AmBank Group

AmBank Economics

#WhatWeThink

FX Update: Reiterating our JPY Forecasts

28 February 2025

In a nutshell…

The Japanese yen has long been considered a go-to safe-haven for global investors, thanks to its low-yielding funding currency status and Japan's enduring net creditor position. Historically, whenever risk appetite took a hit—from the Asian Financial Crisis to the Global Financial Crisis—JPY often rallied, capitalising on its liquid and "safe-haven" allure. Even though the Bank of Japan (BoJ) decade-spanning ultra-accommodative stance kept rates pinned near the floor, JPY still managed to flex its muscles in uncertain times, as traders typically unwind yen-funded carry positions during flight-to-safety episodes. Recent market dynamics, however, have tested the yen's resilience. With global bond yields ratcheting higher while the BoJ was slow to normalise policy, USD/JPY soared toward multi-decade highs, leaving the yen looking historically cheap against the dollar and its broader trading basket.

All eyes now focus on the BoJ's exit from negative interest rates, which it began phasing out through deliberately slow rate hikes and widened yield bands on JGBs. In theory, higher yields should support the yen—especially as inflation finally climbs north of 2% and wage negotiations point to pay bumps further. Yet the path ahead could remain bumpy, as Japan's fragile political climate, a very cautious BoJ, a subdued global growth outlook, and the Fed's still-generous yield advantage keep upward pressure on USD/JPY. We see the potential for a modest yen rebound if the BoJ continues to tighten, but don't expect fireworks: policy normalisation will likely be cautious, limiting any outsized JPY surge. We take that USD/JPY may hold above 150 this year, i.e., slightly weaker JPY vis-à-vis current levels. If there is a pullback on USD/JPY, it may not be unsustainable. We may continue to see official intervention around the 160 mark if it comes to that.

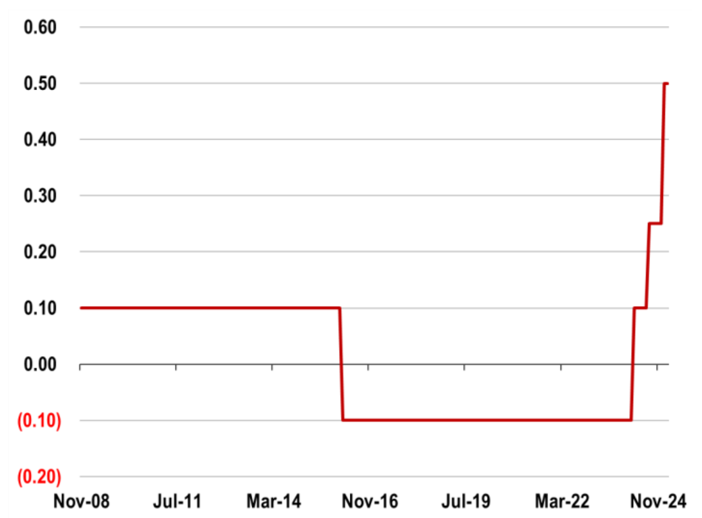
"There is very strong uncertainty on the US policy outlook, including on tariffs, and how other countries could respond. As such, we need to scrutinise developments"

Kazuo Ueda, Bank of Japan Governor, during a news conference after the G20 meeting (27th February 2025)

Exhibit 1: Weekly USD/JPY

Sources: Bloomberg, AmBank Economics

Exhibit 2: BoJ's Short-Term Key Rate (%)



Sources: BoJ, Bloomberg, AmBank Economics

The Japanese yen has been known as a safe-haven currency

The Japanese yen has been revered as a safe-haven status all these while

The Japanese yen has historically enjoyed safe-haven appeal, primarily due to its low-yielding "funding currency" status. In global market turbulence—or "risk-off" episodes—investors typically bid for safer currencies, such as the yen, the Swiss franc, and the highly liquid US dollar. Japan's decade-long low interest rates have supported this role: traders often short the yen to fund positions in higher-yielding currencies, so when sentiment shifts, these positions are unwound, and the yen appreciates.

