to find favour compared to risk assets. Since the introduction of quantitative and qualitative easing measures by the BOJ, there have been broad fund outflows from Japan to higher yielding assets abroad. This weighs on the JPY. However, the search for safe-haven assets is likely to characterise the environment in the next three-to-six months at least until trade war concerns dissipates.

Typically, the rising trade tensions between China and US should spark global risk aversion and in turn trigger safe-haven plays including the JPY amid US monetary policy normalisation. That said, a significant escalation of this Sino-US trade dispute could lead to greater financial volatility and eventually impacting negatively on global growth, limiting further USD upside. This could delay the Fed normalisation plans and weigh on UST yields. The deterioration in global sentiments and potential drag in global growth from escalating trade tensions could see greater demand for the JPY and other safe-haven proxy plays. JPY could strengthen consequently.

As can be seen from Chart 1, the USDJPY has been tracking net portfolio flows into Japanese assets. On a three-month moving average basis, foreign inflows into Japanese assets have been on the rise after slipping lower from Oct 2017. JPY weakness and a buoyant US economy have lifted corporate earnings amid simmering global trade tensions, encouraging foreign inflows into Japanese equities. We however did not see a concomitant rise in the JPY with the foreign inflows into Japanese assets. Instead, as can be seen in Chart 1, the JPY weakened with net portfolio inflows, suggesting a strong positive correlation between portfolio inflows into Japanese assets and the USDJPY. This is because foreign investors usually hedge their Japanese asset purchases against further JPY depreciation by short-selling the JPY. Thus, inflows into Japanese assets have been positive for the USDJPY, possibly accounting for the weakness in the JPY so far.

Chart 1: Further Net Portfolio Inflows Could Weigh On JPY



Source: Bloomberg, CEIC, Maybank FX Research & Strategy

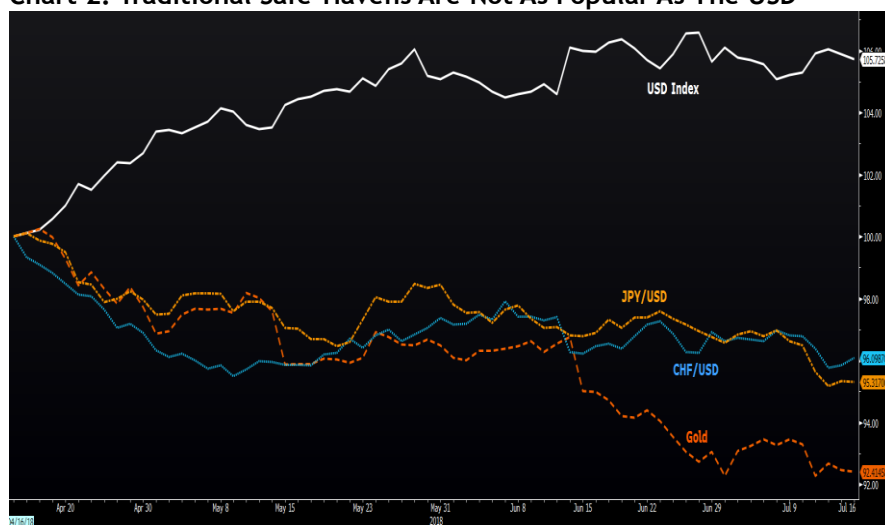
USD Strength Trumps All...For Now

For now though, demand for safe-haven assets appear to be completely offset by broad USD strength amid monetary policy divergence and

optimism over US corporate earnings. More importantly, the measured response from China over the additional tariffs announced by the Trump administration appears to have calmed markets, de-escalating tensions between the two world's largest economies.

At the same time, Fed's guidance for a more rapid normalisation of its monetary policy as well as healthy US data to date have been supportive of the USD. Year-to-date, the USD Index (index of the value of the USD relative to basket of its major trade partners' currencies) have risen by 2.6%. When viewed from the start of the USD index rally in mid-Apr, the USD has risen by an even faster 5.3%.

