FX Monthly Report- Japanese Yen

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FX Monthly Report

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JPY Focus

Since the start of this year, the Japanese yen has been subject to significant appreciation given a combination of its safe-haven status during times of uncertainty, especially during the escalation of the US trade war, as well as the continuation of the BOJ's hiking cycle that started in 2024.

As we enter June, while positive trade deals between the US and both China and the UK are softening the risk-off narrative, waning sentiment regarding the US fiscal prospects are limiting dollar gains. At the same time, domestic performance metrics are starting to expose vulnerabilities in Japan's export-dependent economy, which remains subject to auto and base tariffs, with a scheduled increase set for July 8th unless a deal with the US is reached. As these factors start to compound, what is the outlook for the yen in the coming months?

Trade Negotiations

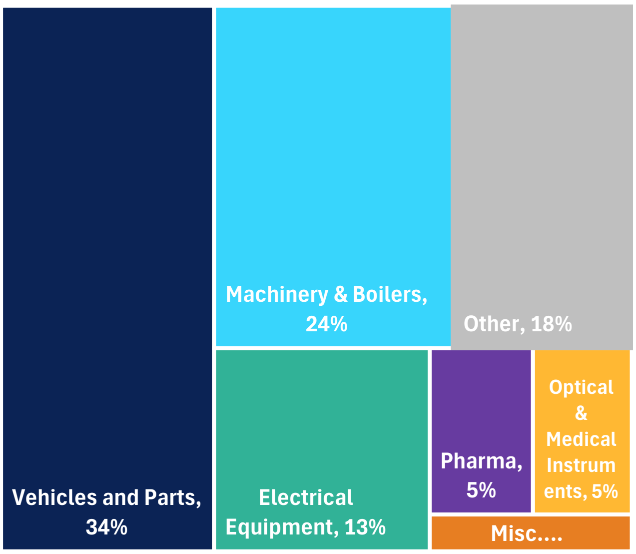
On April 2nd, President Trump announced "Liberation Day", unveiling new tariffs, including a universal tariff on all imports and higher "reciprocal" tariffs on specific countries. Japan faced a 24% tariff and an additional 25% auto tariff, significantly impacting its automotive sector. While a subsequent 90-day pause has not suspended tariffs on Japanese goods, it altered the current structure of the tariff regime:

Tariff Type on Japanese Goods	Current Status
25% Auto Tariff	In Effect. Applies to all imported vehicles, including those from Japan. Not compounded with the 10% baseline tariff.
24% Reciprocal Tariff	Paused for 90 days until July 8th, 2025.
10% Base Tariff	In Effect
Steel & Aluminium Tariff	In Effect

Japan is a highly export-driven economy, with 21% of its total exports going to the US. This heavy reliance means that it is particularly vulnerable to stalled trade negotiations, perhaps more so than many other developed nations. Japan's automotive industry is a cornerstone of its economy, and the imposition of higher tariffs poses a significant threat. In fact, Japan sends more cars and auto parts to the US than any other category, accounting for nearly 30% of its total exports to the country.

US Imports of Japanese Goods by Category, 2024

More than half of American imports from Japan consist of vehicles and machinery, highlighting the significant reliance on these items in the potential trade agreement.



