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Short JPY – Long EUR: Momentum Trade in the currency war

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The new government seems desperately willing to get now what did not achieve in the last decade

- It is expected that BoJ will formalize (during the week of 21st January) the move to an even more aggressive monetary easing program …
- The institution will announce the upping of its inflation target from 1% to 2%…
- … not bad, considering that deflation has been present in 12 of the last 13 years, and that the only year with inflation level "above" zero was in 2008, with prices rising a paltry 1.37%.
- We also expect officials will announce open-ended asset purchases tomorrow, amounting to JPY4 trillion per month.
- Therefore it is time for reflection. If BoJ has been unable to reflate the economy after countless QE programs … What will have to do in order to accelerate prices at a 2% pace?
- Honestly, I can not imagine the degree of aggressiveness in monetary expansion but … what I'm sure is that this is not going to feel great to JPY.

How far and how fast the JPY can depreciate.

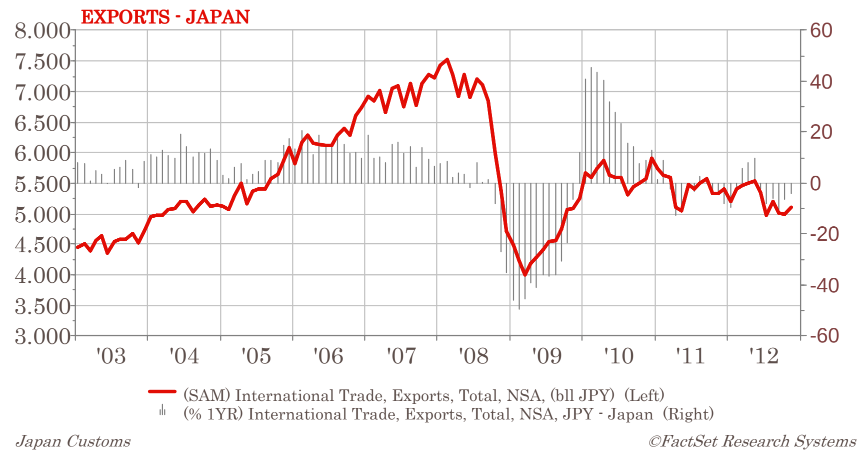
- **HOW FAR?** Viewing the graph, you can bet. Considering global aspects affecting mostly to developed economies, and particularly in Japan, our bet is above 140, with the possibility of reaching the 170 level again.

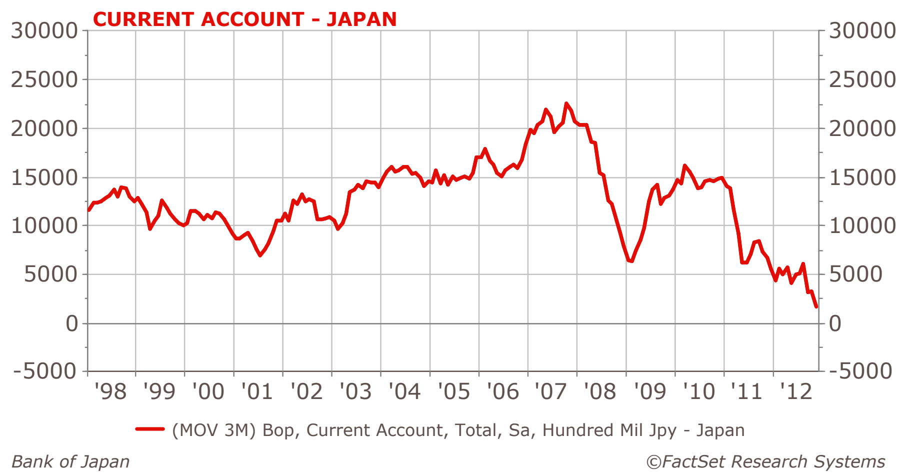
- **HOW FAST?** We consider that a rapid & disorderly JPY depreciation will inflict a severe pain on various business segments and households in the form of a much higher import prices. Steel producers (with a high energy dependence) or Chemicals (net importers) will suffer if pace of depreciation continues with the intensity of recent weeks. We expect momentum to ease with BoJ seeking a more managed weakening. This could well be a 3-5 years process before reaching the targets mentioned.

Why Short JPY vs EUR (and not vs USD)

1. Japan has Europe's export champions in its crosshairs.
2. Germany is a major trade competitor.
3. Japan has recently announced that it would use some of its foreign exchange reserves to buy euro denominated bonds in an explicit move to weaken the yen.
4. In a currency war, Japan has more ammunition. If Shinzo Abe does get the BoJ to adopt more radical measures (and given the dynamics in Japanese exports & current account this seems all the more likely –see the charts-) it is conceivable that the euro may bear all the weight.

   Why? It is simply a question of "money supply power". ECB is straitjacketed with far more restrictions than BOJ.
5. EMU Financial conditions are improving … broadening the perception that a systemic crisis in the euro region is easing.
6. The magnitude and the scope for action is ample. In 1Q2011 the JPY dropped by 14% vs EUR, and in 1Q2012 lost a 13%. Neither of these moves appeared to hurt EMU exports.
7. According to OECD, the yen remains nearly a 9% overvalued against the euro.





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