JAPANESE YEN: CURRENCY ADVENTURES (2007-09 REVISITED)

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In Akira Kurosawa's famous film "Yojimbo", a farmer remarks: "Everybody's after easy money."

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CONCLUSION

In recent months, much marketplace and media attention regarding foreign exchange arenas has focused on the travels of the United States dollar, the Chinese renminbi, the Euro FX, and an assortment of emerging marketplace currencies. The Japanese Yen has captured relatively little of the limelight. But it should.

Marketplace history of course need not repeat itself, either completely or even partly, but players should not overlook or dismiss parallels. The Japanese Yen's rally in the past few months reflects current (and points to further) worldwide economic weakness. Recall the Yen's rally during the worldwide economic crisis of 2007-09.

During the acceleration of the global economic disaster of 2007-09, both the Japanese Yen and the United States dollar made major bull moves on a broad real trade-weighted (effective exchange rate) basis. The Yen tumbled dramatically from its 2011/2012 summits. But that bear move probably ceased in mid-2015. The modest rally in the Yen since June 2015 has coincided with the continued advance of the dollar's broad real trade-weighted major bull move. Moreover, as during the 2007-09 crisis span, the Yen's effective exchange rate climb has accompanied a rally in its cross rate against the dollar.

Not only is the current Yen bull trend a bearish sign for world economic growth. It also is a bearish indicator for the Nikkei, S+P 500, and other key stock benchmarks. As massive Yen depreciation alongside quantitative and qualitative easing (QQE) helped to propel the Nikkei (and thereby other stock marketplaces such as the S+P 500 higher), growing Yen strength (all else equal) tends to push the Nikkei and other stock realms lower. The Yen march upward since June 2015 coincides with slides in equities, a drop in the US Treasury 10 year note yield, and renewed sharp falls in commodities "in general" (and petroleum in particular).

TRACKING TRENDS

"I found her trail in Memphis, but she just walked up the block.
She raised a few eyebrows and then she went on down alone." "Big River", by Johnny Cash

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Currency cross rates such as the Japanese Yen versus the US dollar as well as a given nation's real effective exchange rate (EER) sustain trends, enter ranges, and change directions due to a great number of intertwined variables. Not all data necessarily point in the same direction; evidence may conflict. And the apparent importance and relationship of factors for a given cross relationship or EER can and do evolve. Some variables seem more relevant for one nation than another; picture crude oil prices for a major petroleum exporter. In any case, perspectives on and conclusions regarding economic phenomena and their entanglements not only are diverse, but also subjective, reflecting assorted opinions.

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Japanese political and economic leaders in the past few years (especially via “Abenomics” and its so-called arrows) have battled devotedly to create and sustain GDP growth, partly via a massive expansion of money printing (QQE). This ferocious quest involved a scheme to substantially depreciate the Yen.

On a real effective exchange rate (trade-weighted) basis, the Yen peaked at 105.7 in October 2011, just under January 2009’s 106.8 ceiling, achieved during the depths of the 2007-09 global economic crisis. The Yen EER collapsed almost thirty percent from November 2012’s 96.7 (and 35.9pc from the October 2011 summit), attaining a low of 67.8 in June 2015. (Bank for International Settlements, 2010=100, monthly average; 12/16/15, next release probably 1/18/16).

The Yen’s major high in its cross rate relationship against the US dollar was around Y75.4 on 10/31/11. However, its depreciation accelerated from 11/9/12’s Y79.2 (note additional take-off points such as 2/25/13’s Y90.9 and 4/2/13’s Y92.6). The Yen’s trough against the dollar since then was 6/5/15’s Y125.9, a 67.0pc collapse versus its October 2011 high.

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Why should the Yen rally since June 2015 and nowadays? Survey a few considerations why the Yen should not rally. After all, Japan still engages in massive quantitative easing (money printing; QQE), whereas America ended its program over a year ago. ? The Federal Reserve raised the Federal Funds rate 12/16/15. Many Japanese leaders still fear deflation. The Bank of Japan seems a rather long way from achieving its two percent inflation target and raising policy rates. Japan’s general government debt remains gargantuan, with no progress in reducing it. America’s public debt is much smaller, although the federal government at end December 2015 notably boosted its future debt burden via a bloated spending bill. Japanese real GDP prospects are not better than those of advanced economies in general or America in particular. Despite China’s slowing output, expansion there likely still considerably exceeds Japan’s.

