
FX Market Focus

➤ Japan Cross-border Flows and the Yen

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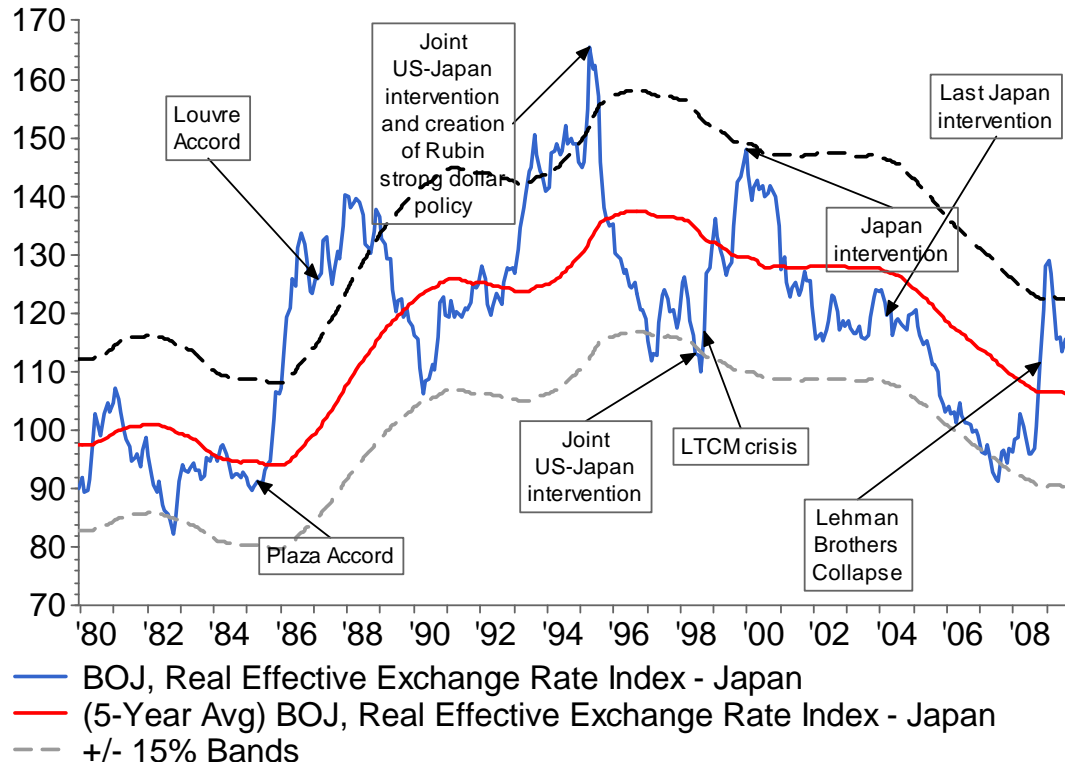
European Central Bank
December 2009



Bank of Tokyo-Mitsubishi UFJ

DPJ Yen Policy Shift – Shifting Again?

