Daiwa's View

FICC Research Dept.

Will there be a resurgence of speculative selling of the yen?

- A substantial decline in volatility would be necessary

Kenta Tadaide
81-3-5555-8466
kenta.tadaide@daiwa.co.jp

Daiwa Securities Co. Ltd.

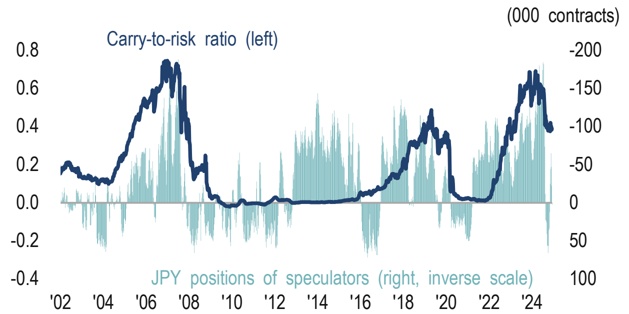
According to Bloomberg, BOJ Governor Kazuo Ueda attended a panel discussion at the IMF/World Bank Group Annual Meetings held in Washington D.C. on 23 October, and stated that if, by proceeding with monetary normalization in a very gradual manner, we were to cause people to adopt the view that interest rates would remain low over a very long period of time, it could lead to the formation of extremely large speculative positions, which could cause problems going forward.

Later, at a press conference at the 30-31 October Monetary Policy Meeting (MPM), he said that he would no longer refer to the BOJ as having ample time. By avoiding the phrase "ample time," which had begun to serve as a keyword for indicating the timing of upcoming rate hikes, he seems to have been aiming to regain a free hand in policy operations and curb speculative selling of the yen.

Under the current circumstances, which could be said to be dependent on forex rates, whether speculative selling of the yen increases to the levels seen in May-June 2024 will be a crucial point when it comes to forecasting the BOJ's rate-hike timing, as well as the JPY market in the future.

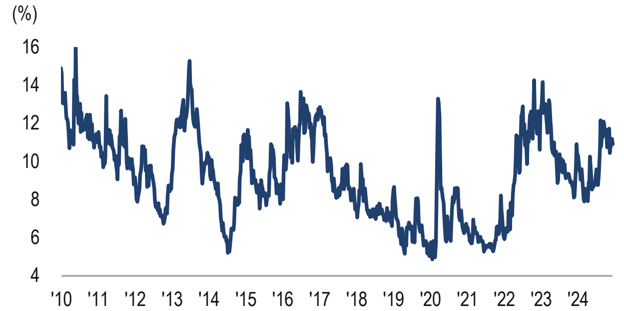
Speculative (non-commercial) net short yen positions seen with IMM currency futures positions stood at 126,000 contracts as of 14 May, but had subsequently risen to 184,000 contracts by 2 July. As of 3 December, net long yen positions stood at 2,000 contracts, indicating that speculative selling of the yen has not intensified recently.

Chart 1: Carry-to-risk Ratio, JPY Positions of Speculators



Source: CFTC, Bloomberg; compiled by Daiwa.
Note: The carry-to-risk ratio is calculated using the 3-month US/Japan interest rate gap and the 3-month USD/JPY implied volatility. Regarding JPY positions of speculators, positive indicates yen buying/dollar selling, negative indicates yen selling/dollar buying.

Chart 2: 3-month USD/JPY Implied Volatility



Source: Bloomberg; compiled by Daiwa.

In general, carry trades (roughly equivalent to speculation) tend to be established when "sufficient interest rate differentials" and "low volatility" are in place. The carry-to-risk ratio, which is calculated by dividing the interest rate differential by the expected exchange rate volatility (implied volatility), is the numerical expression of this thinking, and is regarded as an important indicator in carry trades.

Looking at the carry-to-risk ratio, which is calculated by dividing the 3-month interest rate differential between the US and Japan by the 3-month USD/JPY implied volatility, while we found that it was around 0.6 when speculation was active in May-June (Chart 1 on previous page), it has remained around 0.4 since August. This is partly due to the narrowing of the US-Japan interest rate differential as the BOJ raised interest rates and the Fed decided on a significant rate cut. Another factor is the fact that implied volatility has risen significantly since the BOJ's rate hike in July (Chart 2 on previous page).