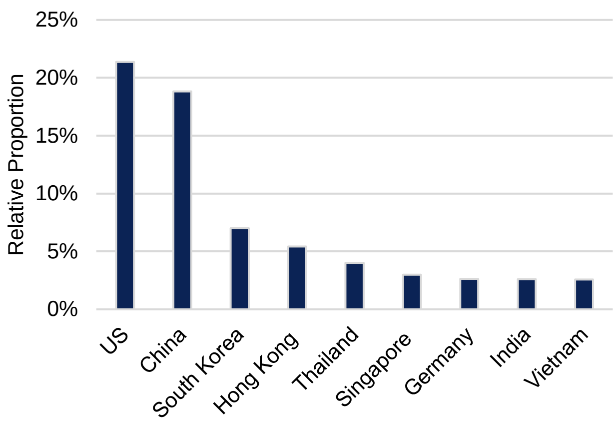
Source: USITC

However, from the US perspective, only 20% of its vehicles are imported from Japan. This figure is lower than the combined contributions from Mexico (21%) and Canada (16%), both of which enjoy tariff exemptions under the USMCA. This suggests that the US could technically increase supply from other regions to compensate for the lack of Japanese cars. However, the Japanese auto industry supplies a unique mix of vehicles, including hybrids and high-efficiency models, that would be difficult to fully replace in the short term without affecting prices and consumer choice.

Recent positive developments in trade between the US and China are setting a strong precedent for potential trade agreements with Japan. Additionally, a trade deal with the UK, which excludes auto tariffs, serves as an important template, providing insights into what a future agreement might entail. Commerce Secretary Lutnick stated that both economies would need a long time before reaching an agreement, but we expect that Japanese policymakers will aim to finalise the deal before the July 8th deadline, when an additional 24% reciprocal tariff is set to take effect. Prime Minister Shigeru Ishiba has indicated progress in negotiations, including discussions on non-tariff measures and economic security, and has offered financial and technical cooperation on US-focused projects such as LNG pipelines and naval repairs. A crucial talking point will likely focus on the exclusion of auto tariffs, highlighting their strategic importance for Japan, which is greater than that for the US.

Japan Top Export Destinations, 2024

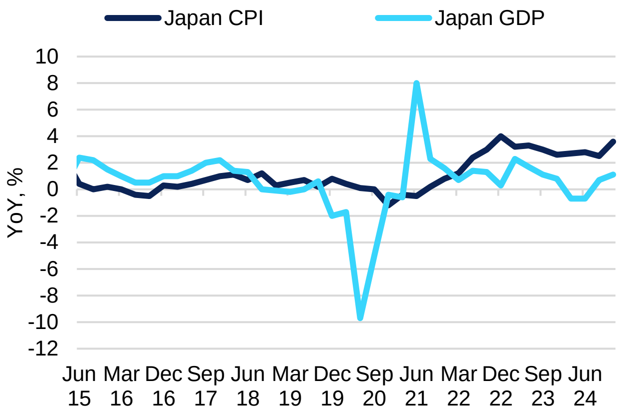
China and the US together account for over a third of Japan's exports, placing significant pressure on trade agreements with these countries.



Source: Trading Economics

Japan GDP vs Inflation YoY

Japanese inflation is steadily increasing, while the GDP is showing significant vulnerability to exports.



Source: Economic and Social Research Institute Japan, Ministry of Internal Affairs and Communications

Our Outlook for Trade Negotiations

It is arguably more important for Japan to be excluded from US tariffs than for the US to maintain them. Still, Japan's substantial share of the US auto market gives it some bargaining power. The most likely outcome is that the trade deal will be finalised closer to the 90-day deadline, around late June or early July. Autos are likely to be excluded from tariffs, but Japan is expected to drive this narrative. Given its reliance on shipping to the US, Japan will probably be inclined to make more concessions as part of the broader trade negotiations.

Japan's Economic Performance

Even before the recent tariffs took effect in early April, the Japanese economy contracted in Q1 2025, with GDP falling by 0.2% QoQ. This reflects a combination of factors, including a drag from net exports and stagnant consumer spending amid elevated inflation. A negative growth print underscores existing economic vulnerabilities and could weigh on sentiment, especially if trade negotiations do not reach a productive stage. This would add pressure on Q2 performance and raise the risk of a technical recession.

Japan currently lacks a strong internal growth engine, and its high exposure to US trade increases the risk of further economic deterioration, and with it, a decline in consumer confidence. Already, given the impact of existing tariffs, Japanese companies are beginning to slash their profit forecasts. Notably, Toyota Motor has projected a decline in its profits of roughly 33% YoY for this fiscal year.

