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JPY strengthens supported by BoJ rate hike expectations

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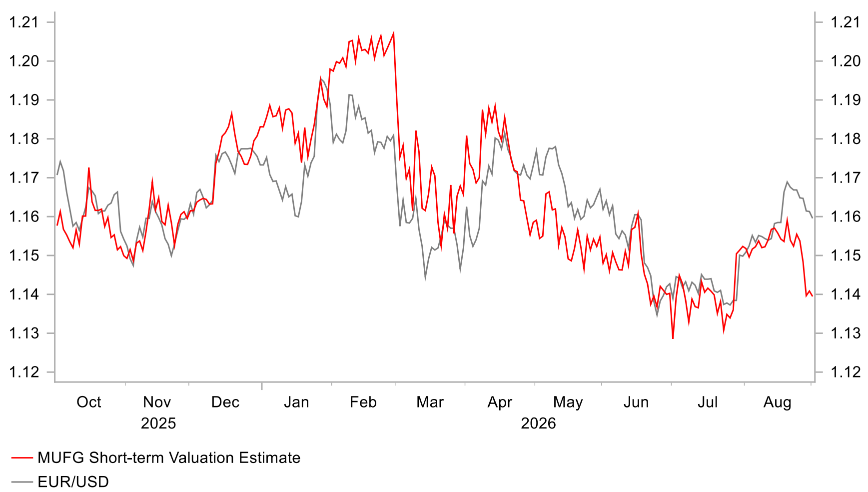
USD/JPY: BoJ & Fed rate hike expectations continue to build

The yen has been one of the biggest movers overnight. After hitting a high of 160.39, USD/JPY has since dropped back below the 160.00-level. The yen has derived some support from hawkish comments from BoJ officials including Governor Ueda which have reinforced market expectations for the BoJ to hike rates again later this month. A 25bps rate hike at 18th September policy meeting is now fully priced in. BoJ rate hike expectations were encouraged by comments from BoJ Governor Ueda who told reporters after a meeting of G20 finance ministers and central bankers that "from the perspective of conducting policy with a risk management approach as the underlying inflation rate approaches 2%, we have to believe that we need to pay greater attention than before to upside risks in our policy conduct". The comments provide the clearest signal yet that BoJ is preparing to hike rates again this month. At the same time, hawkish BoJ board member Hajime Takata has reiterated his call for the BoJ to hike rates after he voted for a hike at the last meeting in July. He believes that Japan's economy has entered a new phase "underpinned by the dispelling of the norm of prices and wages not increasing easily in Japan and by a shift in the overseas environment,

LARGER US POLICY RISK PREMIUM CURRENTLY PRICED INTO USD?



Source: Bloomberg, Macrobond, MUFG Research with this new phase entailing upside risk to prices". As a result, he believes that "2026 represents a regime change where rate hikes will not be carried out at a fixed pace but will instead be conducted in nimble and data-dependent manner". The ongoing hawkish repricing of BoJ rate hike expectations is a supportive development for the yen but it has not been sufficient yet to trigger a reversal of the yen weakening trend.

The yen has remained under selling pressure over the past month undermined by the ongoing negative energy price shock for Japan. The price of Brent crude oil has risen back up closer towards USD100/barrel this week in response to fresh military strikes in Iran. The US Central Command has confirmed it carried out strikes on "air defence sites, radar systems, maritime assets and facilities, mine laying capabilities, and communications sites" associated with the Islamic Revolutionary Guard Corps. It follows recent attempted attacks by the IRGC against commercial shipping in the Strait of Hormuz and against American service members. In response Iran has launched a "decisive operation" against US bases in the region. Hopes for a near-term deal to end the conflict continue to fade with President Trump stating "I couldn't care less if they sign a worthless, to them, agreement".

Rising energy prices are encouraging market expectations for other major central banks including the Fed to raise rates further. The 2-year US Treasury yield climbed to a fresh year-to-date high yesterday at 4.41% helping to strengthen the US dollar. There are now 17bps of Fed hikes priced in for 16th September FOMC meeting. It will be harder for the Fed to leave rates on hold if energy prices continue to raise ahead of the meeting. Fed Governor Michael Barr spoke yesterday and he repeated the message from Jackson Hole. He stated "if trends in the data give me some confidence that inflation is moderating on a path to 2%, then I think we can take a bit more time to assess our policy stance. However, if inflation appears not to be moderating sufficiently, then I think we should act decisively to raise rates". A September rate hike is not yet a done but soft NPF and CPI reports for August are likely required to prevent a hike. A Fed hike this month would pose upside risks to our forecasts (click here) for the US dollar especially if it marks the start of a tightening cycle. Support for the US dollar from higher yields and higher energy prices has not yet fully fed through to the US dollar which has been held back by the pricing in of a higher US policy risk premium. The US Treasury's plans for bigger US Treasury buybacks to dampen long-term US yields has brought debasement fears over the summer weighing on the US dollar.

NZD: RBNZ sticks to plans for gradual rate hikes weighing on kiwi

The New Zealand dollar has sold off sharpy overnight after the RBNZ's latest policy meeting and failing to break above the 0.5900-level. The kiwi has weakened sharply even after the RBNZ delivered the second consecutive 25bps rate hike. The kiwi was undermined by cautious forward guidance indicating that the RBNZ may not hike again as soon as the next policy meeting. RBNZ Governor Anna Breman stated "it's likely that there will be further increase in the OCR, but the timing is highly uncertain because we will consider the effects of the two hikes that we've done now, and also the new information that's happening and how that is affecting the medium-term inflation outlook". The probability of another hike in October has fallen to around 36% down from 65% prior to the meeting. The RBNZ's updated projections for the policy rate were left largely unchanged revealing that they expect the policy rate to average 2.81% in Q4 before rising to 3.07% by the middle of next year. All members agreed that the central OCR projections were appropriate, although acknowledged that it may need to rise more depending on economic conditions. Sticking to plans for gradual rate hikes has disappointed building market expectations for faster pace of tightening which have been encouraged by rising energy prices over the summer. The RBNZ's latest policy update will put a dampener on further kiwi strength in the near-term.

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KEY RELEASES AND EVENTS

Country	BST	Indicator/Event	Period	Consensus	Previous	Mkt Moving
US	13:15	ADP Nonfarm Employment Change	(Aug)	48K	44K	!!!
CA	14:45	BoC Interest Rate Decision	-	2.25%	2.25%	!!!
CA	14:45	BoC Rate Statement	-	-	-	!!
US	15:00	Factory Orders (MoM)	(Jul)	0.7%	-0.3%	!!
CA	15:30	BOC Press Conference	-	-	-	!!
US	19:00	Beige Book	-	-	-	!!

Source: Bloomberg & Investing.com

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