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By Mariko Ishikawa, Masaki Kondo and Hiroko Komiya

April 9 (Bloomberg) -- The yen, the world's worst performing major currency this year, is due for another round of weakness as rising prices on everything from canned tuna to ramen noodles show early signs of inflation that threatens to send investors fleeing from the nation's debt securities.

Analysts have cut their end-of-2013 forecasts for the yen by more than 10 percent since December, while Japanese government-bond prices show investors expect a record negative real yield in the next five years. That would mark a reversal from 15 years of deflation that made real yields on JGBs among the highest in the developed world, attracting record overseas demand that helped the yen gain about 70 percent in the decade ended 2011.

The yen has weakened more than 20 percent in the past six months against its developed-market peers, reaching its lowest level against the dollar since May 2009 today, as the Bank of Japan expanded monetary stimulus to achieve 2 percent annual inflation within two years. In turn, costs from wheat for flour millers to Hagoromo Foods Corp.'s canned "Sea Chicken" are already increasing because of higher production expenses.

"The pace of monetary easing by the BOJ is going to quicken substantially, and its effects on the economy will start to be felt," Yuji Kameoka, the chief currency strategist in Tokyo at Daiwa Securities Co., said by phone on April 4.
"There's more room for inflation expectations to rise, leading to a decline in real yields and further yen weakness."

Revising Forecasts

Daiwa, Japan's second-largest brokerage, forecasts the currency will be at 99 per dollar by year-end. The yen touched
99.66 per dollar, the weakest since May 2009, before trading unchanged from yesterday at 99.36 per dollar as of 12:39 p.m. in Tokyo.

Since the end of 2012, analysts have revised their fourth- quarter 2013 forecasts for the yen against the euro and dollar by more than 10 percent, to 124 per euro from 109 per and to 97 per dollar from 87, the largest and third-biggest cuts among the

51 currency-pair estimates tracked by Bloomberg.

"The yen could easily depreciate to about 120 per dollar"
with declines in real yields, Hiromichi Shirakawa, Japan economist at Credit Suisse Group AG in Tokyo and a former BOJ official, said in an interview yesterday. "Rising inflation expectations will weaken the yen and help actual price gains."

Imported Inflation

While the weaker currency will be a boon for parts of the economy, including exporters such as Nintendo Co. and Toyota Motor Corp. by boosting the value of overseas sales, it's pushing up import costs. Japan relies on other nations for almost all of its oil and gas and about 60 percent of its food on a calorie basis, according to government figures.

Import costs jumped more than 10 percent in January and February, the first consecutive double-digit advance since August 2011. Shipments of liquefied natural gas to Japan rose to a record in 2012 as the country increased its dependence on gas- fired power plants to make up for lost nuclear power generation after the March 2011 earthquake.

Japan will increase wheat prices to companies including Nisshin Seifun Group and Nippon Flour Mills Co. by about 10 percent in April after a weaker yen made grain imports more expensive, the Ministry of Agriculture, Forestry and Fisheries said in February. That's likely to be passed on in prices for bread and noodles.

Canned Tuna

Hagoromo Foods is raising prices of its canned tuna for the first time in 5 1/2 years, said Takaaki Izumi, spokesman for Shizuoka City-based company.

"We are seeing some impact of currency movements since ingredients like bonito and yellowfin tuna are imported," he said in a telephone interview on April 2.

A BOJ report released April 1 showed 74 percent of Japanese households expected prices to rise in a year, the highest proportion since September 2008.

"Hagoromo's price hike for their tuna cans is symbolic in that it flags the risk of stagflation," Satoshi Okagawa, a senior global-markets analyst in Singapore at Sumitomo Mitsui Banking Corp., said in an April 2 interview, referring to a phenomenon characterized by slow growth and faster inflation.

"There's a mood among policy makers that they can close their eyes to risks as long as everything goes well."

The BOJ's new policy may backfire if it only sparks inflation in certain parts of the economy, according to Shigeru Endo, a Tokyo-based fund manager at BlackRock Japan Co., a unit of the world's largest money manager.

Artificial Weakening

"The risk is that, even if there is inflation, price increases will be limited to import costs and hurt growth,"
Endo said in a March 26 interview. "An excessive artificial weakening of the yen could trigger capital outflows if households panic that the yen will become dirt cheap."

Prices of Japan's inflation-linked notes maturing in five years climbed to a record 114.818 yen last month from a low of
76.342 in December 2008.

The correlation between the price of the securities and the dollar-yen rate rose to 0.52 on April 1, the highest since September based on a 20-day period, according to data compiled by Bloomberg. A reading of 1 means prices move in tandem, while zero indicates no relationship and minus 1 means they move in opposite directions.

The yield on the securities, which reached an all-time low of minus 1.25 percent on March 15, represents expectations of future interest rates in real terms, according to Kameoka.

Growth, Inflation

The BOJ will release growth and inflation forecasts at its next policy meeting on April 26. After Haruhiko Kuroda's first BOJ meeting as governor on April 4, it set a two-year horizon for the 2 percent annual price-increase target that it adopted in January at the urging of Prime Minister Shinzo Abe.

Consumer prices will probably rise 0.1 percent in 2013, after four-straight years of declines, according to the median estimate of economists surveyed by Bloomberg News.

Faster inflation, which erodes the purchasing power of fixed payments on bonds, may already be starting to deter foreign investors.

The Swiss National Bank's foreign-exchange profit decreased in 2012 to about half that of the previous year, in part because of the yen's drop against the franc, according to an SNB statement. Japan's currency accounted for 8 percent of the central bank's global reserves, down from 10 percent in 2010.

Bond Binge

Overseas investors scooped up 21.4 trillion yen ($216 billion) of Japanese government bonds in 2011, the most since 2007, according to Ministry of Finance data. Their holdings amounted to 84 trillion yen or 8.7 percent of total outstanding securities in the three months ended Dec. 31, down from a record 9.1 percent of in the September quarter, a BOJ report showed.

"With a strong commitment suggested by the BOJ led by new governor Kuroda to achieve a 2 percent inflation target as soon as possible, inflation expectation will likely heighten further," Tokyo-based JPMorgan Chase & Co. strategists Tohru Sasaki and Junya Tanase wrote in a report dated yesterday. "As the real yield of the currency declines, global investors will sell JPY as a funding currency to invest into various risk assets."

JPMorgan revised its yen forecast for the end of this year to 105 per dollar from 98.

Even domestic investors, who own about 91 of the nation's debt, are starting to shift their holdings overseas. Mizuho Asset Management Co., Sumitomo Mitsui Trust Asset Management Co. and Mitsubishi UFJ Asset Management Co., which together oversee the equivalent of $138.3 billion, said they are shunning JGBs in favor of U.S. Treasuries.

Monetary Base

The BOJ said after last week's meeting it was switching its policy target from the benchmark interest rate to the monetary base -- cash in circulation and the money that financial institutions have on deposit at the central bank. It predicts the measure will double to 270 trillion yen by the end of 2014.

The decision marks a "regime change," said Robert Rennie, chief currency strategist at Westpac Banking Corp. in Sydney.
"One thing I would still like to have seen is the shift in the definition of inflation target. Rather than just achieving 2 percent year-on-year at the earliest possible date, it's achieving that and continuing to achieve in consecutive years."

Westpac revised its year-end yen forecast to 93 per dollar from the previous estimate of 89.

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