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Monthly Insight

20 October 2021

The Well-Oiled Turbulence, in Japanese Style

- As summer turned to autumn, the yen becomes short-seller magnet.
- Being the biggest importer of mineral fuels among the G10, the oil spike seems set to blow a huge hole on Japan's balance of payments.
- As ever, however, when oil inventories are eventually replenished, it will tips the balance in yen-bull favor once again.
- The key thing to watch, therefore, is the activities of oil importers. If JPY reverts back to its age-old appreciation pattern in Tokyo trading zone, it's the first sign that the dollar rally will falter with saturating oil demand.



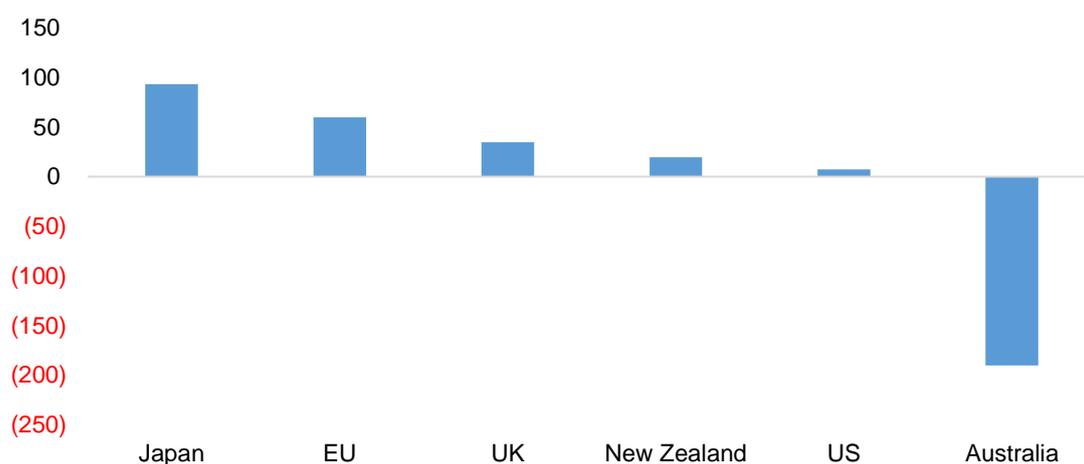
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Theme Article

Japanese yen enjoyed a renaissance ahead of the hope-inspiring PM election. As summer turned to autumn, the yen becomes short-seller magnet. Coal, natural gas, oil and gasoline prices have all spiked, and inflation is no longer looking quite so transitory.

And Japan fits right into this tragedy. Not only the country suffers as the biggest importer of mineral fuels (in terms of GDP) among the G10 (Exhibit 1), households cannot easily scale back their consumption of heat or gasoline. In the absence of proper relief valve, the oil spike seems set to blow a huge hole on Japan's balance of payments, inevitably bringing the JPY down with it.

Exhibit 1: Net Energy Import (% of Energy Use)



Source: World Bank, Shanghai Commercial Bank

The market sinks its teeth into the energy dependence story. Which is certainly fair, but it doesn't speak to the real question. The real question is, "when will oil inventories be replenished; if so, how do we know?" The key thing to watch, therefore, is the activities of oil importers, ideally in real time.

If you don't work at a well-established Japanese bank, don't worry. Typically, Japanese exporters dominate in Tokyo time and USD tends to depreciate against JPY. This trend has been bucked recently, plausibly because oil importers are bidding up USD to get filled on their USD bids. If JPY reverts back to its age-old appreciation pattern in Tokyo trading zone, it's the first sign that the dollar rally will falter.



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UK

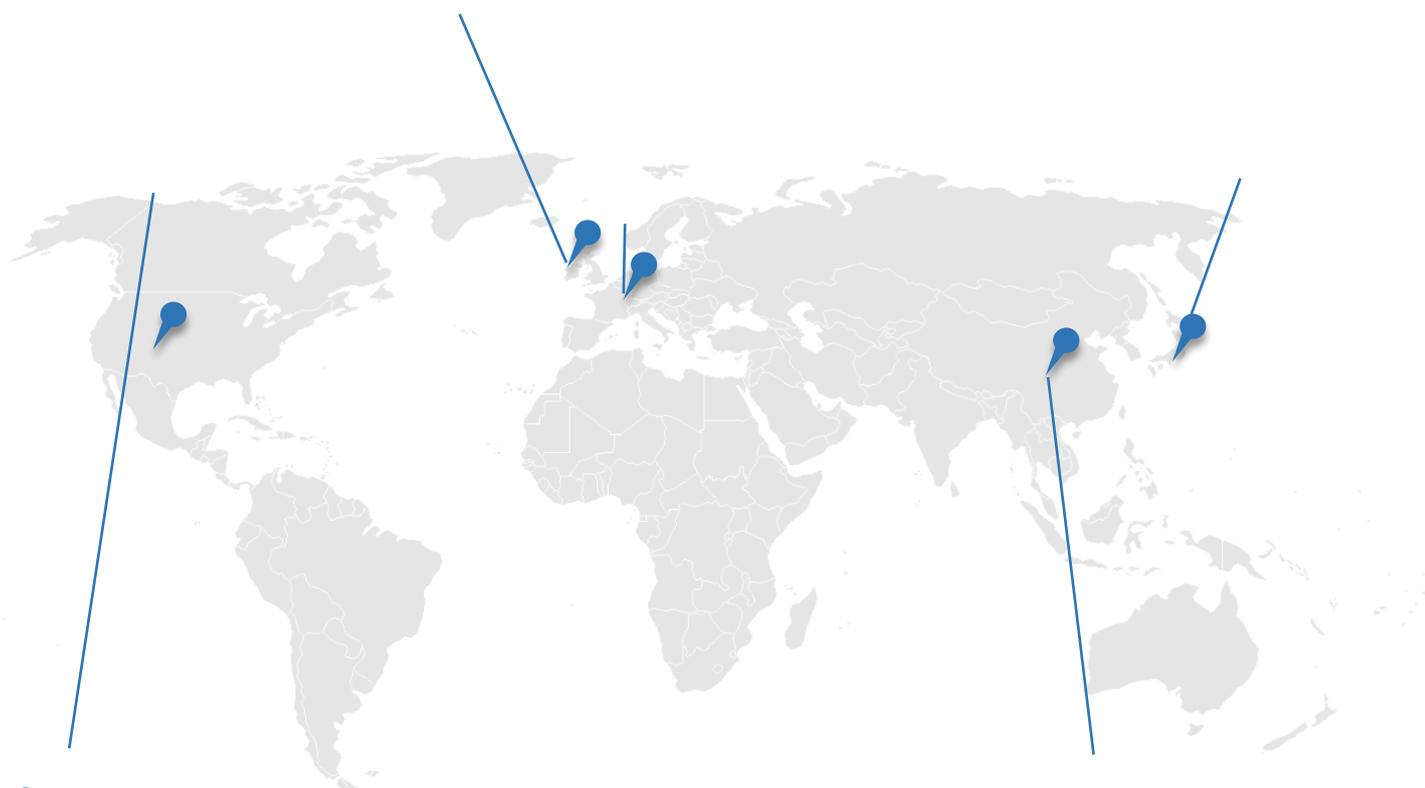
Growth appears to have slowed through the summer. Resurgence of Covid wave, on-and-off energy crunch, and Brexit disruption have likely all dragged Q4 GDP growth to below 2%.