A comparison of G10 currencies shows that the yen was very attractive as a funding currency just before the surge in carry trades in May in terms of the absolute interest rate differential and the carry-to-risk ratio (Chart 3). However, the yen's status (as a funding currency) has seen a relative decline recently, with the Swiss Franc being more advantageous in terms of the carry-to-risk ratio. While there are factors supporting Switzerland's solid supply and demand structure, such as its trade surplus, speculative positions with the Swiss Franc among IMM currency futures positions remain short on a net basis. Furthermore, conspicuous selling has been seen with the Canadian dollar and the euro amid expectations of declining interest rates.

This week and next week, a series of monetary policy meetings will be held by major central banks, and rate cuts are expected in many nations. Looking ahead to March next year, many nations are expected to implement further substantial rate cuts. On the other hand, many expect the BOJ to raise rates, potentially (1) reversing the absolute interest rate differential between Japan and Switzerland and (2) further narrowing the gap with other nations. If the implied volatility of each currency pair were to remain at the current level, the Swiss Franc would remain advantageous as a funding currency from the standpoint of the carry-to-risk ratio, and there would be little difference with the euro, Canadian dollar, and Swedish krona.

Chart 3: Carry-to-risk Ratio of G10 Currencies (vs. US$)

	May-24			Current levels			Mar-2025	
	Interest rate gap	Expected volatility	Carry-to-risk ratio	Interest rate gap	Expected volatility	Carry-to-risk ratio	Interest rate gap	Change
Japan	5.25%	9.57%	0.55	4.35%	10.92%	0.40	3.69%	-66bp
Euro area	1.44%	5.87%	0.25	1.42%	7.23%	0.20	1.90%	48bp
UK	0.13%	6.73%	0.02	-0.12%	7.03%	-0.02	-0.28%	-16bp
Canada	0.32%	5.19%	0.06	0.80%	5.45%	0.15	1.19%	39bp
Australia	1.01%	8.83%	0.11	0.24%	9.75%	0.02	0.06%	-18bp
New Zealand	-0.17%	8.99%	-0.02	0.33%	9.72%	0.03	0.55%	22bp
Switzerland	3.89%	6.51%	0.60	3.63%	6.98%	0.52	3.84%	21bp
Norway	0.83%	10.24%	0.08	0.08%	11.35%	0.01	0.00%	-8bp
Sweden	1.34%	10.20%	0.13	1.80%	10.45%	0.17	2.04%	24bp

Source: Bloomberg; compiled by Daiwa.
Note: The carry-to-risk ratio is calculated using the 3-month overnight interest rate gap between each nation and the US, and the 3-month implied volatility between the currency pair.

If the Fed does not raise interest rates in the near future, the key regarding whether there is a resurgence of speculative selling of the yen will be whether the USD/JPY implied volatility decreases significantly. Even if implied volatility declines to the levels seen around May, the carry-to-risk ratio will remain around 0.4, which is not very different from the current level. If implied volatility drops to 7.5% and 6%, the carry-to-risk ratio will rise to 0.5 and 0.6, respectively, which would lead to a situation in which we should be on the lookout for speculative selling of the yen.

The lowest USD/JPY implied volatility seen since 2000 has been around 4.9%, and levels close to 6% have been observed since the COVID-19 pandemic. Since March 2022, when the Fed started raising interest rates, there have been few times when implied volatility fell below 8%. Therefore, while the possibility may be low, a decline to such a level cannot be entirely ruled out.

If, from the beginning of next year onwards, no policy changes are expected with the Fed or BOJ, or if there is no change for a prolonged period of time in policy trajectories that have already been priced-in, the USD/JPY rate may intensify range-bound movements and implied volatility may decline.

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

Ratings
Issues are rated 1, 2, 3, 4, or 5 as follows:
1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices
Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities
Please refer to https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings
This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law
(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)
If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.
Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association