These concerns are echoed by other producers as well, with merchant sentiment falling to its lowest level over three years. Although manufacturers are expected to bear the brunt of the new tariffs, sentiment has also worsened among retailers and service providers due to ongoing inflation, which continues to undermine consumer confidence. Japan's overall inflation has remained at or above the Bank of Japan's 2% target for nearly three years, further straining household budgets.

Exports to the US are expected to remain subdued in the coming months. In March, shipments showed a drastic slowdown, increasing by only 3.1% compared to 10.5% in February. Exports to China declined 4.8%, while exports to Europe fell by 1.1%. In the first 20 days of April, Japan's exports experienced an even more considerable decline after the US put a 25% levy on imports of steel, aluminium and, subsequently, autos.

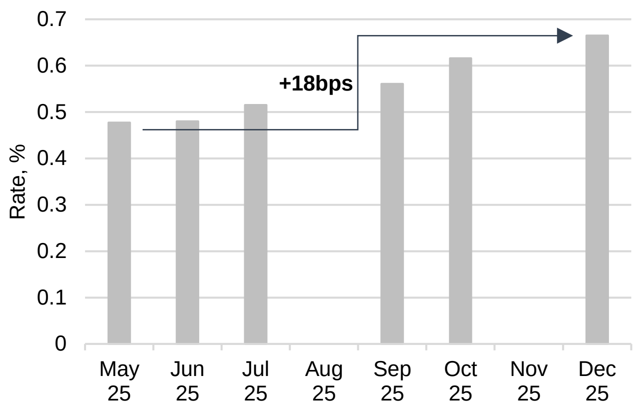
Weak demand both domestically and internationally casts a shadow over Japan's already uneven recovery, putting further pressure on the yen's performance. Without a resolution to ongoing trade tensions, Japan's economy faces growing headwinds, with growing risks of a technical recession and weakening confidence.

BOJ Monetary Policy

Japan's current economic performance, particularly weak consumer spending under elevated inflation, suggests the BOJ is unlikely to raise rates any time soon. Policymakers have already signalled a one-year delay in reaching their stable inflation target and halved their growth outlook for this fiscal year. Markets reflect this cautious stance, with forward swaps now indicating only 16bp of tightening by the year-end, down from 33bps in early March.

Bank of Japan Implied Rate for 2025

The markets do not anticipate another interest rate hike from the Bank of Japan until next year.



Source: Bloomberg

While inflation was the primary driver of the BOJ's normalisation in early 2025, this narrative is shifting. With heightened focus on trade uncertainty, export-driven growth now appears to be taking precedence in monetary policy decisions. In this environment, the BOJ is likely to adopt a wait-and-see approach. While rate cuts remain unlikely, the probability of additional hikes is also fading, with perhaps one 25bps hike possible by year-end at most.

Japanese government bonds have responded accordingly, with the 10-year JGB yield rising to approximately 1.47%, up from 0.89% in April, as markets react to the BoJ's reduced bond purchases and growing fiscal concerns. The yield curve has steepened modestly, reflecting both increased growth expectations and limited monetary policy scope. Demand for safe assets has fluctuated amid ongoing trade friction and domestic policy uncertainty, influencing yield movements.