Chart 2: Traditional Safe-Havens Are Not As Popular As The USD



Note: Normalised as of 16 Jul 2018

Source: Bloomberg, Maybank FX Research & Strategy

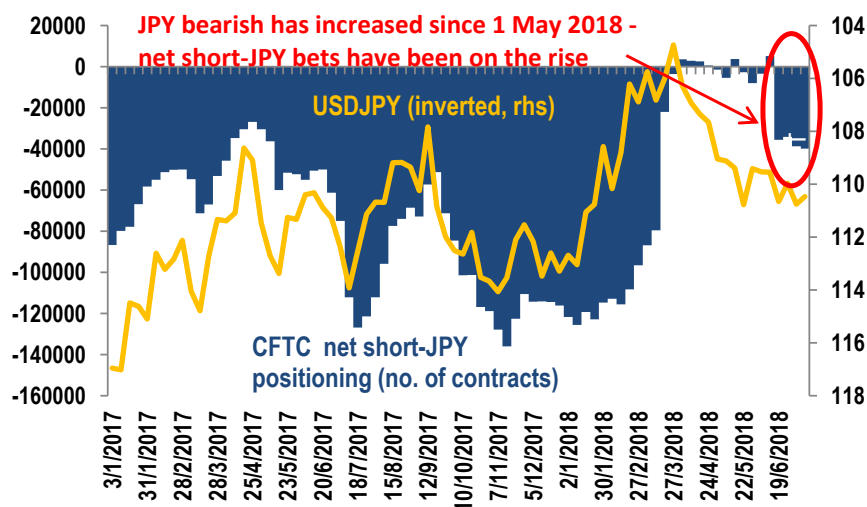
Not surprisingly, this has made the USD the more sought-after refuge in the face of global risk-off sentiments compared to the other traditional safe-haven proxies like gold, JPY and CHF (Chart 2). JPY appears to be underperforming this time round due to the lack of demand for it as a safe-haven proxy play, exposing the currency to USD moves. Just as important, carry trades are back with the JPY as a funding currency. Investors borrow JPY to invest in USD assets in search of higher returns. All of these should lead to increase long-USD short-JPY positioning that should keep the USDJPY supported.

Already we have seen market players positioning for further USD strength (Chart 3). Recent CFTC data showed that since the week of 5 Jun, market has been net short-JPY, i.e., expecting weakness in the JPY, with 39,832 contracts in place. Investors have almost doubled their short-JPY bets from 58,754 contracts at the start of May to 100,395 contracts as of the week of 10 Jul, while at the same time increasing slightly their long-JPY bets to 60,563 contracts as of the 10 Jul week vs. 57,349 contracts as at the start of May. Given expectations for further USD strength in the next three months, we could see further net short-JPY positioning that should weigh on the JPY.

However, we do not expect USD strength against the majors, including the JPY, to extend beyond 3Q 2018. A milder downtrend for the USD is expected towards the end of the year though we cannot rule out bouts of USD strength like the current episode. We maintain our view that the USD is bound for a broad pullback because of (1) rising US deficit and debt from US tax reforms; (2) reserve diversification away from USD; (3)

USD countercyclical play; and (4) broad USD downtrend cycle. Thus we expect JPY weakness to peter out towards the end of the year.

Chart 3: Market Positioning For Further JPY Weakness



Source: Bloomberg, Maybank FX Research & Strategy

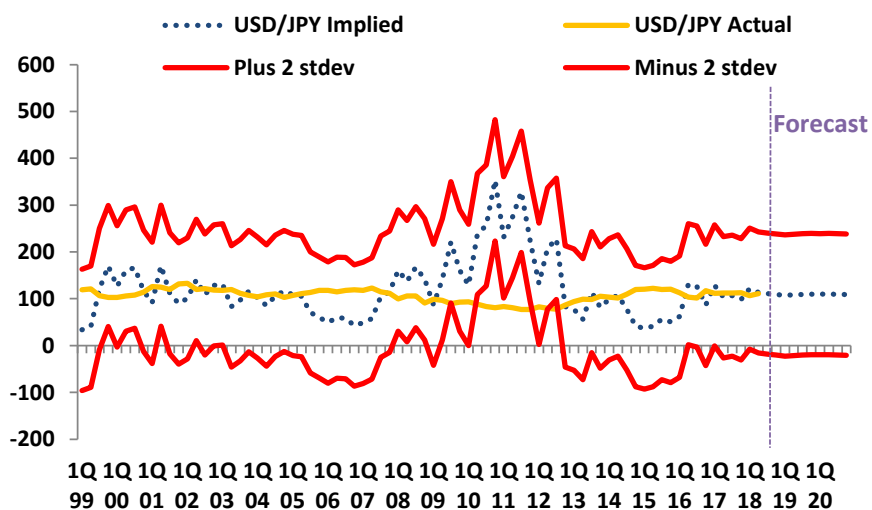
Downside pressure on the JPY is also likely to come from importer demand for foreign currency (usually USD). Healthy economic growth and improvement in wages have seen import demand increase (May imports rose 14% y/y vs. Apr's +6.0%). With economic growth expected to remain healthy (BOJ expects real GDP to expand by 1.6% in FY2018), import demand should also remain healthy and increased import demand should weigh on the JPY. On the other hand, anecdotal evidence suggests exporters could park their export earnings abroad on expectations of further JPY weakness and repatriate earnings only during quarter-end for book-keeping purposes.