Yen Real Effective Exchange Rate

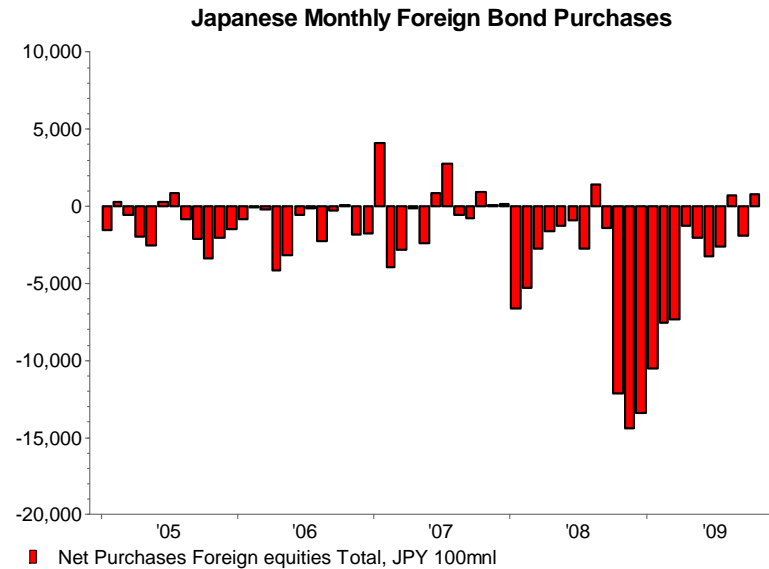
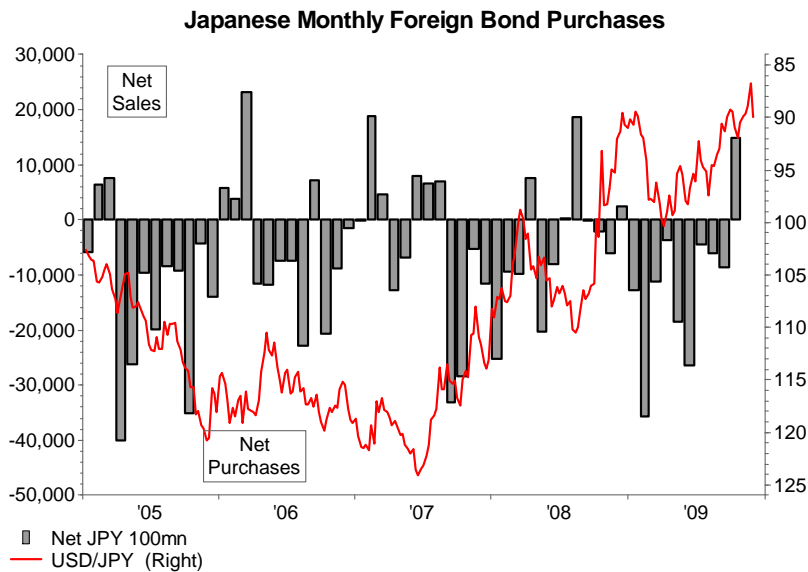


- Fujii – “Weak yen policy is finished”. Oct 13th
- Fujii – “I never voiced support for a strong yen”. Oct 27th
- Fujii – “I never stated that intervention was unthinkable”. Dec 1st
- Gyohten – “Japan and China carry a heavy responsibility to stabilise the dollar. We need to work together with the US to achieve this”. Oct 16th
- LDP shifted FX Policy in 2004. The last intervention was in USD/JPY on 16th March 2004.
- BOJ policy measure on 1st December – another cautious step with little consequence for the yen

Institutional Investor Flows



Substantial Japanese Investor Outflows Have Eased



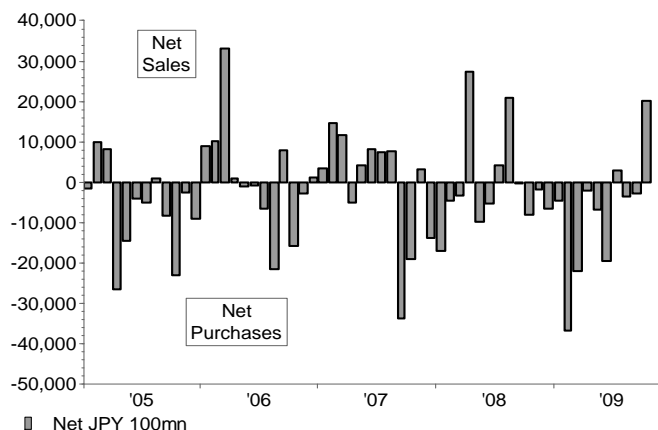
➤ JPY 11.6 trillion worth of purchases in 12mths to Oct