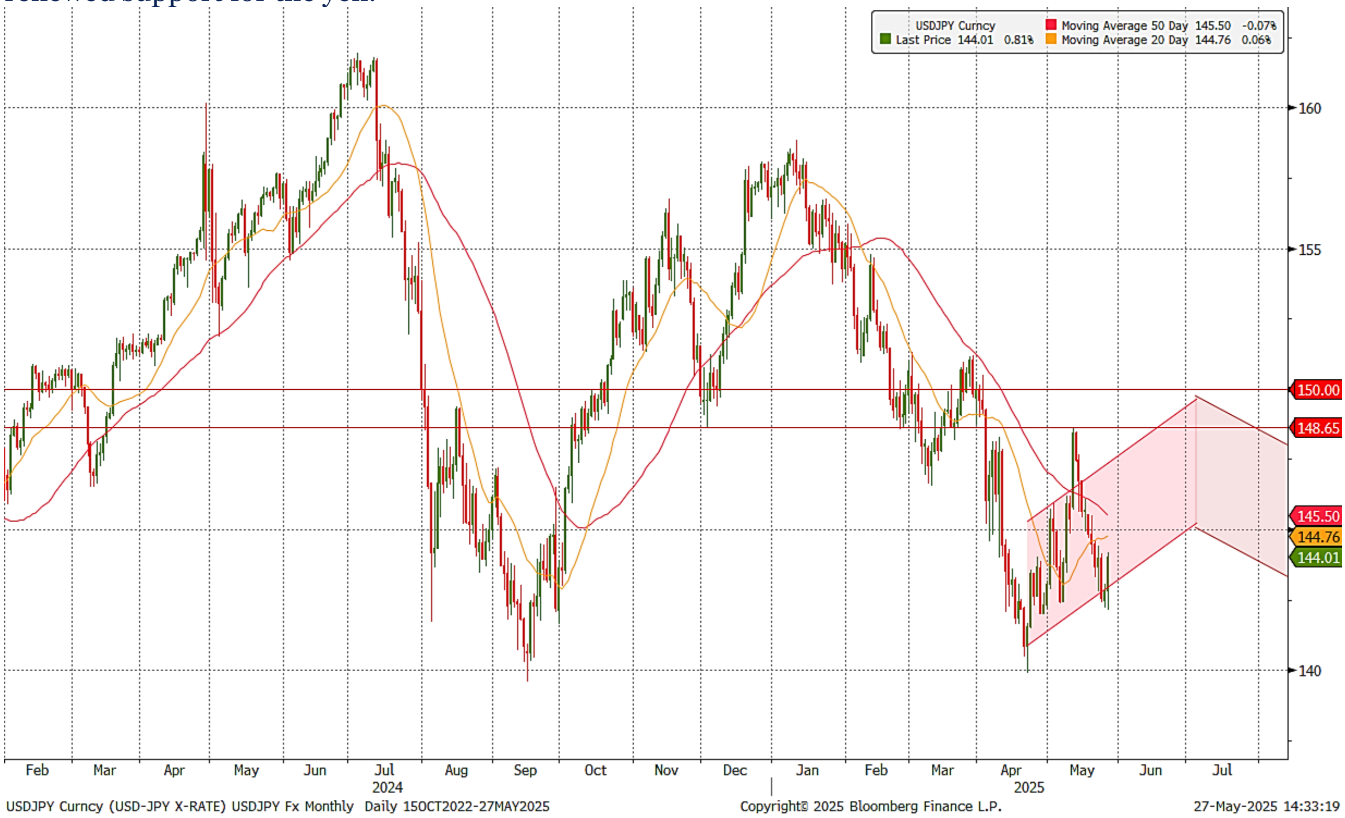
In response to the surge in long-term yields, the Ministry of Finance has initiated consultations with primary dealers and market participants about potentially reducing the issuance of super-long-term bonds (20-, 30-, and 40-year maturities). This move aims to stabilise the bond market, which has experienced heightened volatility and surging borrowing costs. These developments reinforce the view that the BOJ is likely to proceed cautiously, with any policy adjustments being gradual and closely tied to incoming data.

With both the BOJ and the Fed unlikely to make their respective moves until H2 2025, the rate differential is expected to hold. However, trade dynamics could emerge as a more influential driver of USD/JPY. Trade negotiations between the US, China, and the UK are beginning to shift sentiment back toward risk assets. While we do not anticipate broad-based US dollar strength, the yen's safe-haven appeal may fade as it starts to reflect domestic vulnerabilities, including existing tariffs on autos and potential export-led GDP weakness.