At the same time, 4Q tends to be a seasonally strong month for the JPY vs. the USD (Chart 4), and there is the potential for the JPY to rebound in the last three months of the year. This is likely to mitigate the downside pressure on the JPY and lift the JPY higher by end-4Q.

Chart 4: The Last 3 Months Of The Year Tends To Be Seasonally Strong For The JPY Vs. USD

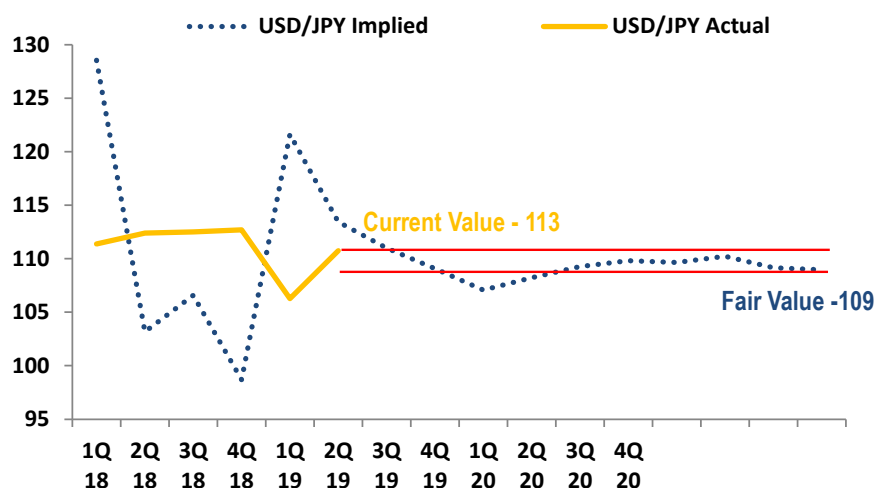


Chart 5 (a): Some Room For JPY To Correct Towards Fair Value Estimate In The Medium Term



Source: Bloomberg, CEIC, Maybank FX Research & Strategy

Chart 5 (b): JPY Undervalued From Current Levels



Source: Bloomberg, CEIC, Maybank FX Research & Strategy

In addition, the current level of the JPY is fundamentally undervalued by about 3.5% and this suggests some room for the JPY to depreciate mildly towards our fair value estimate (Chart 5 (a) and (b)). Our BEER fair value model which takes into account differentials in REER, terms of trade, GDP per capita and interest rate; net foreign assets (as % of GDP); ratio of total trade to GDP; productivity; and government consumption, estimates USDJPY at 109.

Against this current backdrop of USD strength, we have revised our forecasts for the USDJPY. We expect the JPY to remain weighed even as concerns over trade disruption persist. We see upside pressure on the USDJPY to lift the pair and end 3Q higher around 115 instead of the 109 we had previously expected. Thereafter, we expect some pullback in USD strength to allow the USDJPY to ease and end the year around 112 (108 previously). In 1H 2019, we look for the pair to hover around the 111 (from 107 previously). We expect the pair to end 2019 around 110-levels as market begins to price in policy normalisation in 2020.