➤ JPY 6.3 trillion worth of purchases in 12mths to Oct

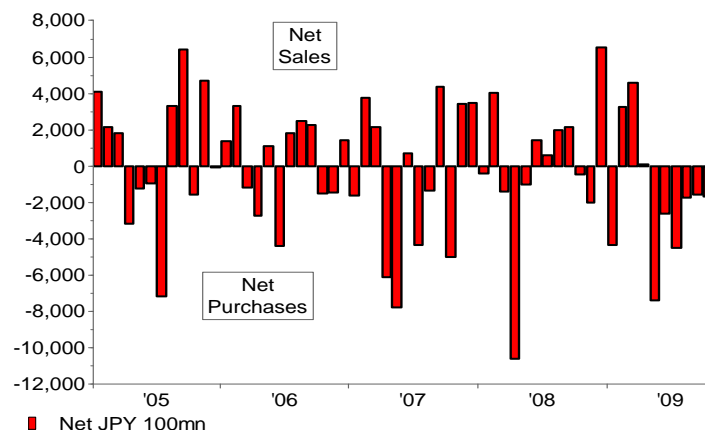


Banks & Life Insurance Companies Active Bond Buyers

FOREIGN BOND PURCHASES BY JAPANESE BANKS

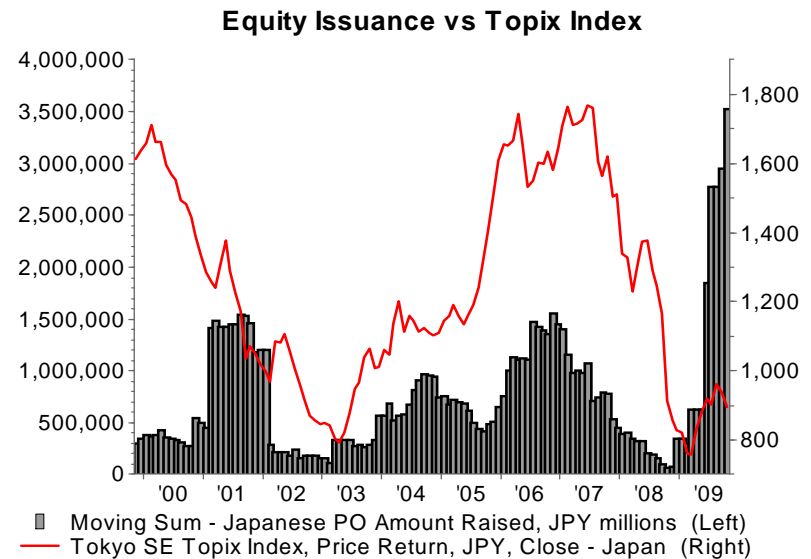
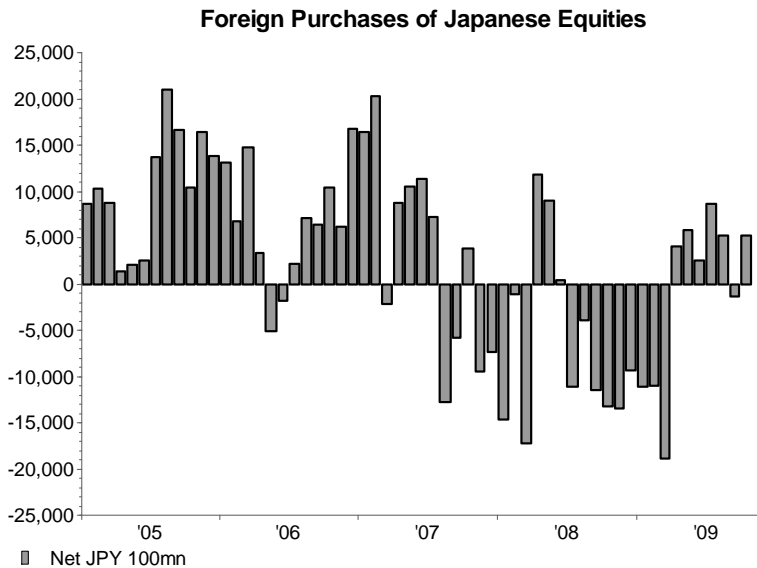


FOREIGN BOND PURCHASES BY JAPAN LIFE INSURERS



(JPY 100mn)	Bonds - Japan Inv	Banks	Securities	L Insurance	Inv Trust	Trust Acq	Eqty Out Japan Inv	Bonds For Inv	Eqty In For Inv
12mth to Oct 08	-65403.00	-6018.00	-54769.00	3281.00	-12468.00	-17482.00	-33081.00	-11354.00	-67772.00
12mth to Oct 09	-116018.00	-82558.00	-23778.00	-11227.00	-15395.00	-6639.00	-62736.00	-79907.00	-32852.00
Since Eq mkt turn	-63992.00	-33184.00	-15164.00	-14687.00	-19589.00	895.00	-16882.00	-51182.00	11841.00
Last 3mths	271.00	14038.00	-5022.00	-4922.00	-8226.00	-1942.00	-392.00	-18856.00	9344.00

