JPY - Warnings Await?

- Weak payrolls could focus attention on the JPY
- The Japanese economy continues to struggle
- Would MOF see a stronger JPY as justified?

Much rests on the outcome of today’s non-farm payrolls; but if they result in a stronger JPY, previous warnings about currency moves from the Japanese government need to be borne in mind.

Throughout this week, markets have witnessed a steady spree of weak and, in some cases, alarming reports relating to the health of the global economy. In the case of Japan, the finalised June PMI was seen to have fallen to 49.3 in June from 49.8 in May, thereby implying the biggest contraction in manufacturing activity in three months, largely as a result of subdued export demand.

Worse, however, the authoritative BOJ ‘Tankan’ survey of manufacturing showed that the mood in the sector stood at a three year low; and the survey also showed that plans for investment had also slipped from the previous quarter in a further blow to one area of aggregate demand that has consistently fallen short of expectations during the six year old Abenomics project.

**Disinflationary forces in**

---

**Newswatch**

1. A number of Conservative MPs on standby for a possible snap October election - FT >

2. China will not buy American agricultural products if the US “flip-flops” again on future trade negotiations -
Yet it is clear that in terms of a suitable policy response, the BOJ remains caught in two minds between its role as guardian of price stability and the risks in doubling-down on existing policy settings given fears about distortions.

Accordingly, in comments on Wednesday, the BOJ’s Yukitoshi Funo communicated that while there was no immediate need for stimulus now, existing policy settings could be left in place beyond the Bank’s current spring 2020 timeframe.

However, the BOJ faces a more immediate problem courtesy of the JPY.

Last month, we noted that mounting dis-inflationary forces in Japan had served to numb the JPY’s sensitivity to domestic monetary policy and that this in turn had honed the currency’s sensitivity to US yields.

With inflation expectations in Japan already barely above zero, the JPY’s advance is untimely to say the least

In fact, this was the implicit point made by Japan’s Vice Finance Minister for International Affairs, Masatsuga Asakawa when he spoke on June 21.

Asakawa said that if the “Fed does cut rates in July because it feels doing so would be necessary to prevent a US economic downturn, that’s an appropriate monetary policy decision … but if exchange rates are moving rapidly in a way that cannot be explained by economic fundamentals, Japan has no choice but to voice concern.”

The incumbent ‘Mr Yen’ will be only too aware that the ongoing suppression of US yields bodes ill for the BOJ’s ability to fend of deflationary forces. Indeed, there remains a reasonable 60-70% rolling 20-day correlation between USD/JPY and the spread between respective US and Japanese bonds from two to ten years.
And as a result of the yield on the 10 year Treasury slumping below 2%, USD/JPY has been unable to post any threat to its post-April downtrend (currently at 108.20) and it currently resides just a few pips north of where it was when Mr Asakawa made his observations about the JPY last month.

With inflation expectations in Japan already barely above zero, the JPY’s advance is untimely to say the least – a fact that certainly warrants vigilance in the market place.

Please direct questions or comments to:

AerialView@BNYMellon.com