The BOJ and the JPY

- The JPY continues to trade in a well worn range
- The Japanese economy is losing momentum
- Has Kuroda's stipulation on policy been met?

USD/JPY has now traded in a 10% range for more than two years – an unprecedented sight for a currency pair that has been subjected to the steep trends and marked gyrations associated with the carry trade.

Yet there is little to suggest the market is anticipating any imminent threat of change on this front: near and longer-term atmf implied vols remain firmly at the bottom of their historical trading range.

Despite this, however, the tectonic plates on which stable levels of monetary largesse have been delivered in recent years are on the move and it is questionable for how much longer the monetary policy status quo can be considered a credible option. After all, an export-orientated economy is always vulnerable to an external shock.

Indeed, China continues to exert influence on the health of the Japanese economy – an assertion reflected in a 72% (inverse) correlation between JPY/CNY and the Topix since the start of last year (and a 91% correlation since the start of 2019.)

Hence the US-Sino trade spat has delivered a further and...
hefty blow to an Abenomics project which has never quite delivered on the key elements of a sustained recovery.

Certainly, the Q1 GDP data flattered to deceive: although 0.5% quarterly growth defied expectations of a contraction, the increase was driven by net trade courtesy of a collapse in imports – a dismal reflection on the health of demand which is corroborated by contractions in both consumption and investment.

Whether or not the US-Sino trade spat will be concluded any time soon - and regardless of what a US-Japan deal may bring - more timely Japanese data raise doubts over any second quarter recovery.

The latest manufacturing PMI fell back into negative territory in May as a result of sliding export orders and official shipments to China fell 6.3% y/y in April, down for the second consecutive month.

The economy, it appears, is at a turning point: the Cabinet Office coincident indicator is showing the economy to be deteriorating for the first time in more than six years.

And investors are no more able to suspend their disbelief in progress towards the BOJ's inflation target than they were in 2014 (after the sales tax hike sapped the Abenomics project of its momentum, never to be truly recovered).

Indeed, after six years of Abenomics, Japan's core inflation stands at just 0.9%.

What more a central bank can do if the biggest monetary blitz in history has failed to achieve its objective?

One might reasonably ask what more a central bank can do if the biggest monetary blitz in history has failed to achieve its objective - particularly in view of the BOJ

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On the Radar

May 28, 2019

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- US May consumer confidence (1500 BST)

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board’s persistent fretting about its distortive impact.

However, the pressure for the BOJ to do more can be justified by the central bank’s own guidance. In a fairly unusual and explicit coupling of policy and the JPY, Mr Kuroda stated back in February that the BOJ would “consider easing policy … if (currency moves) are having an impact on the economy and prices”.

With the trade war taking its toll, with the JPY 1.8% higher against the USD than where it started the month (on account of trade war turbulence) and in view of the Japanese economy’s current trajectory, many will feel that Mr Kuroda’s stipulation is being met.

The next BOJ policy meeting concludes on June 20. Unless the BoJ is willing to gamble on the spill over from any renewed stimulus in China, then albeit with a need to couch it in rather less explicit language, the desire to maximise exporters’ capacities to retain market share becomes all too apparent.

Please direct questions or comments to:

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