FX Thoughts

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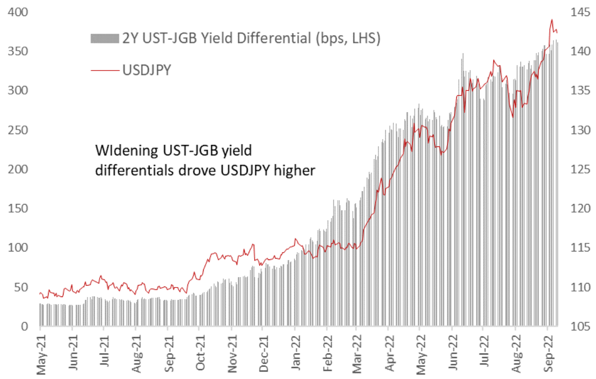
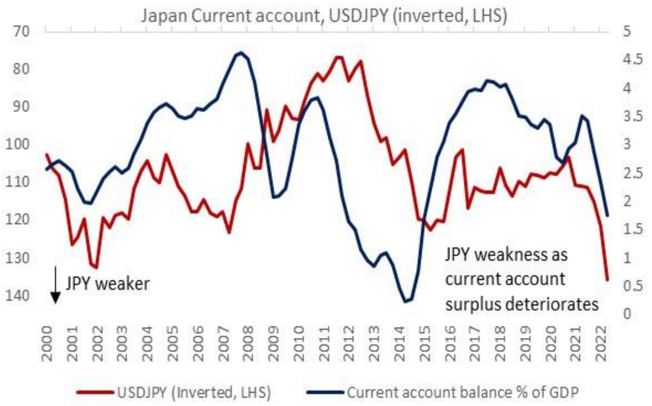
USDJPY – An Interim Peak?

- *While the risk of intervention may be perceived to be low, we caution against complacency as the warning shots fired from Japan officials suggest that their patience may be wearing thin. Any sharp, excessive move beyond 145 – 146 levels could possibly spark off actual intervention though question remains how sustainable it can be if there is no follow through in BoJ policy and that USD and UST yield momentum continues. We expect USDJPY vols to stay elevated as markets await FOMC and BoJ next week. Our base case is for BoJ to stand pat but do not rule out risk of YCC tweaks at some stage. Fundamental drivers underpinning USDJPY's move higher remains intact but technical price pattern and intervention risks suggest that the pace of rise may slow or even retrace in the interim. Near term support at 142.50, 141.50. Resistance at 145.*

- **Policy Divergence Driving USDJPY Higher So Far.** Taking stock, USDJPY rose over 9% from Aug trough to Sept peak and came close to touching 145 levels. Growing monetary policy divergence between Fed and BoJ, deterioration in Japan's current account surplus and USD strength were some of the main factors driving USDJPY higher. On Fed-BoJ policy divergence, we note that 2y UST-JGB yield differentials had widened to as much as +386bps, up from about +300bps at the start of Aug. Hawkish repricing of Fed following the hotter than expected US CPI report accelerated the recent widening of yield differentials. Meanwhile BoJ retains its easing policy stance.



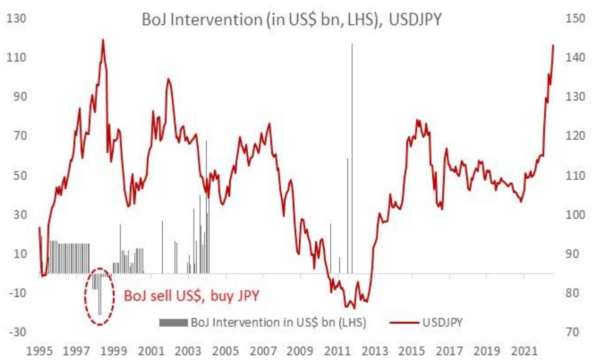


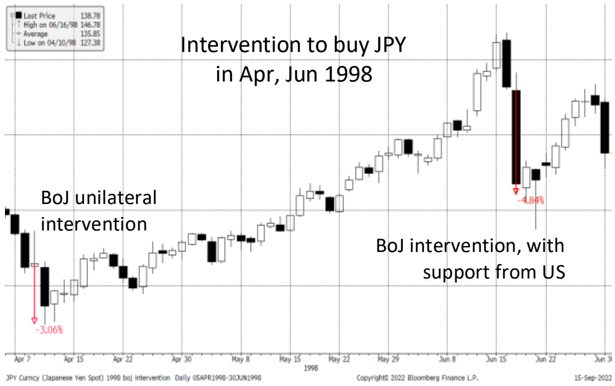
Source: Bloomberg, OCBC

- **Intervention Risk Temporarily Keep JPY Shorts at Bay.** USDJPY briefly traded a high of 144.99 last week before turning lower. The meeting between BoJ, MOF and FSA (8 Sep) was a trigger. Though the comments - *that sharp FX fluctuation is not desirable, watching FX moves with high sense of urgency*, etc came as no surprise, the mention of all options, including FX intervention are on the table is of significance.

