

USD/JPY aftermath of FRB Interest Rate Hike and BOJ's Policy Decision

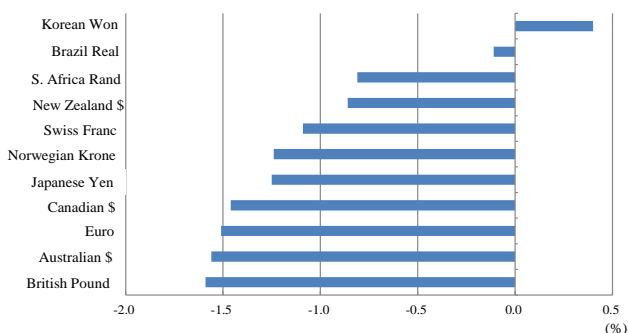
- USD reacted submissively by strengthening after the US interest rate hike. USD may lead the currency market focusing on the timing of the next rate hike.
- Japanese equity market fluctuated on BOJ's policy decision, which is recognized by BOJ Governor Kuroda as a supplement rather than an additional easing.
- Higher expectation of successive US rate hike and/or BOJ's large-scale additional easing are required for USD to rise sharply against JPY.

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US interest rate hike was decided on 16th December, 2015 for the first time in nine and a half years. USD strengthened against most of the major currencies between 14th December and 17th December (Chart 1). In the past, USD tend to weaken against JPY for almost 3 months after US rate hikes as US's trade policies influenced the direction of USD/JPY exchange rates. However, this time, USD reacted submissively by strengthening after the rate hike since there were no trade policies.

I believe that monetary policies of Japan and the US will remain the focal point. There are expectations in the market that the next rate hike by FRB might be decided as early as the March FOMC meeting (scheduled on 15th and 16th of March, 2016). As of 17th December, possibility of a rate hike in March 2016 was about 40% calculated from the futures' market of the FF rate. Therefore, fluctuation of USD/JPY rates led by the USD can be expected, according to US economic data and change in long-term interest rates to be announced in the future.

"Chart 1: Rate of Change of Major Currencies against USD"



(Note) Data period is from 14th December 2015 to 17th December 2015.
(Source) SMAM, based on Bloomberg L. P. data.

"Table 1: Major Monetary Policy Decision made by BOJ"

1. Support to firms that are proactively making investment in physical and human capital
i) Establishment of new ETF purchase program
ii) Enhancement of the fund-provisioning measure to support strengthening the foundations for economic growth
iii) Extension of the application periods for the Loan Support Program and other measures
2. Measures to facilitate smooth implementation of "Quantitative & Qualitative Easing"
i) Expanding eligible collateral for the Bank's provision of credit
ii) Extending the average remaining maturity of JGB purchases from about 7-10 years to about 7-12 years
iii) Increasing the maximum amount of each issue of J-REIT to be purchased The maximum amount shall be increased from 5% to 10% of the total amount issued

(Source) SMAM, based on materials of BOJ.

Japanese equity market fluctuated on BOJ's policy decision, which is recognized by BOJ Governor Kuroda as a supplement rather than an additional easing.

On the other hand, BOJ decided to introduce supplementary measures of Quantitative & Qualitative Easing (QQE) on 18th December at the Monetary Policy Meeting (MPM) which started on the previous day. Nikkei 225 index rose temporarily to JPY 19,869.08 and USD strengthened against JPY to JPY 123.56 as the market did not expect the announcement of the new policies. However, as the details of the policies (Table 1) were analyzed, Nikkei 225 index fell, closing at JPY 18,986.80 and USD/JPY rate weakened to JPY121.89 at 15:00 Japan time.

Although, BOJ established a new ETF purchase program of JPY 300 billion, it does not have a monetary easing effect, as this policy was meant to offset the impact of sales of shares held by BOJ (size of sales: JPY 300 billion based on market price of November 2015). Increase of the maximum amount of J-REIT to be purchased and extension of the average remaining maturity of JGB purchases were also decided, however, at the press conference just after MPM, BOJ Governor Kuroda stated that he recognizes the decision made this time is not an additional easing but a supplement to QQE.

Higher expectation of successive US rate hike and/or BOJ's large-scale additional easing are required for USD to rise sharply against JPY.

The financial market initially interpreted BOJ's policies as additional easing and reacted in a positive way, but turned negative disappointed by its contents. However, if BOJ regards its measures decided this time as a supplement to QQE, it can be deemed that they are still keeping additional easing up their sleeve. Meanwhile, it can be interpreted that BOJ was in pace with the Japanese government promoting wage and capex growth of corporations through public-private dialogue. We can see a strong message included in BOJ's new policies of its support to "firms that are proactively making investment in physical and human capital".

Although I believe that expectations of FRB's additional rate hike will remain as a factor of stronger USD, the key to weaker JPY will be whether the market can continue to expect large-scale additional easing by BOJ or not. I am expecting the highest level of USD/JPY will be around JPY 126 from the end of year 2015 to year 2016 and I think higher expectation of FRB's consecutive rate hike and/or BOJ's large-scale additional easing are required for USD to further strengthen against JPY from this level. On the other hand, I expect bottom of USD/JPY rate will be at around JPY118. However, weaker USD and stronger JPY from this level can only be expected if a number of

multiple events, such as uncertainty over BOJ's monetary policy becomes stronger, further drop of crude oil price, further slowdown of the Chinese economy and lower possibility of additional US rate hike due to US economic slowdown, occur at the same time.

*** Please note that this report is a translation of Japanese report written on 18th December, 2015.**

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