EU

Recent gas price hikes could take a few percentages off corporate profits. ECB's lack of pushback against late hikes surprised us.

Japan

Kishida's position is somewhat left-leaning. His plan is to lift tax levied on financial transactions, in part explaining the underperformance of the Nikkei.



US

The September job report will be interpreted by the Fed as a mixed bag. The hawks will point to the strength in wages, while doves will underscore the weakness of job creation.

Mainland China

3Q GDP growth decelerated to 4.9% from 7.9% in 2Q. Facing headwinds from power crunch, sluggish credit supply and lackluster property investment, meaningful pick up in growth will not be seen until 2022.



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Foreign Exchange Outlook

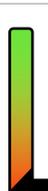
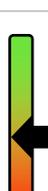
<p>USD</p> 	<p>Overweight Neutral Underweight</p> 	<p>The violent move in US rates seems to have run out of steam. Given the pervasive bias to be long dollar, it would not be surprised to see some profit taking, unless rates resume its ascendancy.</p>
<p>EUR</p> 	<p>Overweight Neutral Underweight</p> 	<p>EUR has shown no interest in attempting to break key support at 1.15. From a tactical risk reward point of view might be worth considering short term longs towards 1.17s.</p>
<p>GBP</p> 	<p>Overweight Neutral Underweight</p> 	<p>Hawkish comments from BoE Governor Bailey continue to justify rate re-pricing. He warned the Bank “will have to act” to curb inflationary pressures. Despite that, we doubt that the BoE will be able to meet the already aggressive expectations.</p>
<p>RMB</p> 	<p>Overweight Neutral Underweight</p> 	<p>The yuan strikes back, driven by record high exports and mouth-watering high carry. Less confrontational US-China relation and a ring fencing around Evergrande credit risks might lend further support for the RMB to extend its exceptional run.</p>
<p>JPY</p> 	<p>Overweight Neutral Underweight</p> 	<p>The energy crisis has left the JPY vulnerable, and the BoJ is under no pressure to join in the race to raise rate. Pension funds also stopped selling foreign equities since August. The heavy tone we saw this month is likely to stay.</p>
<p>AUD</p> 	<p>Overweight Neutral Underweight</p> 	<p>AUD has been at the forefront of the commodity boom. Still, the RBA has pledged to keep policy on hold until February, the AUD may struggle to push through the September high of 0.75.</p>
<p>NZD</p> 	<p>Overweight Neutral Underweight</p> 	<p>The high-beta kiwi remains at the whim of risk sentiment. Be mindful that NZD is the only overbought major currencies against the USD, and is therefore looking at some liquidation-induced downside risk.</p>



Table 1: GDP Growth and Rates Forecasts

	GDP growth (% YoY)				Key policy rate (% yearend)			
	2018	2019	2020	2021F	2018	2019	2020	2021F
US	2.9	2.2	-3.5	5.3	2.25-2.50	1.75-2.00	0.00-0.25	0.00-0.25
Eurozone	1.8	1.2	-6.8	4.0	-0.40	-0.50	-0.50	-0.50
UK	1.4	1.4	-9.8	4.5	0.75	0.75	0.10	0.10
Japan	0.8	0.7	-4.8	3.0	-0.10	-0.10	-0.20	-0.20
China*	6.6	6.1	2.3	7.5	4.35	4.35	4.35	4.35
Hong Kong^	3.5	-1.2	-6.1	5.7	5.125	5.125	5.125	5.125

*1-year lending rate, ^Prime rate

Source: Bloomberg, Shanghai Commercial Bank

Table 2: Foreign Exchange Outlook

	Yearend target		
	Current	2020	2021F
EUR/USD	1.16	1.22	1.15
GBP/USD	1.38	1.37	1.37
USD/JPY	114	103	115
USD/CNH	6.39	6.50	6.45
AUD/USD	0.75	0.77	0.73
NZD/USD	0.72	0.72	0.70

Source: Bloomberg, Shanghai Commercial Bank



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