

Reason of “Stronger JPY” despite widening yield spread of Japan and US

On February 16, JPY temporarily rose to high of 105 level against USD for the first time in 1 year and 3 months. Foreign exchange market saw “Stronger JPY” against USD despite further widening of yield spread of both countries. US long-term rate rose to 2.9% level due to concern over inflation hike and fiscal account deterioration of US, while Japanese long-term rate remained flat at around 0.0%. Recent rebound of Japanese and US equity market should lead to weaker JPY, however, foreign exchange market did not react that way. Why did “Stronger JPY” accelerated?

Point 1

Financial market seems to focus on fiscal account deterioration of US which may cause “Bad Rate Hike”

- In recent days, foreign exchange market seems to consider fiscal account deterioration for the reason of weakening USD despite US rate hike. On February 9 2018, budget related law to increase the total upper limit of FY2018 (Oct. 2017 to Sep. 2018) and FY2019 by USD300billion had passed both the Senate and the House of Representatives. There seems to be a pressure towards weaker USD as foreign exchange market starts to discount “Bad Rate Hike” due to possible fiscal account deterioration if the government expenditure will be increased up to the upper limit of the US budget.

Point 2

Weaker USD under risk-on sentiment Risk-on sentiment did not trigger JPY sell-off

- Global equity markets consolidated between late January to early February this year, however, they are recovering lately and CBOE Volatility Index known as “Investor fear gauge” that had worsened the investors’ sentiment, has stabilized as well. Global economic sentiment seems to move toward risk taking mode (Risk-on) as emerging countries’ currencies and commodity price such as oil price have started to recover. In such environment, JPY (deemed as a safe asset) generally is not preferred, however, JPY sell-off was not observed. We therefore believe that the background of “Stronger JPY” is weakening USD as foreign exchange market is uncomfortable with US’s fiscal account deterioration and protectionism under Risk-on sentiment.

Future Outlook

In mid term, weaker JPY is expected based on fundamentals

- One of the reasons of accelerated “Stronger JPY” can be attributed to increasing speculative JPY purchase, as JPY surpassed resistance level of 107.32 against USD (yearly high of 2017). According to International Monetary Market (Chicago Mercantile Exchange) data, we can observe increasing short position of JPY by speculators which might further enhance “Stronger JPY” in a short run.
- However, we believe that JPY will weaken in mid term based on trend of economic fundamentals such as widening yield spread of Japan and US and strong US economy. Abe government submitted appointment of Mr. Kuroda as BOJ Governor for second term and that of reflationist for Deputy Governor to the Diet. This is also expected to weaken pressure on “Stronger JPY” as super-accommodative monetary policy is likely to continue going forward.

■ Disclaimer

Please read this disclaimer carefully.

- This material is for non-Japanese institutional investors only.
- The research and analysis included in this report, and those opinions or judgments as outcomes thereof, are intended to introduce or demonstrate capabilities and expertise of Sumitomo Mitsui Asset Management Company, Ltd. (hereinafter “SMAM”), or to provide information on investment strategies and opportunities. Therefore this material is not intended to offer or solicit investments, provide investment advice or service, or to be considered as disclosure documents under the Financial Instruments and Exchange Law of Japan.
- The expected returns or risks in this report are calculated based upon historical data and/or estimated upon the economic outlook at present, and should be construed no warrant of future returns and risks.
- Past performance is not necessarily indicative of future results.
- The simulated data or returns in this report besides the fund historical returns do not include/reflect any investment management fees, transaction costs, or re-balancing costs, etc.
- The investment products or strategies do not guarantee future results nor guarantee the principal of investments. The investments may suffer losses and the results of investments, including such losses, belong to the client.
- The recipient of this report must make its own independent decisions regarding investments.
- The opinions, outlooks and estimates in this report do not guarantee future trends or results. They constitute SMAM’s judgment as of the date of this material and are subject to change without notice.
- The awards included in this report are based on past achievements and do not guarantee future results.
- The intellectual property and all rights of the benchmarks/indices belong to the publisher and the authorized entities/individuals.
- This material has been prepared by obtaining data from sources which are believed to be reliable but SMAM can not and does not guarantee its completeness or accuracy.
- All rights, titles and interests in this material and any content contained herein are the exclusive properties of SMAM, except as otherwise stated. It is strictly prohibited from using this material for investments, reproducing/copying this material without SMAM’s authorization, or from disclosing this material to a third party.

Registered Number: Kanto Local Finance Bureau (KINSHO) No.399

Member of Japan Investment Advisers Association, The Investment Trusts Association, Japan and

Type II Financial Instruments Firms Association

© Sumitomo Mitsui Asset Management Company, Limited



Sumitomo Mitsui Asset Management