Our USDJPY Outlook

Our View: The outlook for USD/JPY remains heavily influenced by the US dollar, particularly the Trump administration's trade policies. For Japan, an export-driven economy, trade negotiations with the US are critical. While we expect positive developments before the end of the 90-day pause in early July, including potential auto tariff exemptions similar to those granted to the UK, Japan would still face at least two more months of uncertainty. This continued limbo is likely to weigh on consumer confidence and economic performance. As a result, the BOJ appears firmly in wait-and-see mode, with any potential rate hikes likely postponed until late 2025 or even early 2026.

Meanwhile, as sentiment cautiously shifts back toward US assets, the yen faces a moderately bearish outlook in the near term, with USD/JPY technical resistance around the 150 mark. However, much will depend on how trade talks evolve. By July, we expect positive news on that front to provide some renewed support for the yen.



Desk Comments

GBP

The price action of GBP has demonstrated positive performance, outpacing all but the commodity currencies within the G10 space.

Several factors support a favourable outlook for the British pound. UK GDP exceeded expectations, registering a growth rate of 0.7%, surpassing the forecasted 0.6%. This growth was driven by increases in consumer spending and business investment. However, it is important to note that these figures are yet to be affected by the US tariffs and the rise in UK employer taxes in April. As a result, this strong growth rate is unlikely to persist.

The post-Brexit reset of relations has also provided a boost to GBP. Notably, the UK has agreed to allow EU vessels access to its fishing waters for an additional 12 years, in exchange for the EU dropping demands regarding agrifoods. Additionally, discussions surrounding youth mobility are gaining momentum, which increases the likelihood of enhanced freedom of movement for people.

The trade agreement between the UK and the US holds promise for reducing trade barriers and fostering closer economic cooperation. The agreement includes provisions for lowering US tariffs on British steel, aluminium, and car exports. However, concerns have emerged from China, China has argued that bilateral trade agreements should not be used to target third-party nations. As the Financial Times highlights, "the comments place London in a difficult position between the two economic superpowers and could complicate efforts by the UK government to reset relations with China."

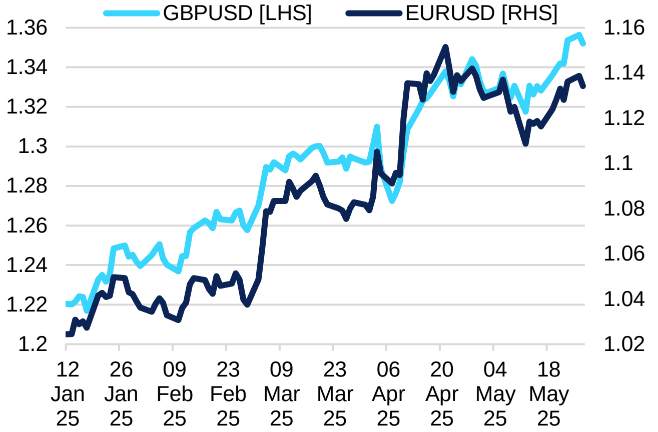
In the near term, there appears to be potential for GBP appreciation, driven by the already established trade deal with the US and the uncertainty surrounding the next phase of tariff negotiations between the US and other nations, particularly as the current tariff pause is set to expire on 8th July which is likely to introduce a new wave of uncertainty.

EUR

The euro has strengthened following the reset of relations with the UK. However, prior to this boost, the Dollar Index had declined by 2% in recent sessions, yet the euro has made little progress. This marks a notable shift from earlier trends observed this year. One key reason for the euro's lack of momentum is the absence of an imminent trade deal with the US. As noted earlier this week, with the White House having already reached a truce with China, it may be less eager to finalise a deal with the EU.

GBP and EUR vs The Dollar

EUR and GBP continue strengthening against the dollar.



Source: Bloomberg

At present, the euro lacks a clear catalyst to drive it higher. The European Central Bank (ECB) reduced its key interest rate by 25 basis points to 2.5% in March, with market expectations factoring in an additional 50 basis points of rate cuts during this policy cycle. However, a recalibration of this stance seems unlikely before the ECB's governing council meets next month.

