

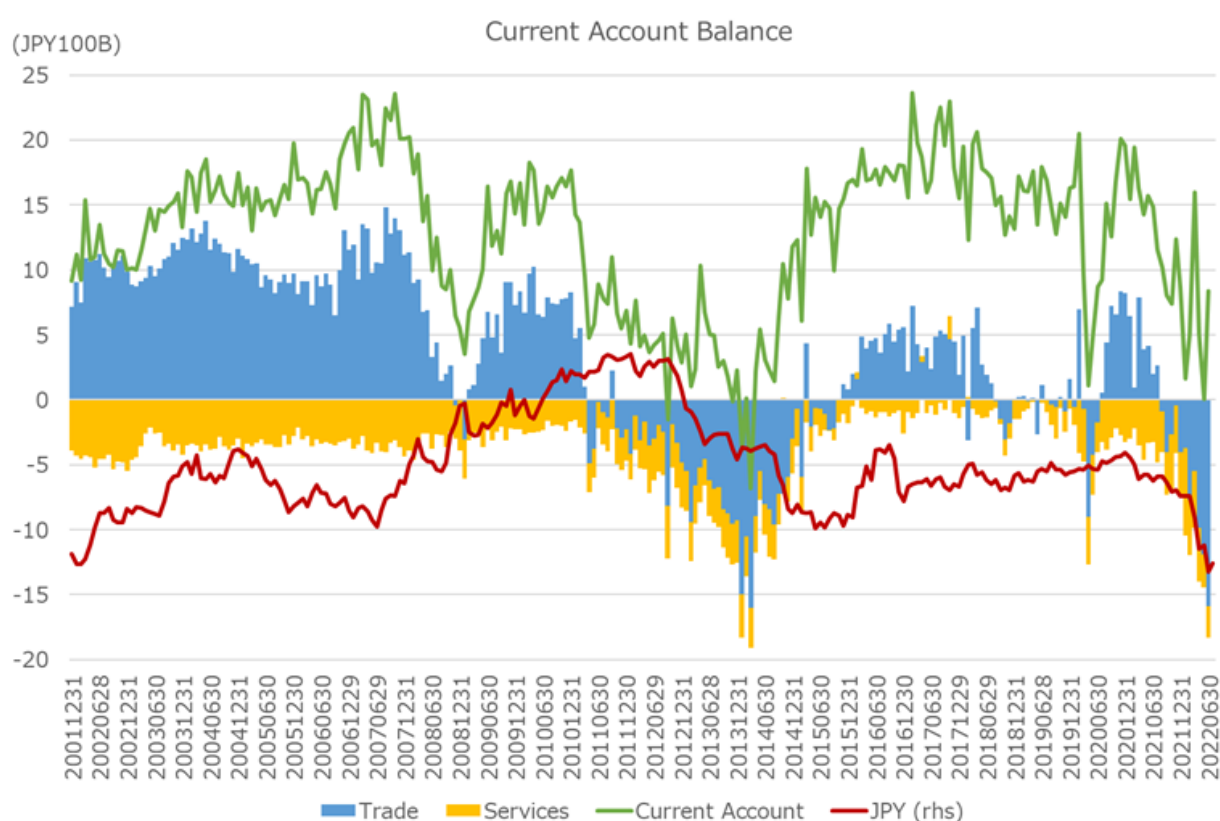
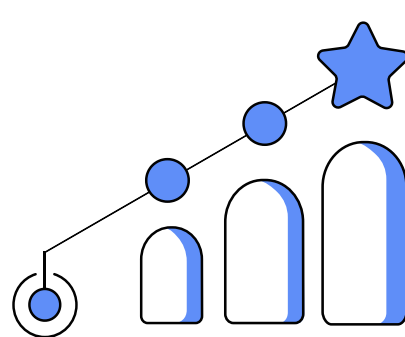