Safe-haven currencies like the yen gain value during economic uncertainties, as seen in the past

Japan's persistent current account surpluses and positive net international investment position are also among key factors underpinning the yen's safe-haven status (Exhibits 5 and 6). Despite Japan's high government debt-to-GDP ratio, the BoJ holds nearly half of this debt, and the private sector remains relatively strong—helping maintain Japan's standing as a net creditor to the global economy. Meanwhile, the yen's role as a funding currency also supports its safe-haven profile: when markets turn volatile, investors unwind yen-funded carry trades, creating demand for the currency.

Despite high government debt, Japan's current account surpluses and global creditor position bolster the yen's safe-haven status

Safe-haven currencies buffer against market volatility because they tend to hold or gain value during economic uncertainties. In the yen's case, past episodes of risk aversion demonstrate its strength: during the Asian Financial Crisis, the yen rallied around 21%, while during the Global Financial Crisis, it gained roughly 28%. These moves corresponded with notable declines in the S&P 500 Index, a common barometer of global risk sentiment (Exhibits 3 and 4).

The yen has faced downward pressure due to recent developments, but a recent policy shift by the BoJ could mean different things.

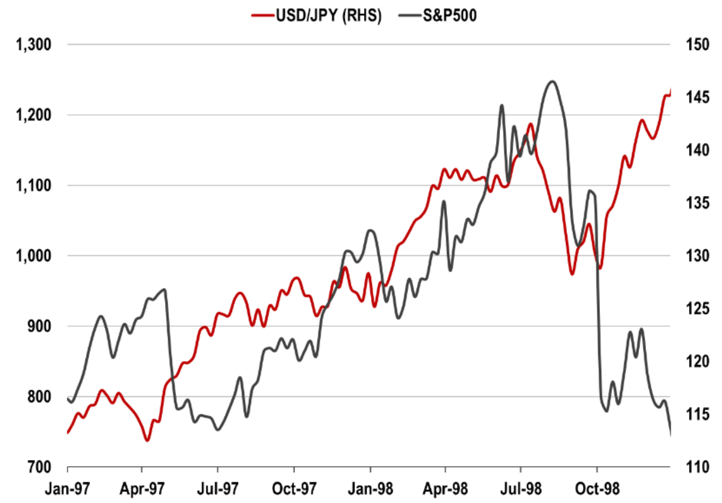
However, the yen has not been immune to downward pressure in recent years. Since the pandemic, USD/JPY has steadily risen to levels last seen in the 1990s. At the same time, the yen's real effective exchange rate (REER) has hovered near record lows—signalling broad undervaluation against multiple trading counterparts. One contributing factor is the divergence in global monetary policies. While many central banks began hiking rates to combat multi-year-high inflation, the BoJ maintained an ultra-accommodative stance, putting additional pressure on the yen. Yet recent policy shifts at the BoJ may chart a new path for the currency.

Exhibit 3: AmBank JPY Forecast

Pair	1Q25 (f)	2Q25 (f)	3Q25 (f)	4Q25 (f)
USD/MYR	4.51	4.50	4.48	4.45
BBG*	4.49	4.53	4.52	4.48
USD/JPY	155	154	152	150
BBG*	152	150	149	147
JPY/MYR**	2.91	2.92	2.95	2.97

