

The JPY Conundrum

Heightened Volatility: A point we have made before, but worth reiterating is that JPY could be **both the subject and source of heightened volatility** in the current environment.

Accentuated by Opposing Monetary Policy Stance: For one, the **diametrically opposed direction of travel in the BoJ monetary policy** (tightening) in contrast to the easing bias evident in other major/Asian central banks further **amplified by expectations gap** inadvertently **accentuates the FX impact from any relative shifts** in the BoJ's policy stance.

The "Carry" Conflict: What's more, despite the BoJ's tightening bias, the existing wide gap in rates means that JPY carry trades are not completely washed out. Hence, the **conflict between opportunistic JPY-funded carry trade**, which pressures the JPY and the **BoJ's tightening bias that ought to underpin the JPY aggravate the latent JPY volatility**, which inevitably manifests in outbursts.

Trump 2.0 Trade Vulnerabilities: Moreover, the ongoing **Trump 2.0 trade conflict**, while not overtly trained on Japan, **will inadvertently hurt Japan's exports-reliant economy**. And with *non-negligible probability for adverse demand shocks*, which would **intensify the BoJ's policy dilemma** (driven by event/geopolitical risks). The two-way feedback between JPY depreciation pressures from trade shocks and BoJ dilemma only adds to noisy volatility.

Misleadingly Obfuscated by Carry Unwind: Especially given that the **initial reaction of JPY boost to generalized risk off from tariffs threats is misleadingly** opposed to weakness amongst other trading partners (of the US). But this initial JPY pick-up is **deceptive, and a mere quirk of JPY-funded carry unwind that is likely to be fleeting**. And JPY could subsequently pullback, and perhaps even more aggressively, if the assessed trade devastation is significant.

Unstable Correlations: The upshot being, **unstable (negative) JPY correlations to risk (appetite) threaten to upend the usual bets on JPY** moves such as higher JPY on "risk off" as well as lower JPY-higher Nikkei causation. And the **unpredictability lends itself to accentuating volatility** as JPY becomes more susceptible to whiplash from a **conspiracy of policy and "carry" tensions in an exceptionally charged and precarious global environment**.

Unavoidable AXJ Hit: In turn, this is likely to induce **considerable spillover AXJ volatility** as well. **But not merely from sympathetic AXJ moves** (in tandem with JPY volatility). Instead, attendant AXJ volatility could also **involve the complexity of rapidly shifting correlations**. For example, JPY carry unwind which

involves negative JPY-AXJ correlations could abruptly shift to sympathetic negative shocks in both JPY and AXJ - especially as Trump 2.0 trade shocks take hold (after the initial carry unwind). In which case, the relative buffer borrowed from JPY for currencies such as THB (during carry unwind) and SGD could also be suddenly diminished, resulting in more fluid relative shifts within AXJ as well.

The upshot is that **received wisdom on the JPY has probably lost significant relevance, if not given way to the JPY conundrum**. The JPY's **safe haven status**, previously flattered by carry unwind dynamics (during periods of "risk off"), is now **fatally undermined by Trump 2.0 brand of risks**. And the **BoJ's dilemma** does not help. Crucially, **assumptions of weak JPY benefits** to the economy (exports boost lifting Nikkei) are also **threatened amid global trade antagonism and price shocks**. Consequently, *relative AXJ volatilities may also be accentuated and less predictable as JPY correlations shift.*

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