Yen appreciation probably partly derives from further falls in oil prices, which improve its current account. Regard the roughly similar timing of interim tops in the long-running bear trend in the petroleum complex. For example, NYMEX crude oil (nearest futures continuation) established highs on 5/6/15 at $62.58 per barrel (broad Goldman Sachs Commodity Index top 5/6/15 at 459) and 6/10/15 at $61.82. NYMEX crude crashed further from 10/9/15’s $50.92 elevation.

According to the Bank for International Settlements, China is Japan’s largest trading partner, with a currency weight of 31.0 percent. Other leading ones include the US at 15.2pc, the Eurozone at 13.0pc (United Kingdom is 2.0pc), and various other notable Asian nations 22.0pc (Taiwan 4.2pc, Korea 6.6pc, Indonesia 2.4pc, Malaysia 2.3pc, Singapore 2.6pc, Thailand 3.9pc). China’s decision to devalue the renminbi since mid-August 2015 (note also its mid-December 2015 renminbi index basket introduction) is bullish for the Yen.

However, although the Japanese government is a big spender and enormous debtor, the nation’s private sector is a huge saver, owning a massive quantity of assets. Probably a key reason for the Yen’s ascent on a real effective exchange rate basis as well as against the US dollar is that Japanese institutions and individuals are bringing their money “back home”. This arguably accounted for much of the Yen’s spike as the international economic crisis raced forward in mid-year 2008. This involves moving into Yen-denominated instruments and deposits and other assets, and out of those denominated in other currencies. The process also could involve sending significantly less investment money into emerging and other overseas marketplaces (converting

Yen to other currencies) than before. Of course other marketplace participants than Japanese ones may influence Yen voyages by electing to place some or more money in Yen.

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The Yen probably will continue to climb on a real effective exchange rate, as well as against the dollar. However, the Yen's bull move probably will be much less substantial than that during 2007-09's global crisis. After all, Japan's economy has substantial problems, and other nations may engage in competitive devaluations.

BACKTRACKING TO 2007-09: THE YEN, THE DOLLAR, AND STOCKS

Detective Sato declares in "Stray Dog": "Bad luck can make a man or destroy a man." (Akira Kurosawa, director)

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Recall the paths travelled by the US dollar and Japanese Yen during the global economic crisis.

The broad real trade-weighted United States dollar ("TWD"; Federal Reserve data, H.10, monthly average) appreciated about 15.1 percent from its April 2008 low at 84.1 to its summit in March 2009 at 96.8. Its sharp advance from September 2008's 88.8 to October's 93.9 is noteworthy.

The Japan EER made a major low at 79.1 in July 2007. After traveling sideways for several months, it soared upwards from August 2008's 82.0. It reached 85.8 in September (note the S+P 500's collapse gained momentum from around 8/11/08 at 1313 and 9/14/08's 1265; emerging stock marketplaces also endured murderous falls), 95.5 in October (compare the TWD's jump), and 100.9 in November, peaking at 106.5 (December 2008)/106.8 (January 2009). The Japan EER major bull move was a thirty-five percent leap.

The Nikkei stock marketplace's initial top was at 18300 on 2/26/07, but its next one at 18297 on 6/20/07 was right next to that height and close in time to the Japan EER low. The Nikkei's final high was 17488 on 10/11/07 (S+P 500 major peak 10/11/07 at 1576). The Nikkei made another interim top during its bear crash at 14601 on 6/6/08 (5/19/08 S+P 500 final peak at 1440) before collapsing to its major bottom at 6995 (10/28/08)/7028 (3/9/09; major bottom in S+P 500 3/6/09 at 667).

What about the cross rate for the Japanese Yen versus the dollar? The dollar peaked against the Yen at 124.1 on 6/22/07. After the Yen rallied to Y95.8 on 3/17/18, it slumped to Y110.7 on 8/15/08 (Y111.7 equaled a 10 percent rise from the June 2007 peak). The Yen thereafter spiked up against the dollar (even though the broad real TWD was rallying), reaching about Y87.1 (12/17/08 and 1/21/09), a 29.8pc climb versus June 2007's low.