USDJPY Forecast

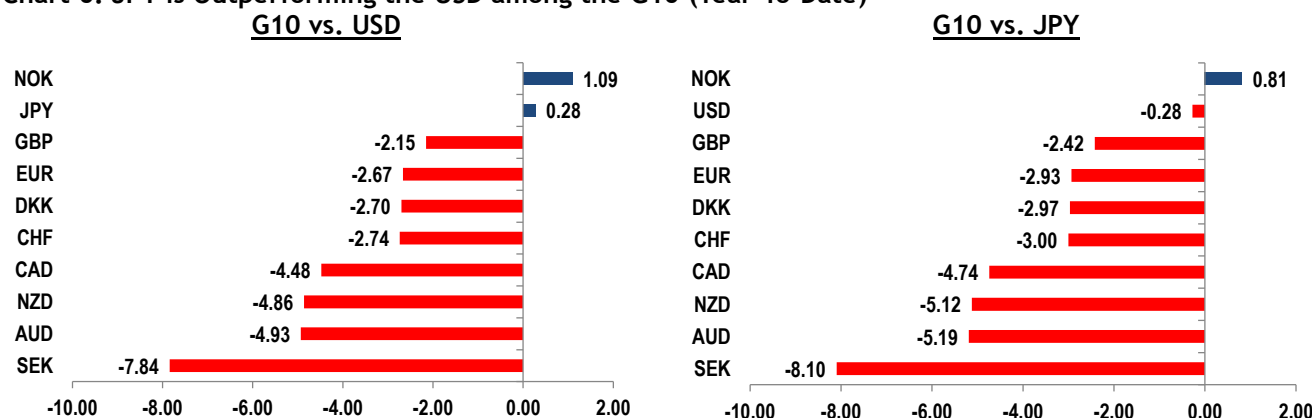
Forecast	3Q 2018	4Q 2018	1Q 2019	2Q 2019
USDJPY	115.00 (109.00)	112.00 (108.00)	111.00 (107.00)	111.00 (107.00)

Previous Forecasts in Parenthesis

JPY Has Been Resilient

The JPY has been largely overshadowed by the USD especially amid all the hoopla over trade war. Conventional wisdom would assume that the USD would be the best performer among the G10 currencies. An examination of the G10 currencies against the USD and JPY respectively proves otherwise.

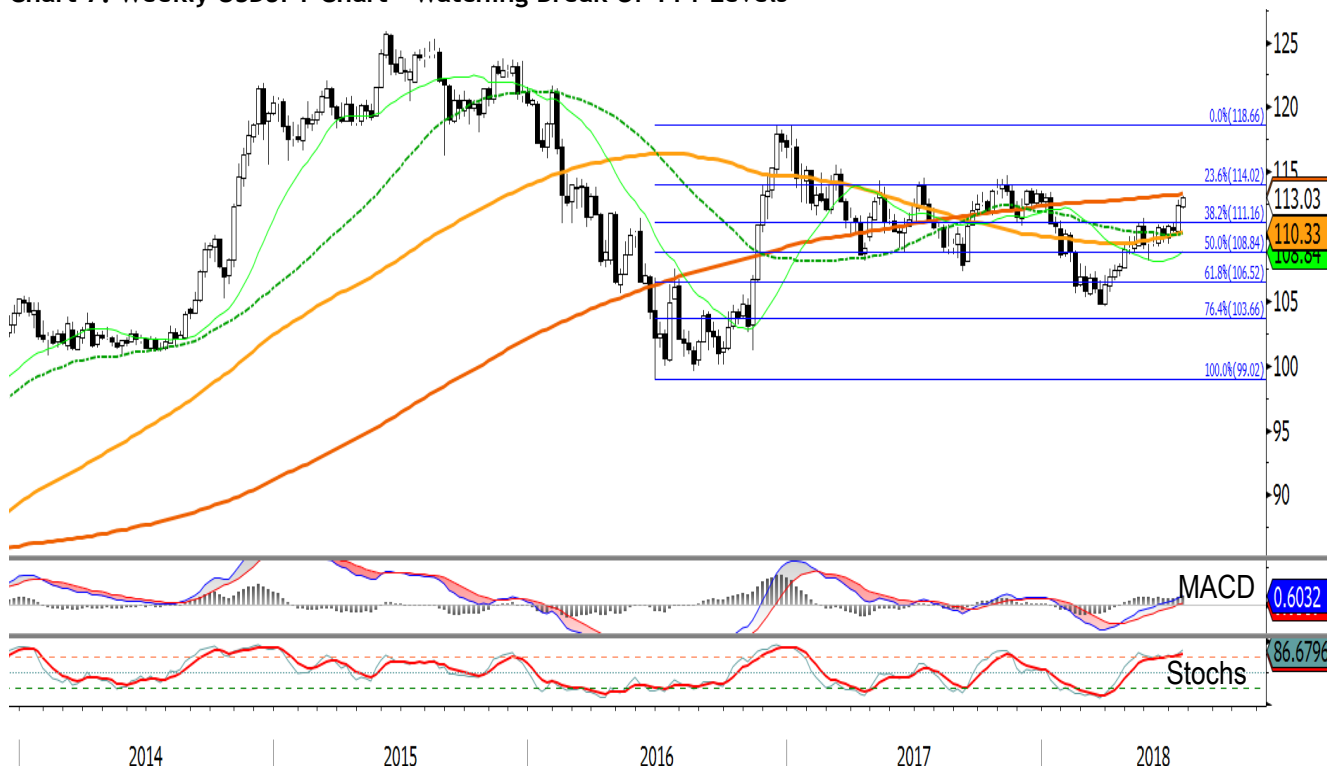
Chart 6: JPY is Outperforming the USD among the G10 (Year-To-Date)