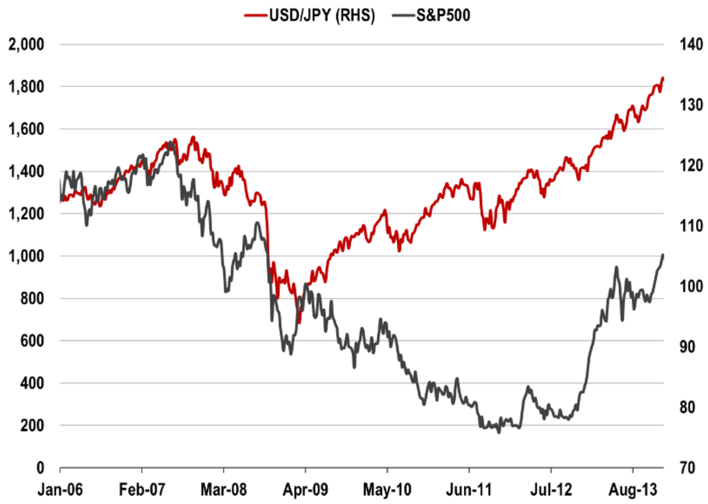
Sources: Bloomberg, AmBank Economics
**Extracted on 28th February 2025*
***Calculated on crosses*

Exhibit 4: S&P500 vs. USD/JPY – Asian Financial Crisis



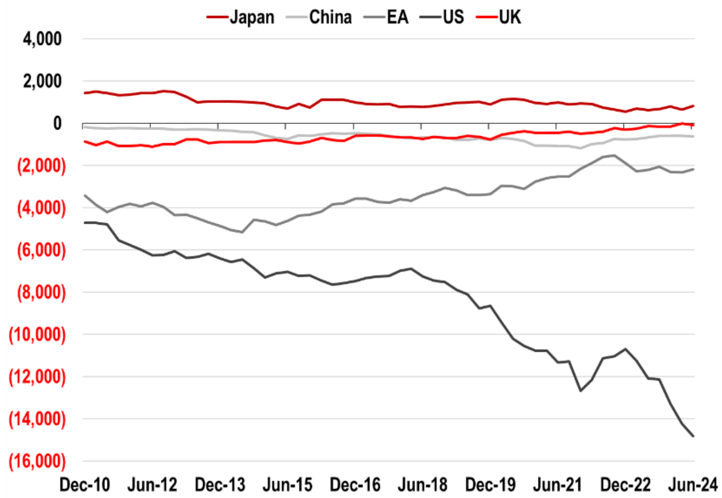
Sources: CEIC, AmBank Economics

Exhibit 5: S&P500 vs. USD/JPY – Global Financial Crisis



Sources: CEIC, AmBank Economics

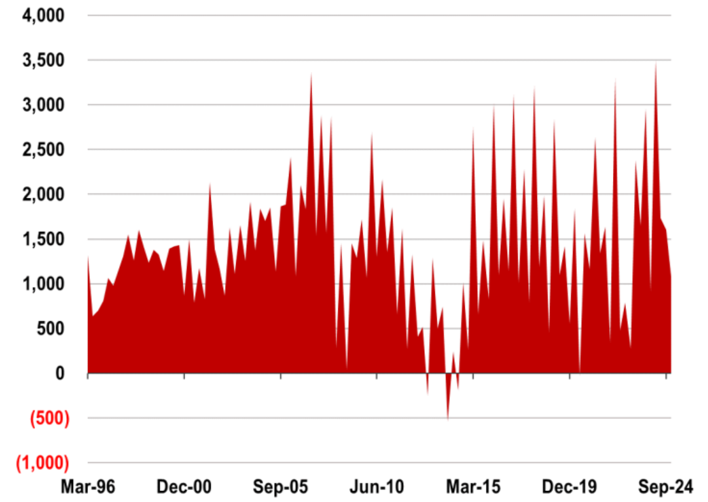
Exhibit 6: Selected Countries Net IIP* (USD' bn)