- Another round of verbal intervention re-surfaced again when USDJPY came close to 145 levels (14 Sep). From observation in the past 2 weeks, the jawboning gets more intense when (1) the magnitude of the move was sharp and (2) when USDJPY was near 145. This time, we found the language and tone to be sterner and more urgent as Finance Minister Shunichi Suzuki warned that authorities will not announce intervention plans and will act swiftly without interruption if it were to act. It was also reported that BoJ conducted a rate check in the FX market after Japan currency chief Masato Kanda delivered a verbal warning (14 Sep).

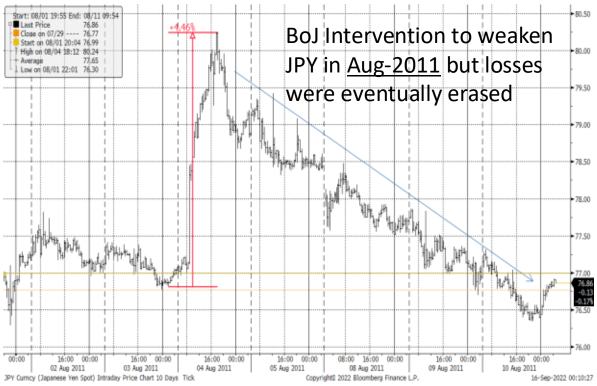
- The last time BoJ intervened on multiple occasions to buy JPY was more than 2 decades ago, during the period of Nov-1997 to Jun-1998 in the midst of Asian financial crisis. In particular, the 2 episodes of JPY intervention in 9-10 Apr 1998 and 17 Jun 1998 saw JPY appreciated between 3% and 5% vs. USD. The impact lasted between 2 days and 5 days, before JPY reversed those gains in about 2weeks or so.

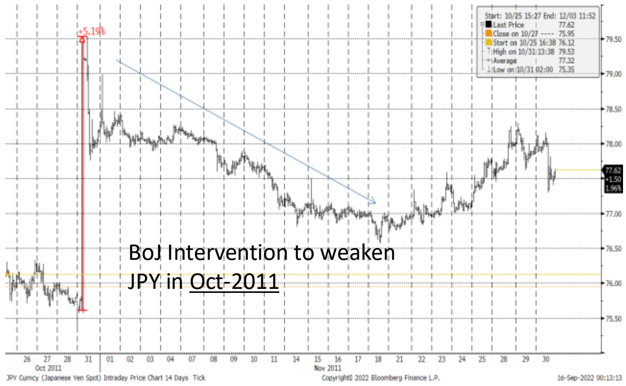




Note: JPY Intervention was confirmed by BoJ officials and documented in various reports and journals.
Source: Fed bulletin 1998, Japan MOF, PIIE, Bloomberg, OCBC

- But for most of the time when the BoJ intervened, the move was to sell JPY. The most recent episode was more than a decade ago in 2011, when BoJ and other G7 nations jointly intervened to stem JPY strength post-tsunami in Mar, and then in Aug and Oct when the BoJ intervened alone to sell JPY. During the joint intervention in Mar-2011, JPY fell > 7% over 2 days while during the solo intervention, JPY fell around 5% over 2 days. But subsequently JPY weakness post-intervention was reversed.

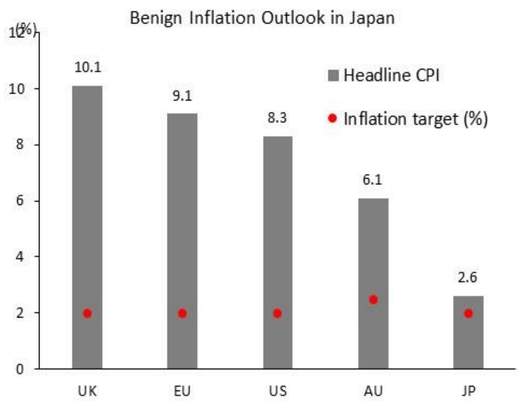


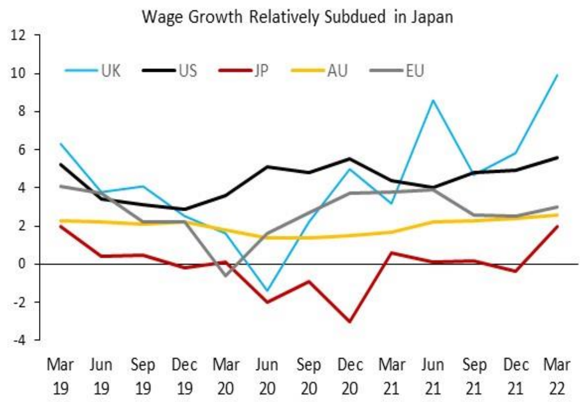


Source: Bloomberg, OCBC

- On net, based on historical observation of BoJ intervention, JPY typically move between 3% and 5% in the direction of intervention and the impact is more pronounced within the first 48 hours. While intervention may slow the pace of JPY depreciation, the move alone is not likely to alter the underlying trend unless USD, UST yields turn lower or the BoJ changes/tweaks its monetary policy.