Source: Bloomberg, Maybank FX Research & Strategy

From Chart 6, the JPY has risen against all every G10 currencies except for the Norwegian Krone (NOK) so far this year (start of the year to 13 Jul). By comparison, the USD has gained against eight of its G10 peers to date. The JPY has gained an average of 3.4% against its G10 peers, while the USD has advanced by 3.1%. The outpacing of the JPY compared to the USD reflects the resilience of the JPY in the current environment amid trade war concerns and more aggressive Fed rate hike prospects.

Chart 7: Weekly USDJPY Chart - Watching Break Of 114-Levels



Source: Bloomberg, Maybank FX Research & Strategy

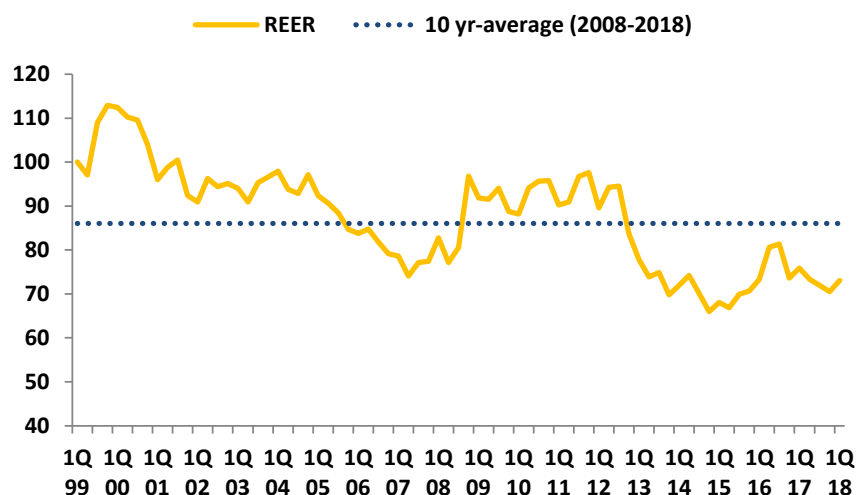
USDJPY climbed nearly 3 yen in the past two weeks, lifted by the broad USD moves higher amid optimism over strong US corporate earnings and expectations of Fed rate hike moves in 2H 2018. The muted response of China to the threat of additional tariffs on Chinese exports to the US was also supportive of the USD and reduced demand for safe-haven assets.

Pair was last seen around 113.04 levels. Momentum indicators remain bullish bias while stochastics is at overbought conditions. The golden cross pattern we had flagged previously has been formed and this typically is a bullish signal. Pair could thus potentially head higher towards 118-levels should resistance level at the 114-handle be broken on a weekly close. A move towards 118 though is likely to be short-lived with a retracement likely back towards the 115-levels. Support is around 111.20-levels (38.2% fibo retracement of the Jun 2016 to Dec 2016 rally).

JPY Crosses

At the same time, the JPY is on the weak side on a real effective exchange rate (REER) basis when compared to its 10-year historical average (Chart 8). This has increased the economy's competitiveness vis-à-vis its trading partners. But risks among its trading partners, particularly the EU and Australia re-emerge, and these could lift the JPY REER back towards its 10-year average.

Chart 8: JPY REER Has Been Trending Lower Since Start Of QQE



Source: Bloomberg, CEIC, Maybank FX Research & Strategy

In the current risk environment, Fed rate moves in 2H 2018 has largely been telegraphed by the Fed and is mostly priced-in by the market. Market expects monetary policy divergence between the Fed and BOJ to weigh on the JPY. On the other hand, Sino-US trade war concerns should be supportive of the JPY because of safe-haven proxy plays, especially if these tensions escalate into a trade war. The net effect of trade war concerns amid US policy normalisation would be a stronger JPY especially against its non-USD G10 peers.

