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Foreign Exchange View for 2016: Three Key Factors to Support the Yen

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There are three key factors that will be at play to support the Japanese yen into 2016. As the lack of further upside move for USD/JPY confirms itself, the dynamics in the yen market has been changing. Lower USD/JPY is likely this year but with a limited trading range.

Firstly, the current weakening trend of the yen against the US dollar, started in October 2011, has been lasting over 50 months, far exceeds the historical average. It is thus reasonable to assume that the trend will be waning rather than strengthening as a technical perspective. The USD/JPY has been trading entangling the 52weeks-moving-average, a signal that often used as a trend checker (Chart 1). The upside potential for USD/JPY is diminishing.

Secondly, Japan's current account surplus is rapidly expanding, or more precisely, it has made a remarkable turnaround (Chart 2). Japan's 12mth current account balance has gone from a deficit of JPY 298bn in Sept 2014 to a surplus of JPY15,236bn in Oct 2015, with the surplus equating 3.1% of GDP. While the trade deficit has shrunk notably due to the falling oil prices, the income surplus is far more stable and alone accounts for a larger 4.0% of GDP.

Finally, the foreign exchange policy stance appears contrasting between the US and Japan. Year 2016 is the election year for both (Japan's upper-house election in July and US presidential election in November), so they probably have an idea in common that currency appreciation should be avoided. However, the sense of urgency is not the same given that US manufactures suffered from prolonged strong dollar and the US Treasury described yen as "undervalued" in "Semiannual Report on International Economic and Exchange Rate Policies" released last October. In contrast, after four years of currency depreciation in Japan, it is said that the positive effect on macro economy, e.g. export stimulus, has been saturated and weakened purchasing power has become an issue of concern.

Mostly important of all, the monetary policy influence is fading in driving the USD/JPY direction. Fed made its policy move, at long last, and raised the Fed funds target by 25 bps in December last year but upside for USD/JPY was quite limited. For the BOJ, implementing the current monetary policy will become more difficult given the scale of JGB purchase that they committed to buy. The additional BOJ easing is unlikely and, if any, the impact on yen weakening will be further lower due to above mentioned three key factors. Even though the Fed is raising rates, the upside potential for the yen will be essential to determine the course of USD/JPY for the next twelve months.

Chart 1: USD/JPY (52wks average and its ±15% band)

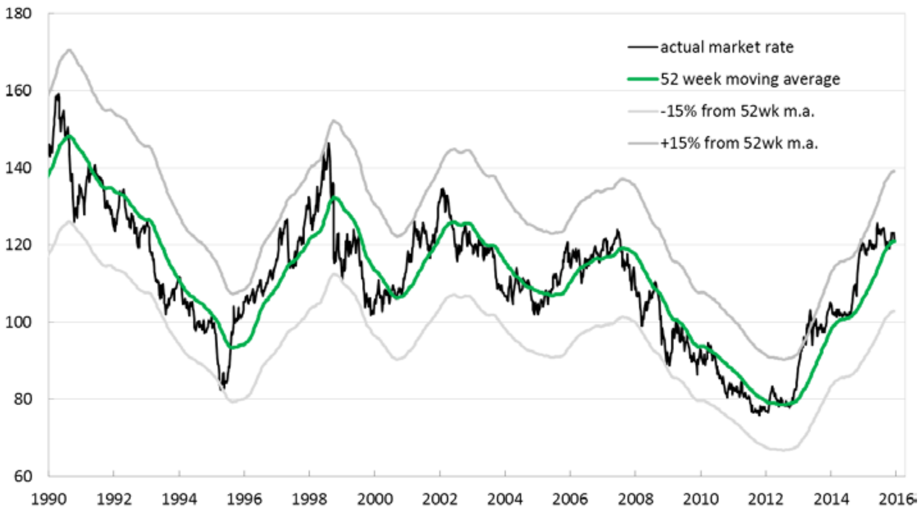
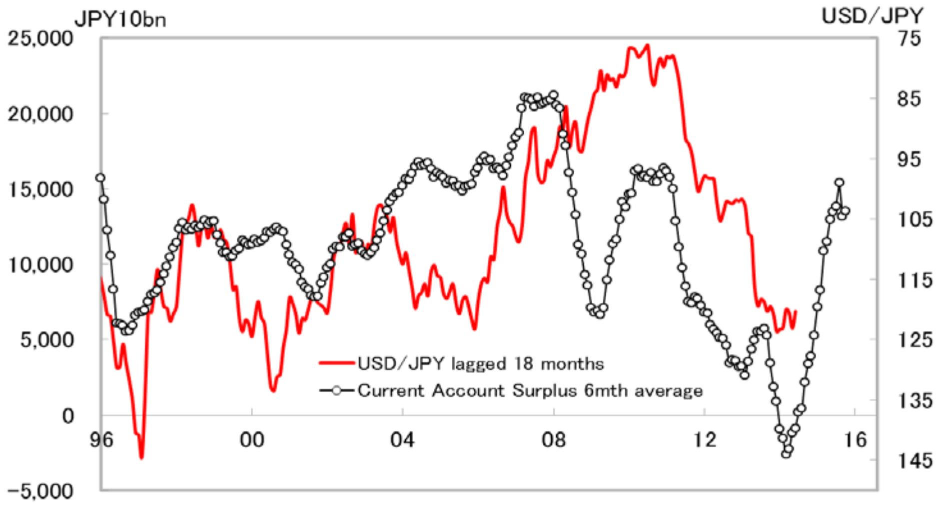


Chart 2: Japan's BOP and USD/JPY



(Data) Ministry of Finance , Thomson Reuters