THE CURRENT HORIZON: THE YEN ALSO RISES

The current bull move in the Yen so far admittedly is relatively minor in extent. But the bull move nevertheless is important in its implications. The Yen's EER recent low occurred at 67.8 in June 2015. The Yen EER rallied 6.3 percent to 72.1 in September 2015. Though it dipped to November 2015's 70.7, the Yen's cross strength in recent weeks suggests the EER climbed during December 2015 (the BIS will release data for December soon).

A five pc rally in the EER from its June 2015 trough gives 71.2, 10pc 74.6 (half the record Yen EER high of 149.8 in April 1995 is 74.9; BIS data commences January 1994), 15pc 70.0, 20pc 81.5, 25pc 84.8 (compare September 2008's level).

With the worldwide financial crisis history in mind, note the modest rally in the Yen versus US dollar cross rate. The Yen's low against the dollar occurred at Y125.9 on 6/5/15 (the same calendar month as its June 2007 cross rate bottom). It then climbed over that Y124.1 depth.

From Y125.9, a five percent appreciation against the dollar gives Y119.6, 10 percent Y113.3. Not only do many currency wizards monitor ten percent moves. The Yen's ability to extend its rally versus its June 2007 bottom beyond 10pc during the 2007-09 crisis was significant to numerous financial marketplaces. A 15pc Yen ascent against the greenback gives Y107.0, 20pc Y100.7.

Significantly, the Yen's high to date in its bull move occurred 8/24/15 at Y116.2. The low for the S+P 500 since its 5/20/15 major high at 2135 likewise occurred 8/24/15 at 1867. The recent Yen high on 1/11/16 around Y116.7 occurred close in time to the S+P 500 low on 1/14/16 at 1879.

WALL STREET MARKETPLACE ESCAPADES

In the movie "Rashomon", the Commoner remarks: "Man just wants to forget the bad stuff, and believe in the made-up good stuff. It's easier that way." (Akira Kurosawa, director).

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The MSCI Emerging Stock Marketplace Index (from Morgan Stanley; "MXEF") is a key yardstick for emerging marketplace stocks. The broad Goldman Sachs Commodity Index is a widely-followed benchmark for commodities "in general". Major peaks in emerging marketplace stocks and the GSCI preceded by several years those in the S+P 500 and Nikkei. However, strength in the broad real-trade-weighted dollar (TWD) links closely to the bear trends in the MXEF and the GSCI.

The MXEF's summit in the aftermath of the worldwide economic crisis is 4/27/11's 1212; the broad GSCI peaked at 762 on 4/11 and 5/2/11. The TWD established a major bottom in July 2011 at 80.5. On 9/4/14, the MXEF made an important interim high in its bear trend, 9/4/14's 1104. The GSCI made a significant minor top in its crash on 6/23/14 at 673. In September 2014, the TWD 86.6 ventured above June 2012's interim barrier at 86.2.

During January 2016, the MXEF had smashed beneath its minor low at 763 on 8/24/15, venturing under 720 to about 35 percent beneath its September 2014 elevation. The GSCI's decline carried to around 283 as of 1/12/16, a 58.0pc collapse from its June 2014 height. As of December 2015, the broad real TWD had rallied 23.5 percent relative to its July 2011 bottom.

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The TWD's initial advance beyond October 2008's important 93.8 height occurred with March 2015's 94.9. The TWD jumped decisively over the October 2008 level with July 2015's 95.7. Significantly, the US Treasury 10 year note made an interim yield high around that time, on 6/11/15 at 2.50pc. Falling UST 10 year yields since then probably represent a "flight to quality". The MXEF made a second and lower high on 4/27/15 around 1069. Note the S+P 500, Nikkei, and Shanghai Composite made important peaks around the same time in late spring 2015, thereafter joining (and encouraging) the feebleness in the MXEF and commodities in general (and petroleum in particular). The nominal broad TWD, unlike the real broad TWD, has daily data.

Note that an interim low in the nominal TWD, 5/15/15's 112.8, occurred shortly before the S+P 500's major high. And underscore in this context the Japanese Yen's important lows in June 2015. All this intertwining between marketplaces is a noteworthy warning that worldwide economic growth will continue to weaken.