EURJPY - Political Uncertainty In The EU Could Re-Emerge

Despite the relative calm on the political front in the EU, uncertainty could re-emerge just as quickly with the trigger point possibly coming from migration and anti-EU policies. These were manifested earlier this year in the near-collapse of Chancellor Angela Merkel's coalition government over immigration policy; and concerns over Italy's nationalistic and anti-EU government that rattled the financial markets. At the same time, ECB policy normalisation is supportive of the EUR. For now, the political calm and ECB policy normalisation are proving positive for the EURJPY cross.

Chart 9: Weekly EURJPY Chart - Upside Bias But Potential For Downside Risks Near Term



Source: Bloomberg, Maybank FX Research & Strategy

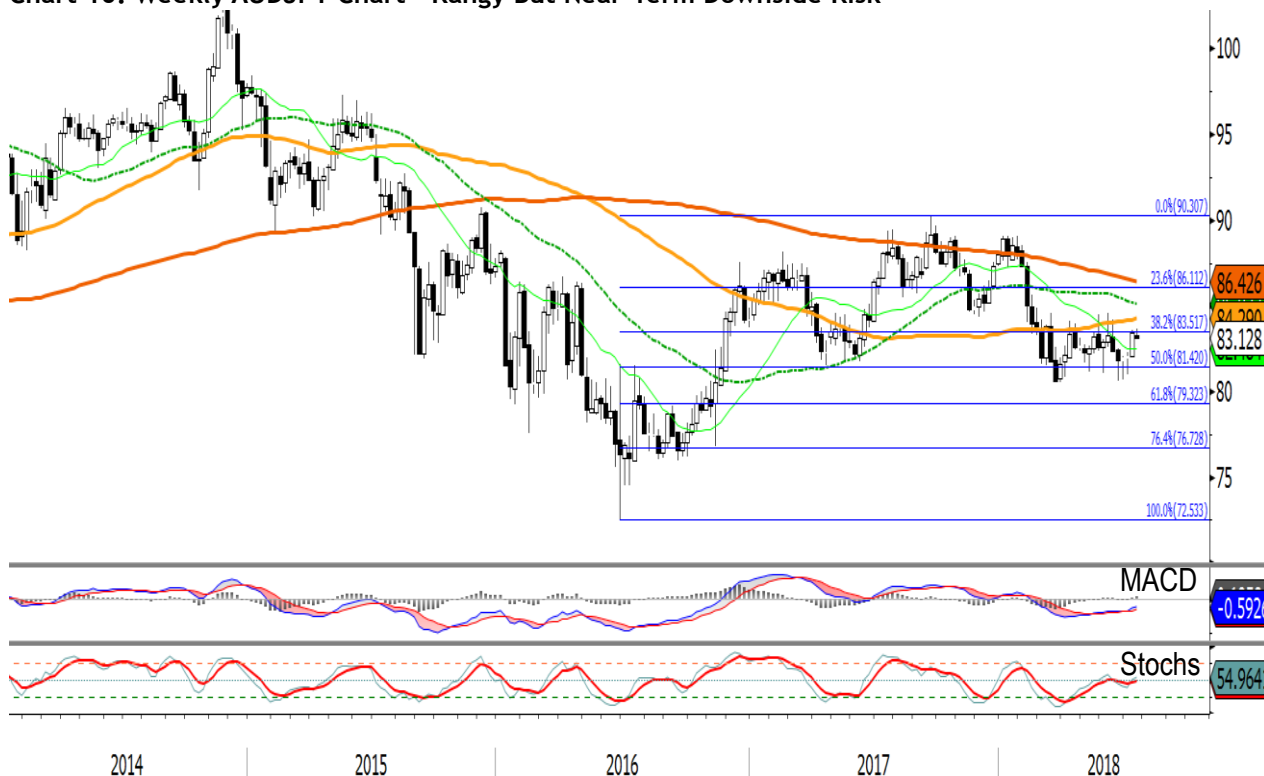
EURJPY has rebounded from its 2018 low of 124.62 on 29 May amid ECB policy normalisation and easing political concerns in the EU over Italy at that point in time. With risk sentiments supported, long-JPY, short-EUR bets are being unwound, putting downside pressure on the JPY and lifting this cross higher. Last seen around 131.53-levels. Momentum is turning bullish, while stochastics is climbing higher. Daily chart though suggests some downside risks in the near-term. Immediate resistance is around the 132-levels (50DMA) ahead of 133.50-, 134.50-levels. Support around 131-levels (23.6% fibo retracement of the Jun 2016 to Feb 2018 rally), 129.50-levels.