Japan Equity Market Under-performance Not Just an Issuance Story



➤ Muted (JPY 1.2 trillion) purchases since March trough

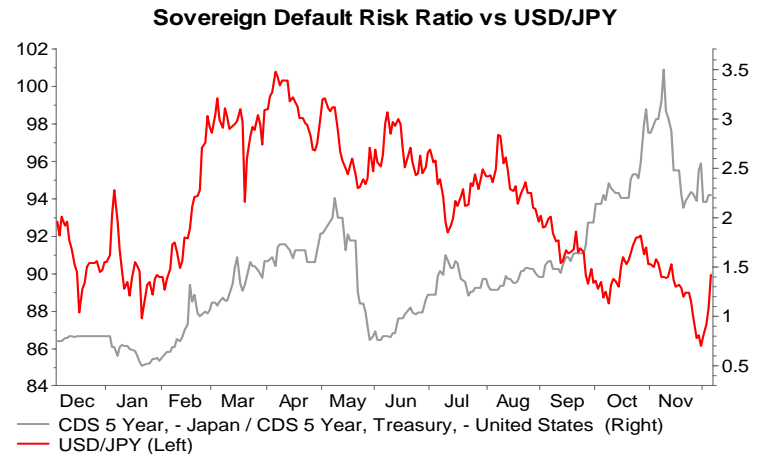
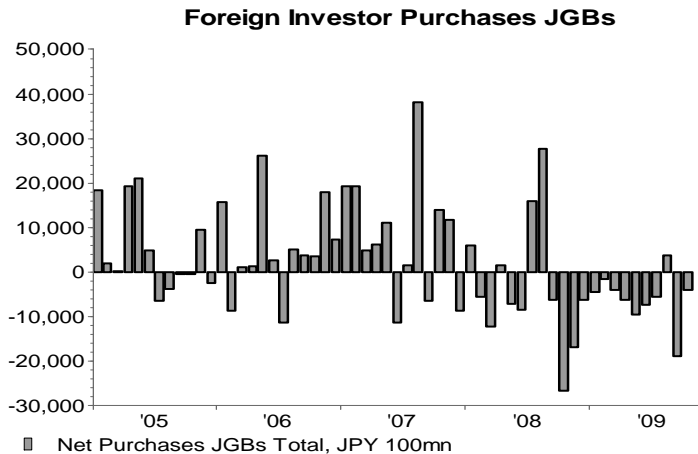
➤ Estimated JPY 5 trillion of net issuance in 2009



DPJ Triggering Foreign Investor Concerns

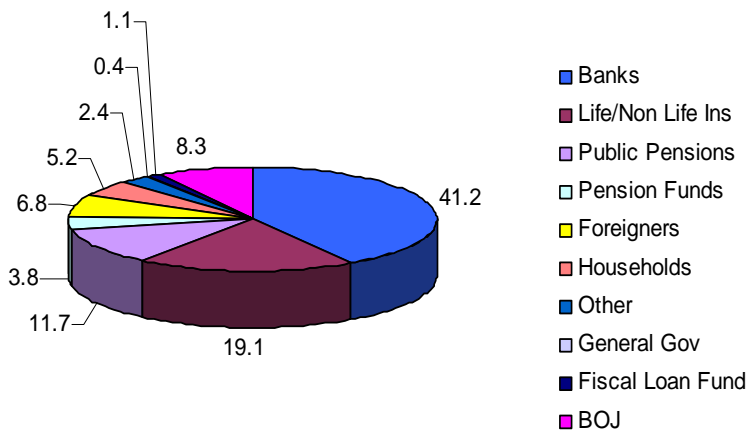
DPJ Manifesto "Democratic Party of Japan's Platform for Government"

【Funding Source】		JPY/TRN	
① Eliminate Wasteful Spending Public Works Personnel Costs Consignment / Facility Costs Others	Cancel Kawabegawa River, Yamba Dam Project, cost benefit analysis of road projects	1.3	9.1
	Transfer authority to local regions, review staffing and benefit levels, revise pay scales	1.1	
	Review government contracts, reform subsidies, review and abolish independent administrative institutions	6.1	
	Reduce the number of Diet seats, stricter budget assessments	0.6	
② "Buried Treasure" and govt costs Buried Treasure Planned Sales of Govt Assets	Portion of Foreign Exchange Fund Special Account, special accounts in the FY2009 supplementary budget	4.3	5.0
	Selling unused land, official residences, shares in privatized companies	0.7	
③ Tax System Reforms	Review special taxation measures, abolish spouse and dependent income tax deductions		2.7
Total			16.8

