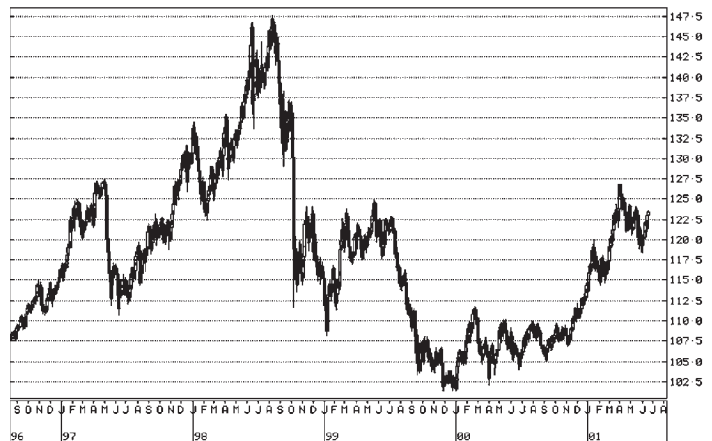


The yen's contra-trend rally is over

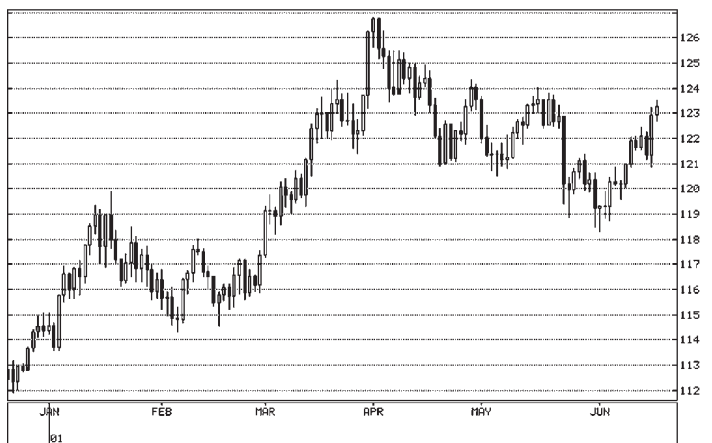
Back to square one for Hayami and the yen - In March, Japanese monetary officials worried that the yen was weakening too rapidly. Their jawboning triggered a medium-term reaction, as short positions were unwound. This recreated one of Japan's bigger problems - a currency much too strong given the ongoing deflationary slump. Further jawboning ensued, this time to weaken the yen, particularly against the euro. Markets have taken note and charts indicate that the yen's technical rally (shown inversely here) ended on 1st June at ¥118.28 and ¥99.98 against the US dollar and euro, respectively. Traders may remain wary for a while longer, given the euro's flaccid performance and concern over global growth. However economic problems for the US and Europe are mild compared to Japan's continuing malaise. As for Hayami, while emotionally attached to a strong yen, he can't ignore an economy that contracted 0.2% in Q1 and the BoJ's latest comment: "Adjustments in economic activity are gradually intensifying as production is declining substantially, reflecting a fall in exports". The Bank repeated its concern that weak demand will extend Japan's deflation, even as the yen weakens against the dollar and oil prices remain high. It has pledged to keep interest rates close to zero until prices have clearly ended what is now a 20-month slide. Meanwhile, Prime Minister Junichiro Koizumi has promised to reduce wasteful government spending and compel commercial banks to dispose of bad loans amounting to trillions of yen, even though these necessary steps could slow the economy further in coming months. Needless to say, Japan's enormous budget deficit continues to balloon. Against this background, if Japanese investors continue to save rather than spend and invest, the BoJ will be compelled to increase the supply of yen in circulation enormously. Short yen against the US dollar and other reserve currencies remains a promising trade, in terms of interest rate differentials and capital appreciation potential. Some temporary resistance can be anticipated between current levels and the year's earlier highs but downside risk should now be limited to brief reactions and consolidations. I expect the US dollar and euro to be much higher against the yen in 12 month's time.

Best regards - David Fuller

US Dollar/Yen : Weekly (122.95)



US Dollar/Yen : Daily (122.95)



Euro/Yen : Weekly (105.37)