Sources: IMF, AmBank Economics

**International Investment Position*

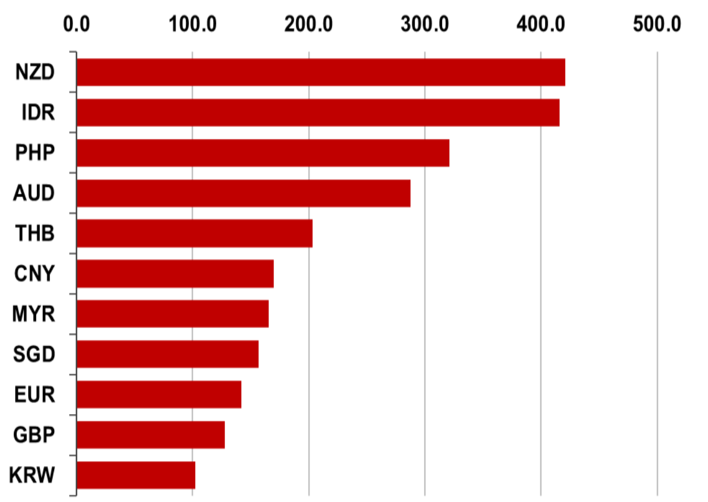
Exhibit 7: Japan's CA* – Balance of Payment



Sources: CEIC, AmBank Economics

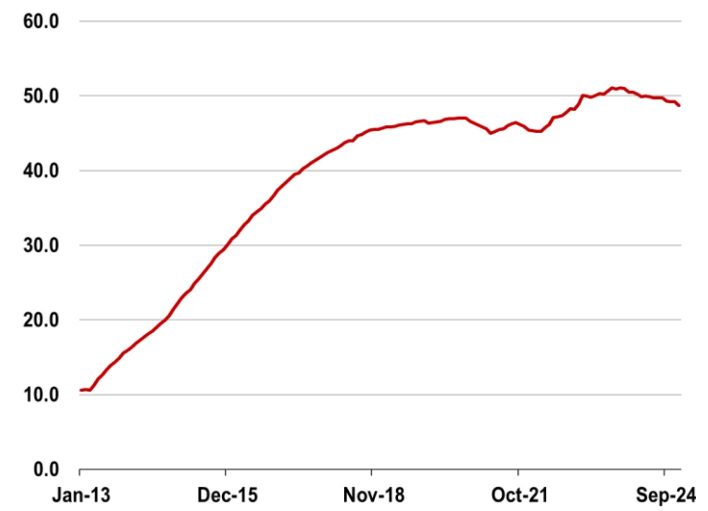
**Current Account*

Exhibit 8: Carry Returns by Short JPY and Long Other Currencies (%) – from 2000 to 2024



Sources: CEIC, AmBank Economics

Exhibit 9: Percentage JGB Holdings by BoJ (%)



Sources: CEIC, AmBank Economics

What would the latest BoJ rate hike mean for the JPY?

With market expectations already looking at one more 25 bps cut and around 34% for another hike by the end of this year, it is fair to assume that the JPY could take the reins and firm up in 2025. However, we caution here that the upward path could be limited, as reflected in our forecasts.

The BoJ has gradually exited its ultra-accommodative policy, widening yield bands and raising interest rates …

The BoJ had conveyed their intention to exit the ultra-accommodative policy since March 2021. The central bank conducted a "comprehensive assessment" of the effects of quantitative and qualitative monetary easing (QQE) with yield curve control (YCC) on Japan's economic activity and prices. During the same month, the BoJ decided to widen the 10Y JGB yield band to 25 bps above and below the 0.0% target, which previously was only 10 bps. In 2022, as the actual 10Y JGB yield frequently reached the band's upper limit, the central bank took further steps and widened the band to ± 50 bps. But at the same time, those decisions are accompanied by an unlimited purchase amount of JGBs so that the yields revolve within the band, maintaining the accommodative policy stance, especially by stabilising long-term interest rates. In July 2023, the BoJ decided to treat the ±50 bps band as "references" and not rigid limits and started to offer to purchase 10Y JGBs at 1.0% on a daily basis through fixed-rate purchase operations. The March 2024 meeting raised the key uncollateralised overnight call rate from negative territory to around 0% - 0.1%. It marked the first raise since 2006/2007, acknowledging that the QQE and YCC "have fulfilled their roles". To build on that, the rate was raised further in July 2024, which caused a big stirrup in global markets, and then the latest decision was to bring the short-term policy rate to 0.5% in January 2025 meeting.