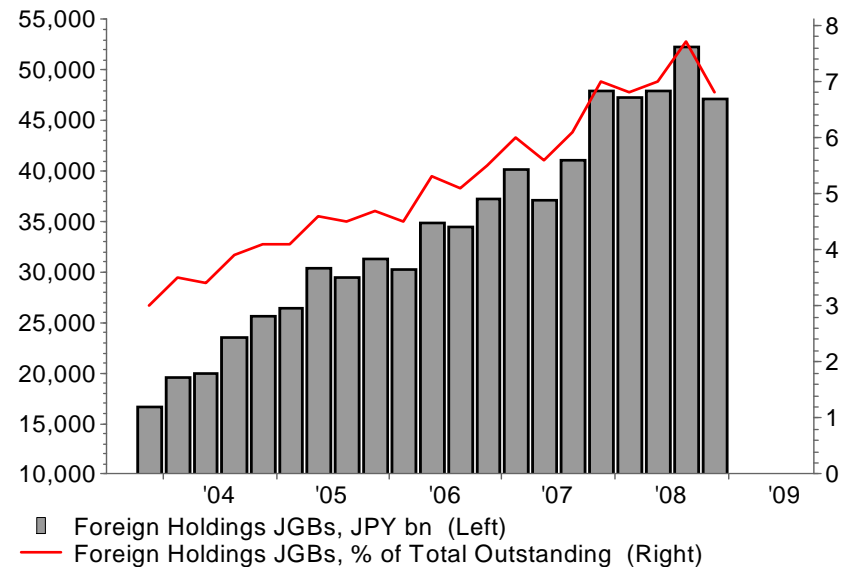


Foreign Investor Participation in JGB Market Modest and Now Reversing

JGB Investor Base as of Dec 2008



Foreign Holdings JGBs - JPY vs % of Total

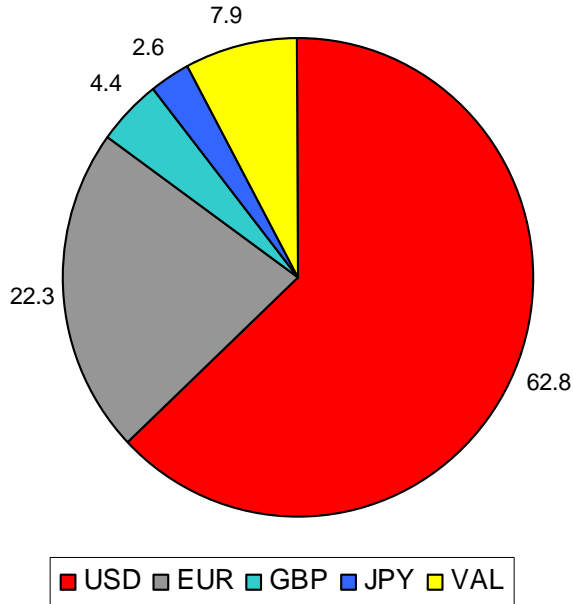


➤ Domestic Investors' behaviour key for JGB yield

➤ Steady expansion of foreigners' JGB holdings now reversing

Trend Decline in JPY Reserve Holdings

Constant FX Reserves Q2 2009



IMF Foreign Exchange Reserves - Yen, Constant Terms



➤ 8% of FX Reserve increase since 1999 accounts for other currencies and valuation

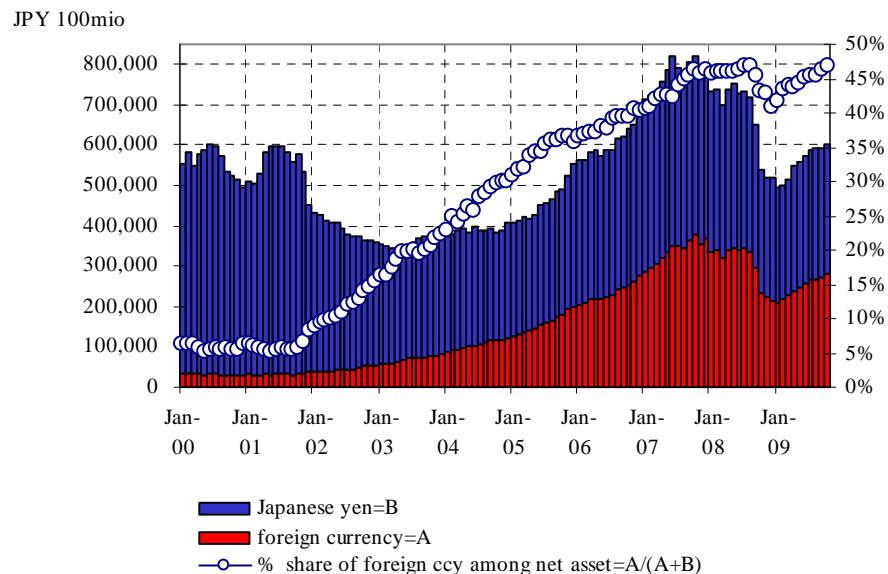
➤ JPY holdings down from peak of 6.1% in 2000