On the macroeconomic front, the eurozone's GDP grew by 0.3% in Q1 2025, largely driven by the services sector, while manufacturing remains subdued. Employment rose by 0.3% compared to the previous quarter, marking the highest growth in a year.

In addition, the new German government, which plans to ease fiscal policy by approximately 2% of GDP to stimulate growth and potentially boost interest rates in Europe, has received approval. However, the government had to be voted on twice after losing its initial vote, highlighting its narrow parliamentary mandate. We anticipate that the fiscal easing will have only a modest impact on the economy in 2026, with more significant effects likely occurring the following year. As a result, this is unlikely to hinder the European Central Bank from further reducing interest rates in the coming months and not give an immediate boost to the EUR.

USD

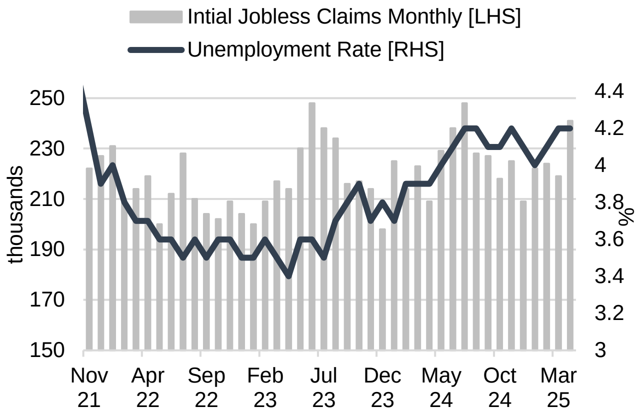
The recent trade agreement between the US and China has sparked a general risk-on sentiment in global markets. Following the announcement, the USD Index rose, and the S&P 500 recovered much of its previous losses tied to tariff concerns. The news has encouraged investors to return to US. risk assets, as the perceived risk of a U.S. recession has significantly diminished.

Moody's downgrade of the US. credit rating was largely anticipated, as the agency had placed the US on watch since November 2023. Given that rating actions typically follow within 18 months, the market reaction was relatively muted. However, the downgrade underscores growing concerns over unsustainable budget deficits.

April's inflation data came in slightly below expectations, with headline inflation easing to 2.3% (vs. consensus 2.4%), while core inflation remained steady at 2.8%, in line with forecasts. So far, there is little evidence of tariff-induced price pressures, though it may still be too early to see the full effect in the data.

US Labour Market

US Labour Market remains healthy.



Source: Bureau of Labor Statistics, Department of Labor

The trade war has not significantly dampened consumer sentiment in the US Retail sales saw a slight monthly decline, we believe the softer retail figures reflect a normalisation following earlier front-loading, rather than a sign of broader weakness.

Despite speculation of declining trade activity, there has been no significant drop in shipping volumes from China to the US, according to ship-tracking data indicating an average of six to eight US-bound ships daily, consistent with historical levels. While there has been a slight slowdown since mid-April, it appears to be a seasonal correction following the Chinese New Year rather than a structural decline.

Foreign exchange volatility remains subdued. We do not anticipate any significant changes until the current tariff pause ends.

Technical Analysis

EURUSD

The EURUSD has been trending upward this year, but in the short term, we expect the pair to remain rangebound, with the tariff developments likely to shape any sustained directional move. On the downside, key resistance from the trendline sits at 1.1193, followed by support at the 38.2% Fibonacci retracement level of 1.1026. On the upside, the previous high of 1.1570 serves as the next key resistance level.

GBPUSD

GBPUSD is trending higher inside an upward channel. Breaking through the previous strong resistance at 1.3440 paves the way for the pair to move toward 1.3750, the high from 2022. On the downside, former resistance at 1.3440 now acts as support, followed by the channel's support level at 1.3105. We anticipate the pair will continue to trade within this upward channel.

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