Depreciation of the Japanese Yen



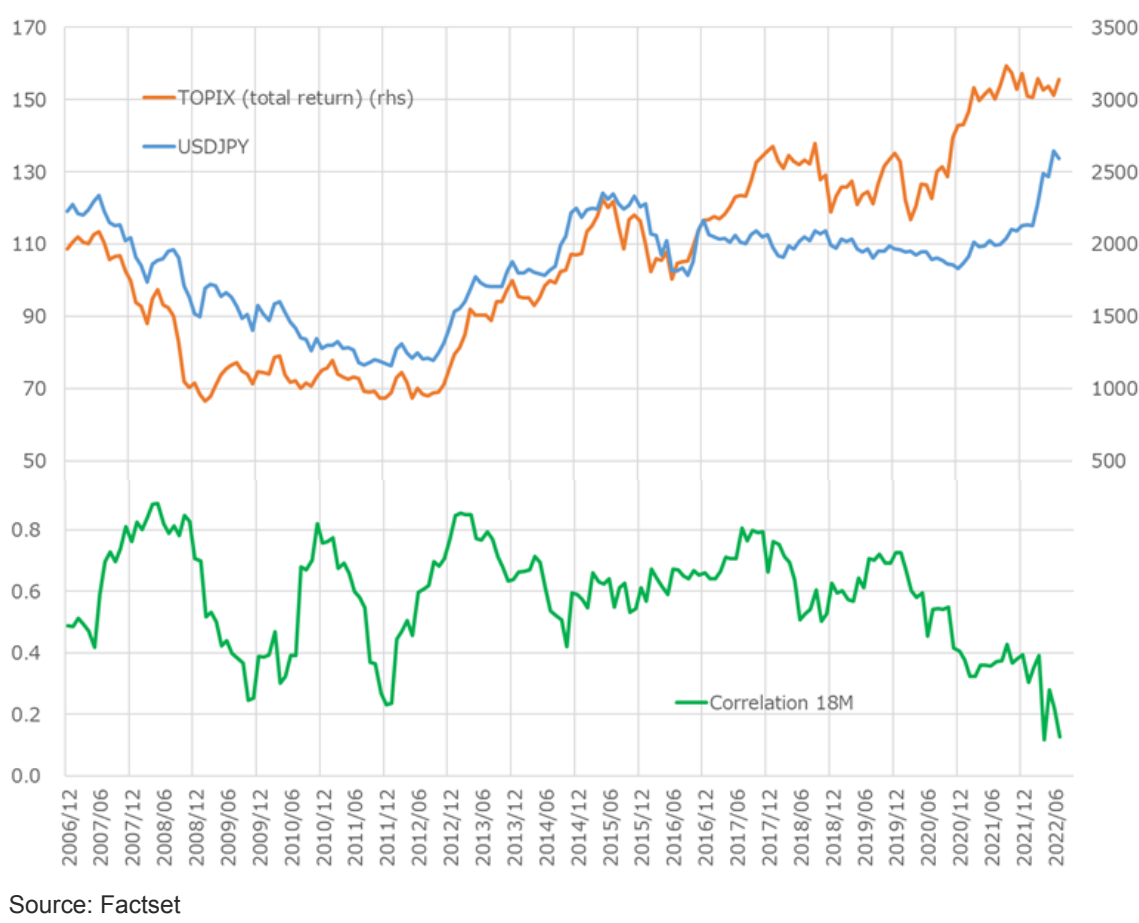
Multiple Factors at Play

- Interest rate differential caused by monetary policy gap.
- Deteriorating trade and service balances amid high commodity prices.
- Hedge unwinding as Japanese institutional investors repatriate funds.
- Chinese foreign reserve shifting out of JPY assets.



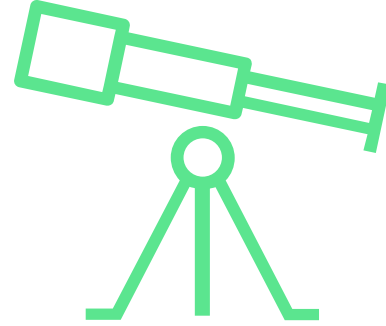
Effects on Equity Market

- JPY and TOPIX less correlated than previously, but weak JPY helps corporate profits.
- Beneficiaries include autos, steel & metals, and machinery; weak JPY hurts utilities and retailers.



Outlook

- Narrower interest rate gap looks unlikely.
 - BOJ's easy stance based on still modest core inflation.
 - Fed anti-inflation stance confirmed at Jackson Hole.
- BOJ waiting for wage hikes to confirm turnaround in deflationary environment.
- For FX to appreciate, BOJ would need to raise interest rates, which seems unlikely under current condition.
- US slowdown or lower commodity prices may weaken USD.
- Effective Yen rate is strongly negatively correlated with commodity prices represented by CRB Index.



Japanese Price Indices

	Jan	Feb	Mar	Apr	May	Jun	Jul
Import Price Index	35.2%	32.9%	32.5%	42.5%	44.7%	47.6%	48.0%
Corporate Goods Price Index	9.0%	9.4%	9.3%	10.0%	9.3%	9.4%	8.6%
Service Producer Price Index	1.3%	1.2%	1.3%	1.8%	1.9%	2.0%	2.0%
CPI	0.5%	0.9%	1.2%	2.5%	2.5%	2.4%	2.6%
CPI excl. fresh food	0.2%	0.6%	0.8%	2.1%	2.1%	2.2%	2.4%
CPI excl. fresh food and energy	-1.1%	-1.0%	-0.7%	0.8%	0.8%	1.0%	1.2%
GDP deflator		-0.5%			-0.4%		

Source: BOJ, Cabinet Office

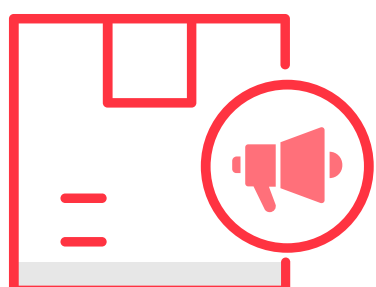
Correlation with CRB Index

AUD	0.72
GBP	0.64
USD	0.19
EUR	-0.48
JPY	-0.91

Source: Factset, BIS

What to Watch

We highlight below the factors that are affecting the Japanese Yen.



Factors affecting JPY

Interest rate differential – US tightening shifts to easing

Interest rate differential – change in BOJ stance, lifting of Yield Curve Control (YCC)

Trade and services balances

Capital in/outflows

Chinese sale of JPY assets

What to watch

- US inflation
- US employment
- US Fed

- Japanese inflation
- Japanese wage
- New BOJ Governor

- Oil and commodity prices
- Reopening of nuclear plants
- Inbound tourists

Institutional investors' activities

Chinese foreign reserves' activity



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