Scotiabank
Global FX Strategy

FX SNAPSHOT
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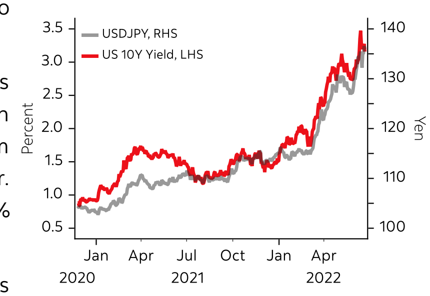
No Change in BoJ Policy in Prospect to Halt JPY Slide

USDJPY Pulled Higher by Yields



Source: Macrobond, Scotiabank FICC Strategy

The JPY decline has extended to 136, with no sign of any major reprieve in the trend. The JPY decline is prompting a fair degree of speculation about when the BoJ will "crack" and adjust monetary policy settings to halt the slide but we don't think a change in policy is likely anytime soon.

JPY negatives are significant. We can list these briefly as 1) Adverse interest rate differentials, 2) Weak terms of trade and 3) Weak external accounts, reflecting surging import costs. In the context of point 1, Western economies are experiencing a sharp acceleration in inflation, prompting more aggressive policy moves from North American and European central banks—even those (SNB) we expected to remain sidelined for longer. Headline inflation rates are surging and core inflation for these larger economies range between 4-6% roughly.

Inflation has picked up in Japan; headline prices are above 2% but the BoJ does not believe price stability has been achieved sustainably; core inflation measured 0.8% Y/Y in Japan at the last count, meanwhile, reflecting still weak underlying price dynamics. Having only just (April) strengthened their yield curve control policy, there is little incentive for policy makers to adjust settings at this point. Even if there was, the policy gap between Japan and the US would not close significantly and would not result in a major JPY rebound—particularly while energy prices remain elevated (see points 2 and 3 above).

The weak JPY is, however, rising on the domestic radar. Upper House elections will be held on July 10th and polling suggests voters are unhappy with the government and feel the BoJ should not continue its ultra-easy policy settings. This may not necessarily translate into a significant loss of support for the government as polling also suggests opposition parties are not making much headway. The Prime Minister and the BoJ Governor got together last week but the meeting did not appear to pressure the BoJ into doing anything differently. BoJ Governor Kuroda said he told PM Kishida that FX should reflect economic and financial and financial fundamentals and move in a stable manner.

And there is the rub for Japan and the JPY. The JPY is reflecting (interest rate) fundamentals and these dynamics are unlikely to change anytime soon. While price moves have been significant, USDJPY 3m historic vol at just above 10% is still well below historic peaks. If the BoJ is not going to adjust monetary policy and it is not going to intervene (the case for unilateral intervention is weak and there is zero chance of multilateral support while other central banks are tightening domestic monetary policy), USDJPY will have to find its own level. We expect the BoJ to pursue its monetary course for now; a modest change is possible later this year if inflationary pressures pick up or if the yield curve control target becomes too disruptive for JGB markets. A broader rethink of policy settings might not occur until after Governor Kuroda's term expires next April and his replacement takes over.

We noted at the start of the month that USDJPY could rise to 140 and we still think that is a reasonable target for the next few weeks (the 1998 high at 147 is the next technical point on the charts above here). The JPY should stop falling when US yields and spreads stabilize but it might not recover unless or until energy prices ease significantly. These events could occur more or less simultaneously; long term rates and energy prices could fall if global growth trends weaken materially—perhaps later this year or early in 2023—in response to the current rise in central bank policy rates.