… culminating in a short-term policy rate of 0.5% by January 2025.

The BoJ's exit from ultra-accommodative policy is driven by rising inflation …

We must understand that it is not without reasons that the BoJ intended to exit its ultra-accommodative policy stance. Partly, we think the BoJ adjusted its policy view as it appears that the economy has turned decades-long deflation around, which is just what the BoJ had targeted all this while. In fact, since April/May 2022, the headline and core inflation have been travelling at the north of 2.0%. This is all thanks to the surge in oil prices over the past few years, which was prompted by the start of the Ukraine-Russia war. As a net energy importer, a weakening yen and elevated gas prices were perfect for sending inflation to its highest level since the '90s. We noted that the price pressures have trickled into other components of inflation, with five averaging above 2.0% for the past two years.

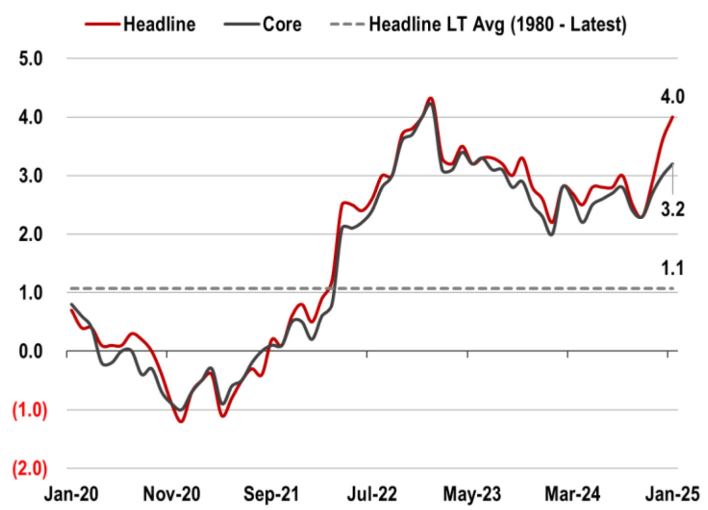
… and wage growth …

Wage growth has also been encouraging and could feed into the demand-pull part of inflation. Last year's Shunto wage negotiation resulted in major companies agreeing to a total % pay raise of 5.1%, the highest since 1991. We saw multiple factors contributed to this factor: (1) a tight labour market, (2) companies reported record high profits, and (3) the government promoted "structural wage increases" as an investment to enhance corporate productivity and achieve economic growth. For 2025, the Rengo trade union group is targeting the annual pay increases to exceed 2024's, which could spell another year of healthy wage growth.

… with expectations of further interest rate hikes potentially strengthening the yen in 2025. But there is a catch.

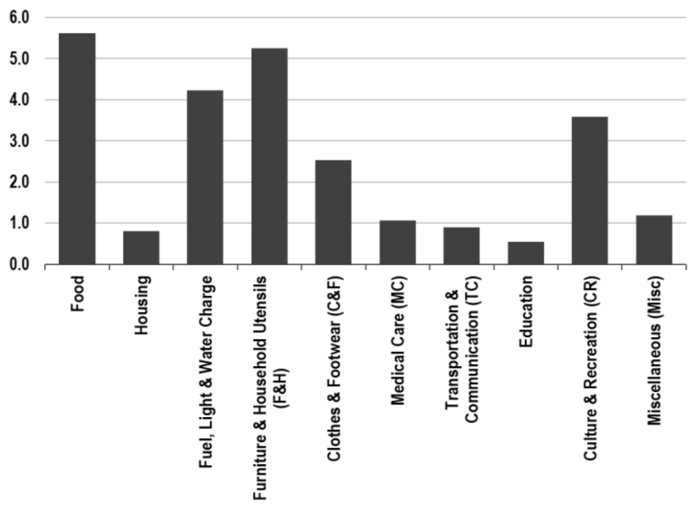
With this, we now see an imminent need for the central bank to exit its ultra-accommodative policy, given inflation is no longer stubbornly low and both cost-push and demand-pull are working towards BoJ's favour. Theoretically, a currency should strengthen when its interest rate is upward and expected to rise further.

