Two Key JPY Crosses

- Renewed pressure on both KRW and AUD emerging
- Similar patterns of outflows from both since start of year
- Realized volatility remains muted. However, exit door can prove narrow

One of the key themes that emerged last year was that as the Fed commenced reducing its balance sheet, the market environment began to take on some of the characteristics seen at the major turning points in late 2000 and late 2007.

It was therefore not that surprising when what looked an awful lot like the "put" reemerged in late November. Muted echoes of 2008, however, have begun to emerge in recent weeks from beneath the somewhat anesthetized calm.

These have been apparent again this week as evidence has emerged of a sharp deterioration in the US/China trade talks. Perhaps the clearest indication that China now expects a new round of tariffs on its exports came from an editorial yesterday in The People’s Daily.

It noted that China has “full confidence” to deal with difficulties and challenges that may arise during its trade talks with the US. It added: “What matters most now for China is to stay calm,” and stated “Don’t underestimate China’s resilience and strategic determination”.

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Newswatch

1. China/US: President Donald Trump tells a rally: “You see the tariffs we’re doing? Because they broke the deal. ... They broke the deal. So they’re flying in. The vice premier tomorrow is flying in, but they broke the deal. They can’t do that. So they’ll be paying. If we don't make the deal,
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One of the most obvious victims of the souring sentiment since mid-April (much as proved the case back in the summer of 2008) has been the KRW - thanks primarily to its exposure to China.

The net result is that the KRW is now trading at close to the lowest levels seen against the JPY since late 2016 after one of the sharpest (over 6%) 16-day moves seen since that summer.

If South Korea is a perfect example of the slowing China (and arguably global) growth story then it also makes sense that an equally sensitive bellwether such as AUD/JPY should be coming back into focus, particularly given the notable weakening of yield support seen this year.

As a result the yield gap between 2-year Australian and Japanese government bonds now stands at its narrowest since the summer of 1992.

2. China/US: The Ministry of Commerce issues a short statement: “US is planning to raise tariffs form 10% to 25% on China’s exports on May 10th. Such escalation in trade frictions is not in line with the US or China’s interests or the interests of the world, thus this is of China’s deepest regret. If the US goes ahead with its tariff measures against China, China will have to resort to necessary countermeasures.”xx

3. China: CPI in April rises 2.5% y/y (in line with the Reuters consensus forecast). This compares to a 2.3% y/y gain in March.

4. Japan: Bank of Japan Governor Haruhiko Kuroda says (when asked by an opposition lawmaker about the recent JPY rise) that the bank is watching exchange-rate moves carefully. He reiterates that “the BOJ would not do something for exchange-rate stability” as currency policy is

nothing wrong with taking in more than USD 100 bn a year.” >
"Don’t underestimate China’s resilience and strategic determination"

Unsurprisingly, our own iFlow data show very similar patterns of outflows from both currencies since the start of the year. In contrast the JPY has seen modest but sustained inflows emerging since April 22.

Given this it’s worth being reminded of two things. Firstly, while 10-day realized volatility in both pairs has picked up since April 22 it still remains well below the average levels seen over the past five years. In short, the environment

5.

UK: Labour leader Jeremy Corbyn will launch his party’s campaign for the European elections today. In his speech he is expected to say: “No one expected us to be holding these European elections, but the government’s complete failure on Brexit means they are going ahead.”

On the Radar

May 9, 2019

- Norges Bank policy decision (0900 BST)

- US Mar international trade balance (1330 BST): Reuters consensus forecast - USD 50.2 bn; previous - USD 49.4 bn

- CA Mar trade balance (1330 BST): Reuters consensus forecast - CAD 2.45 bn; previous - CAD 2.9 bn
remains very quiet.

Secondly, the exit door from the AUD and KRW back into the JPY can often prove narrow. This was highlighted not only by the remarkable price action seen on the first few days of this year but also by how events played out in the summer of 2008, when the AUD dropped about 15% against the JPY between early August and early September, while the KRW fell about 40% overall during the second half of that year.

With this in mind, it might be worth noting that the base of the post-January 7 range for the AUD is found at around current levels while the January peak for the JPY was just below KRW 10.67, a level that has been breached overnight.

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