FX Viewpoint

Currencies
Global

JPY: Recovery, interrupted

- USD-JPY has rebounded with the market's hawkish repricing of the Fed, fuelled by the US election results
- With high uncertainty on the US's policy priorities and timeframes, a strong USD should weigh on the JPY
- But a significant overshoot of USD-JPY from fundamentals will be met with FX intervention and a possible BoJ rate hike

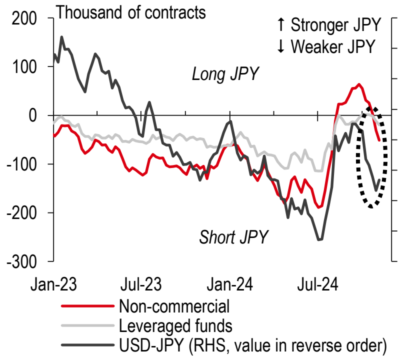
USD-JPY has rebounded with the market's hawkish repricing of the Fed

The JPY has weakened c8% against the USD quarter-to-date because of the market's hawkish reassessment of the Federal Reserve's (Fed) policy rate trajectory, on the back of positive US data surprises and potential policies that the new Trump administration may implement. **The futures market pricing of a year-end 2025 Fed rate is now at c3.8%**, c80bp higher than its end-September pricing of c3% (*Bloomberg*, 14 November 2024).

Japan's basic balance deficit weighs on the JPY ordinarily

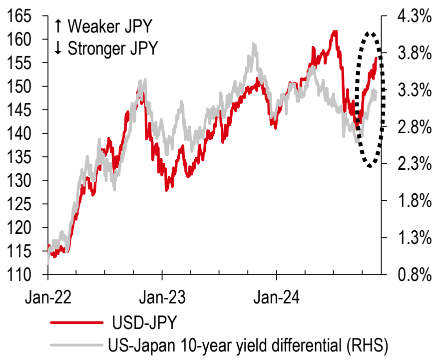
Admittedly, there is limited information at this juncture on the incoming US administration's policy priorities and timeframes. But **amid high uncertainty, the USD should have an upper hand over the JPY, given the former's much higher yields and more robust growth**. Japan's basic balance (a combination of current account balance, net foreign direct investment and net portfolio flows) is still in deficit, weighing on the JPY ordinarily.

1. Speculative market has turned short JPY again, with positioning still far from extreme levels seen in 2Q



Source: Commodity Futures Trading Commission, Bloomberg, HSBC

2. USD-JPY may have risen faster than its 10-year yield differential recently



Source: Bloomberg, HSBC

A return of JPY-funded carry trades could also weigh on the JPY, but FX intervention is possible

Additionally, **the JPY faces headwinds from the possibility of the return of JPY-funded carry trades** (i.e., selling the JPY to fund the purchase of higher-yielding currencies or assets), as speculative market has started turning short JPY again since late October and the current positioning is still far from extreme levels seen in 2Q (Chart 1). It is also worth monitoring that **USD-JPY seems to have already risen faster than its yield differential recently** (Chart 2). But if we do get to that point of divergence from fundamentals, we think **a significant overshooting of USD-JPY will be met with FX intervention again, and potentially, a rate hike by the Bank of Japan (BoJ) too** – similar to what happened in July.

The JPY is likely to weaken further against the USD before consolidating later in 2025

All things considered, **we now see USD-JPY rising further over the coming quarters**, before stalling at around the multi-decade highs (last reached in the beginning of July).

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