- **Will the BoJ Surprise at Upcoming MPC?** The next BoJ policy decision is due on 22 Sep and market consensus as well as ourselves lean towards BoJ inaction. BoJ Governor Kuroda's comments at Jackson Hole Symposium in late-Aug was rather clear that the BoJ still need to stick to accommodation bias perhaps till his term ends in Apr-2023. In particular, he said that *inflation is now at 2.4% but is wholly caused by international commodity price hike, energy and food*. He *expects inflation to approach 2% or 3% by end of this year but inflation may again decelerate towards 1.5% next year. As such, the BoJ will continue to stick to its easing stance until wages and prices rise in a stable and sustainable manner.* At this point, there is no compelling evidence to suggest that wages and prices in Japan can rise in a sustainable manner.

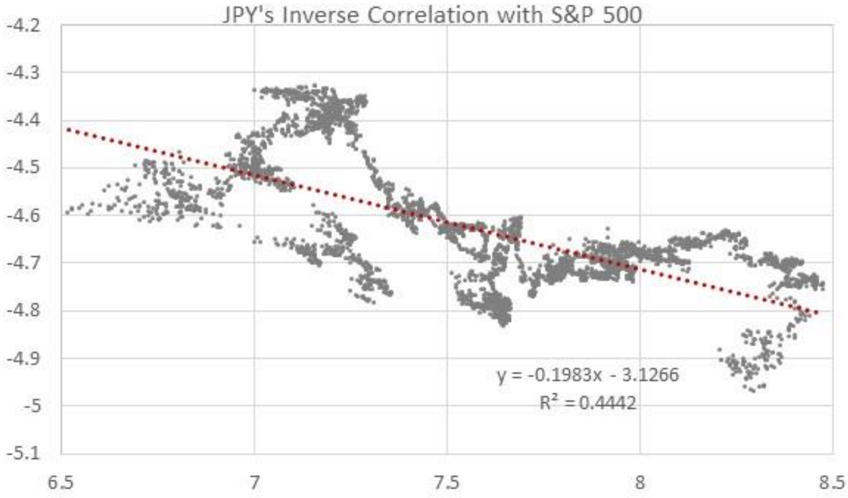




Source: Bloomberg, OCBC

- While our base case is for BoJ to stand pat at the upcoming MPC, we do not rule out the risks of possible tweaks at some point. To recap, BoJ adopted the yield curve control (YCC) in 2016. Under the YCC, BoJ guides short term rates at -0.1% and around 0% for 10y JGB yield. BoJ has also pledged to buy unlimited amounts of 10y JGBs daily to defend a 0.25% cap around its 10y yield target. A few options that the BoJ may consider is: (1) exit negative policy rate; (2) adjust the 10y JGB yield target higher potentially to 0.25%; and/or (3) raise the upper bound of the YCC cap of 0.25%. Any of this policy tweaks can potentially help to slow JPY's depreciation. Specifically increasing the 10y JGB yield target and/or raising the YCC upper bound could have bigger impact as JGB yields are expected to rise and UST-JGB yield differentials can narrow somewhat, helping USDJPY lower.

- In conclusion, the JPY is at risk of further depreciation as long as the BoJ's YCC remains in status quo and other central banks, including the Fed continue to embark on tightening or policy normalisation. The Japanese officials may engage in FX intervention to stem JPY weakness but history suggests that the impact may only be short-lived unless (1) intervention is coordinated or (2) BoJ tweaks monetary policy or (3) USD's bull trend turns or UST yields come off significantly. Another scenario would be a sharp deterioration of global growth or sharper equity sell-off. Risk aversion thematic could in turn support demand for JPY.



Note: OLS regression with y variable as JPY and x variable as S&P 500, using daily log values over past 15 years
Source: Bloomberg, OCBC

- **USDJPY Technical:** Pair was last at 143.40 levels. Bullish momentum on daily chart shows signs of waning while RSI is falling from overbought conditions. Risks skewed to the downside though bullish trend channel intact for now. Support at 142.50 (channel lower bound), 141.50 (23.6% fibo retracement of Aug low to Sep double-top). Decisive break below 141.50 puts next support at 140.10 (21 DMA) and 139.35 (38.2% fibo). Resistance at 145 (interim double top).

USDJPY (Daily): Bullish Trend Channel Intact But Gains Slowing

Source: Bloomberg, OCBC

- **SGDJPY Technical:** YTD, the cross has rallied >20%. Last seen at 101.80 levels. Bullish momentum on daily chart shows signs of waning while RSI fell from oversold conditions. Potential exhaustion on bullish trend. Retracement lower not ruled out. Support at 100.20 (21 DMA), 98.80 (50 DMA) and 96 levels (23.6% fibo retracement of 2020 low to 2022 high). Resistance at 103 (2022 high).

SGDJPY (Daily): Exhaustion; Retracement Likely

Source: Bloomberg, OCBC

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