Exhibit 10: Japan CPI (% y/y)



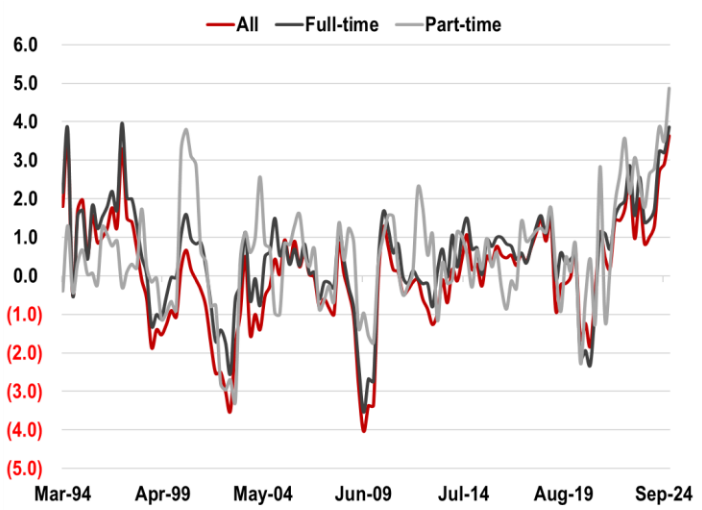
Sources: CEIC, AmBank Economics

Exhibit 11: CPI Components – 2 Years Avg. (% y/y)



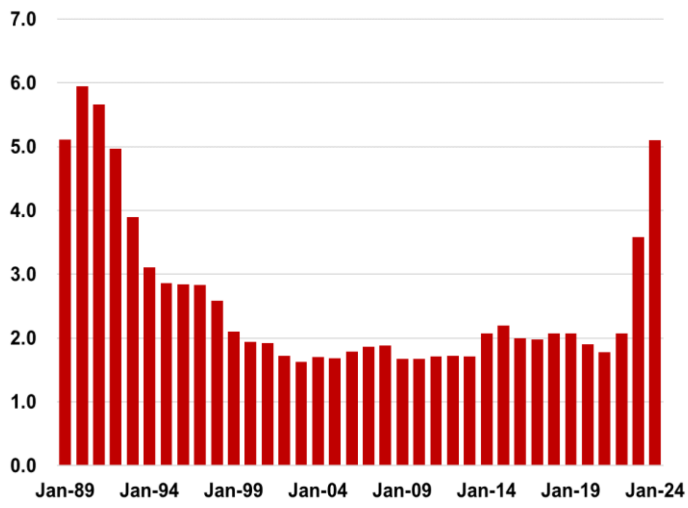
Sources: CEIC, AmBank Economics

Exhibit 12: Japan Wage Growth Quarterly Avg. (% y/y)



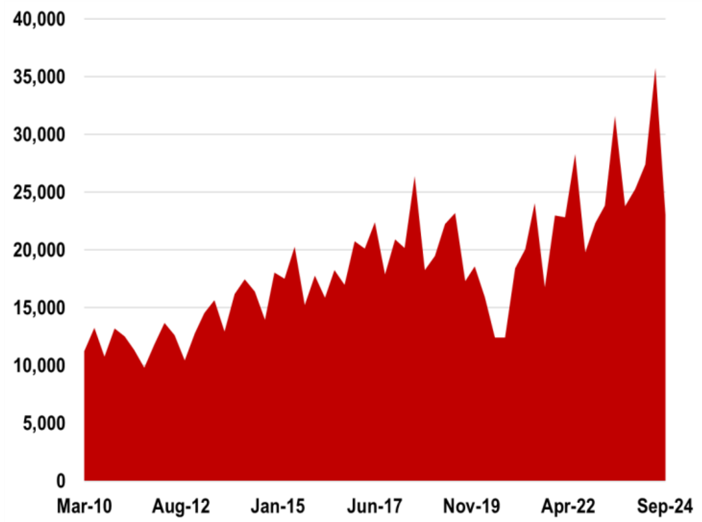
Sources: CEIC, AmBank Economics

Exhibit 13: Japan Shunto Wage Negotiations (% y/y)