	S+P 500	**Japan Nikkei**	**China Shanghai Composite**
Recent High	2135	20953	5178
	(5/20/15)	(6/24/15)	(6/12/15)
Recent Low	1867	16901	2851
	(8/24/15)	(9/29/15)	(8/26/15)
Percent Fall	**12.6**	**19.3**	**44.9**

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Note other recent S+P 500 highs close to its May 2015 summit: 6/22/15's 2130, 7/20/15 at 2133 (collapsing from 2103 on 8/18/15), 11/3/15's 2116 (MXEF minor high 11/4/15 at 873), and 2104 on 12/2/15. The initial low in the Nikkei after its June 2015 peak, 8/26/15's 17714, occurred alongside the S+P 500's 8/24/15 one. The Nikkei high since its 16901 low on 9/29/15 is 12/2/15's 20012; compare the timing with the S+P 500's minor high that day. The S+P 500's second low, 9/29/15's 1872, occurred alongside the Nikkei's 9/29/15 bottom. The MXEF made minor lows on 8/24/15 at 763 and 770 on 9/29/15.

The similar timing of important stock marketplace lows in late August/September 2015 emphasized the pattern revealed after late spring 2015: worldwide equities in general currently are "trading together".

The Yen cross against the dollar, following its 8/24/15 high at 116.2, weakened to Y123.6 on 11/9/15 and Y123.7 on 12/2/15, fairly close in time to the S+P 500's early November and early December 2015 minor tops (another minor Yen low 11/18/15 at Y123.8).

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The nominal TWD did not stop rising with its 8/26/15 height at 120.2. It reached 121.8 on 9/23/15, shortly before the second low in the S+P 500. It slipped slightly to about 118.0 on 10/15/15 (around the time of the GSCI's 10/9/15 minor high at 386; recall the NYMEX crude oil top at $50.92 on 10/9/15), and thus a couple of weeks before S+P 500's 11/3/15 minor top at 2116 (compare the timing with the MXEF's 11/4/15 minor top).

However, the nominal TWD then resumed its rally, reaching a new high in its bull move at 124.9 on 1/8/16 (the latest day for which Fed H.10 data is available). As the trade-weighted dollar ascended, note the collapse in commodities and stocks. The broad GSCI broke decisively under its 2008-09 major bottom, 2/19/09's 306. Key crude oil prices (NYMEX and ICE Brent/North Sea; nearest futures continuation) plummeted to $30 a barrel. Emerging marketplace stocks (MXEF and the Shanghai Composite) dropped. The S+P 500 and Nikkei likewise fell. Though the Yen versus dollar cross has not yet broken through its 8/24/15 resistance at 116.2, its rally to its 1/11/16 depth at 116.7 approached it.

BOTTOM LINES

On 1/14/16, the S+P 500 touched a low at 1879, very close to its 8/24/15 low at 1867. It then rallied, closing around 1922. The Nikkei's 1/14/16 low at 16944 hovers right above its 9/29/15 trough. What about the Shanghai Composite? Its low on 1/14/16 at 2868 neighbors its 8/26/15 depth at 2851.

Previous essays have discussed the Federal Reserve Board's effort to slow, halt, or reverse marketplace declines in the S+P 500. For example, see "Playing Percentages: Stock Marketplace Games" (7/13/15). In the current environment, stock slumps of around ten and 20 percent from an important plateau (such as the May 2015 one) are important guideline levels for the Fed. The Fed's preferred method to stop downward moves of around ten percent is talk (wordplay) rather than action. Falls of around 20 percent (or more) increase the odds of action (perhaps even renewed quantitative easing).

Thus today's speech from James Bullard, the President of the St. Louis Fed, is rhetoric aiming to support US (and perhaps other) stocks ("Oil Prices, Inflation and U.S. Monetary Policy").

Such charming wordplay from the Fed (and its central banking allies) can induce rallies in the S+P 500. However, it probably will not stop the S+P 500 from resuming its bear move and breaking beneath its August 2015 bottom. The Nikkei will fall under its 9/29/15 low, and the Shanghai Composite will venture beneath its late August 2015 bottom. The broad real TWD will remain strong for at least the near term; the Japan EER will continue its modest rally, as will the Yen's advance against the US dollar.

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For additional currency, stock, interest rate, and commodity marketplace analysis, see "The Curtain Rises: 2016 Marketplace Theaters" (1/4/16) and earlier essays.

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