AUDJPY - Downside Risks Abound

Australia is among the most sensitive to trade war concerns between China and the US given its exposure to China and its increasing reliance on trade. Softer commodity prices (possibly on a moderation in Chinese growth) weigh on the AUD. For now, the de-escalation in trade war concerns between China and US is providing some relief for the AUD. Still, there are downside risks to the AUD ahead, namely a re-escalation of Sino-US trade tensions, US yield curve inversion that could trigger concerns about a potential US recession, and possible political risks leading into the 2019 general elections. Until then, we could see the AUDJPY cross edge higher.

It is worth noting here that should the Fed stay on hold in Sep, we could see a softer USD and stronger funding currencies, including the JPY. This suggests that the cross AUD/JPY could fall. But should Fed hike rates as planned then we could see the AUDJPY trade range-bound as the Fed moves have already been priced-in.

Chart 10: Weekly AUDJPY Chart - Rangy But Near-Term Downside Risk



Source: Bloomberg, Maybank FX Research & Strategy

AUDJPY has been trading within a tight range since end-Mar amid China-US trade war concerns. Last seen around 83.135-levels. This cross shows no strong momentum on the weekly chart. Daily chart though shows risks of a pullback. We could see range-bound trades for now, but there is a risk for a near-term pullback. Resistance is around 84.290-levels (100DMA) ahead of 85-handle (50DMA), 86.425-levels (200DMA). Support around 81.420-levels (50% fibo retracement of the 2016 low to 2017 high).

JPYSGD - Trade Disruption Risks Supportive

As a small open economy heavily reliant on trade, any disruption to the global supply chain due to trade war concerns is a drag on the economy. Already the synchronous export recovery is showing signs of slowing and together with trade war concerns could exacerbate the downside risks to the economy. With China and the US among the largest trading partner with Singapore, a trade war puts the economy between a rock and a hard place, which could be reflected in a weaker SGD. This in turn should be supportive of the JPYSGD. That said, the SGD is a quasi-safe-haven asset as well given its triple-A credit rating in the Asia. This could keep the cross range-bound to a certain extent.

Chart 11: Daily JPYSGD Chart - Bearish, But Risk Of Rebound



Source: Bloomberg, Maybank FX Research & Strategy

JPYSGD was last seen around 1.2115-levels. Daily bearish bias on the daily chart remains intact, while stochastics is at oversold condition. This suggests there is a potential for a rebound. Until then, pair could continue to drift lower. Support is around 1.2045 levels (61.8% fibo retracement of the 2018 rally), 1.1980-levels. Resistance around 1.2145 levels (50% fibo, 200DMA), 1.2230 (50DMA).

JPYMYR - Downside Risks Persist

Malaysia faces several downside risks, namely softer oil prices, trade tension concerns and RMB moves. Possibility of a supply glut in light of the OPEC and Russia agreement to boost output, the return of Libyan supply after a short disruption and push by US to increase oil supply could weigh on oil prices and hence the MYR. Similarly, trade disruption could weigh on the MYR given its dependency on trade. The RMB, which has been an anchor of stability for most of AXJs, is losing some of its shine on concerns over the repercussions from an economic conflict with the US and the lack of PBoC presence to slow RMB depreciation and which is likely to impact the MYR. A softer MYR could lift the JPYMYR higher ahead.

Chart 12: Daily JPYMYR Chart - Downside Risks



Source: Bloomberg, Maybank FX Research & Strategy

JPYMYR has been trading softer since early Jul amid elevated oil prices. Last seen around 3.5928-levels. Bearish bias on the daily chart remains intact but waning, while stochastics has entered into oversold territory. For now, we could see this cross pressured lower. Support is around 3.5720-levels (76.4% fibo retracement of the 2018 low to high), 3.5500-levels. Resistance is around 3.6050-levels (61.8% fibo), 3.6245-levels (50DMA).

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