Sources: CEIC, AmBank Economics

Exhibit 14: Corporates' Financial Statements: Current Profits (JPY' bn)



Sources: CEIC, AmBank Economics

Exhibit 15: 12-Months Ahead BoJ OIS (%)

Sources: CEIC, AmBank Economics

Reiterating our USD/JPY forecasts

The yen could benefit from its cheap valuation and BoJ's policy shift…

We believe that the JPY could take advantage of its historically cheap valuation to reverse its position through long-term mean reversion, alongside the regime shift by BoJ exiting from a negative interest rate policy. Nonetheless, several headwinds may limit the scope of yen gains.

…but political instability and cautious BoJ …

Domestically, political instability could hinder the BoJ in raising key borrowing rates. As the longstanding Liberal Democratic Party (LDP) lost its parliament majority for the first time since 2009, it led to a rather complicated minority government where Prime Minister Shigeru Ishiba needed support from opposition parties to pass legislation. The fragile political situation proves difficult for the already cautious BoJ, especially if the rising inflation becomes uncontrollable and the central bank is expected to address it without sacrificing economic growth or prompting further public dissent. It is uncertain to what extent Ishiba would endorse BoJ's exit from negative interest rate policy.

…negative real interest rates,…

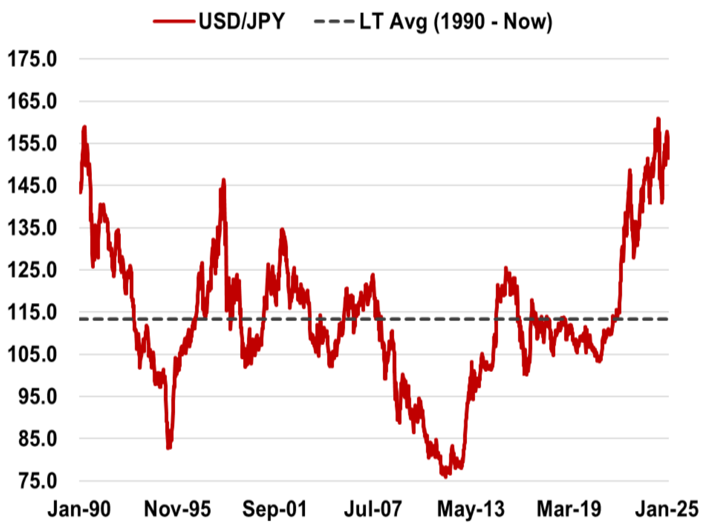
Secondly, Japan's key interest rate remains deep in the negative territory even when compared with other major countries, thus making it hard for the JPY to gain meaningfully. Notice that during the latest inflation shock post-pandemic, most central banks took unprecedented action by raising their borrowing rates to decades high to fight the red-hot price pressures. As the BoJ was considered lagging in this manner, the current situation poses a huge disadvantage for the JPY yields, i.e., market players can continue to use it as funding currency. The only way for the JPY to perform well is for the BoJ to hike its interest rates to be, at least, at the same level as the current inflation level, which translates into a 350 bps increase. We do not think that the BoJ can do so without weighing on Japan's economic growth after it has been used to low interest rates for the past decades. Therefore, we can only assume that the central bank would take a careful approach in normalising its rate without crossing into tightening territory, where one could imagine the pace of rate increase would be staggered, and the terminal rate would still have more way to go to switch real interest rates into positive.

…and global economic factors, coupled with the US Fed's cautious approach, may limit gains.

Also, with the ongoing political and inflation development, it warrants that the US Fed press brakes to thread its easing paths. Recent inflation figures show stubbornly slow progress and tariff salvos shot by President Trump and escalated to "retaliatory tariffs", which pose upside risks on price pressures, risking the Fed's efforts to go down the drain. Just after Trump won the US elections, the Fed revised its PCE and core PCE inflation and FFR projections upward, suggesting the Fed had already priced in those risks related to policy uncertainty in their decision. We see more Fed policymakers opting to be patient and wait for more data before cutting FFR further. Generally, this would sustain the US yield advantage over Japan's, leaving the USD/JPY supported.

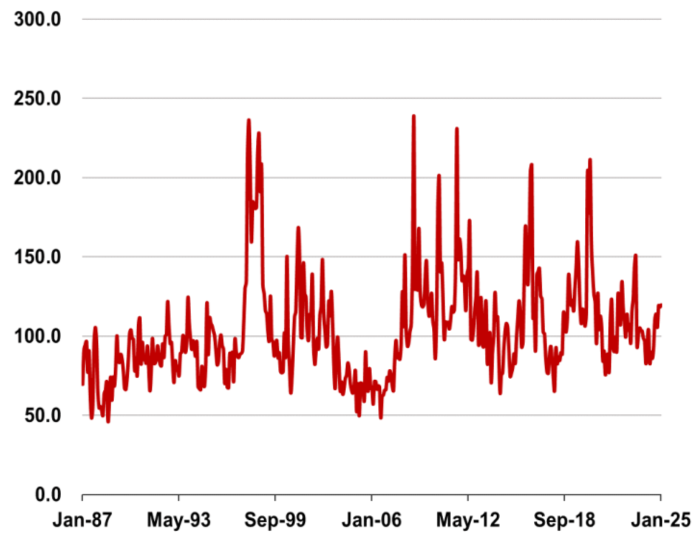
All in all, we reiterate our forecast for the USD/JPY to remain above the 150 level this year, and even if there is a slight sharp fall in the pair, we think it will not be sustainable. Even the number of net long positioning contracts for JPY among institutions (speculators) remained subdued below 45,000 contracts recently, in a sign that JPY's room to gain will be limited. However, if the yen weakens towards the 160 range, intervention risks could be similar to those observed in 2024.

Exhibit 16: USD/JPY



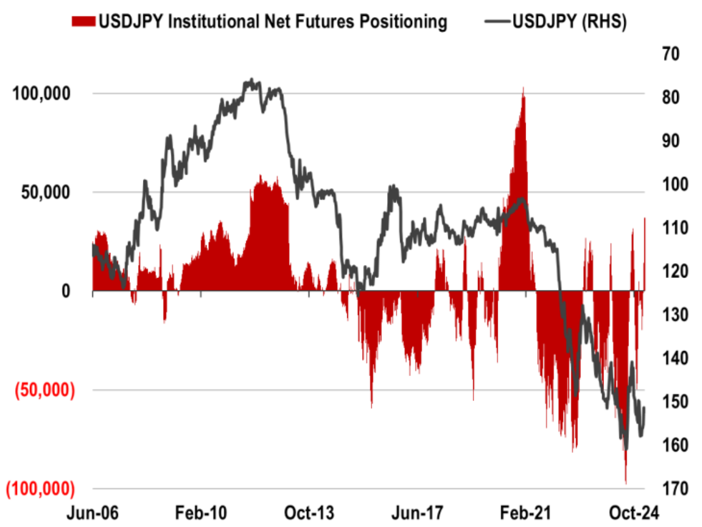
Sources: Bloomberg, AmBank Economics

Exhibit 17: Policy Uncertainty in Japan



Sources: By Elif C. Arbatli Saxegaard, Steven J. Davis, Arata Ito, and Naoko Miake

Exhibit 18: USD/JPY Institutional Net Futures Positioning vs. USD/JPY



Source: Bloomberg, AmBank Economics

Exhibit 19: 2Y UST vs. JGB (%)

Source: Bloomberg, AmBank Economics

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