Retail Investor Flows



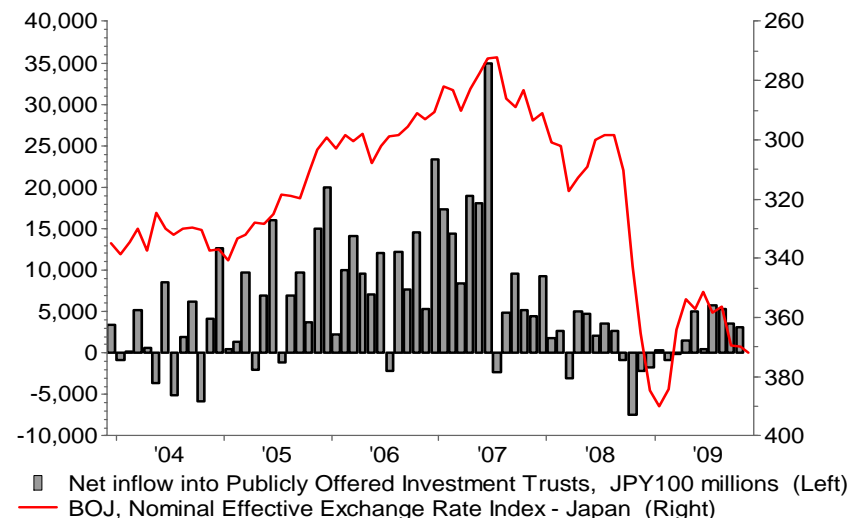
Retail Appetite for Investment Trusts Yet to Recover Notably

Net Asset of Japan's Investment Trusts



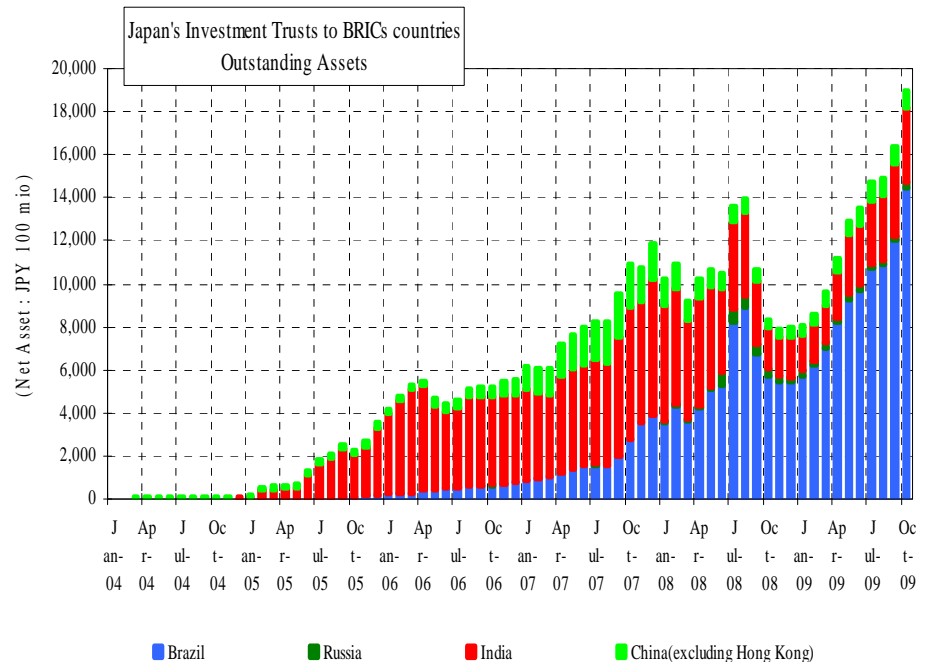
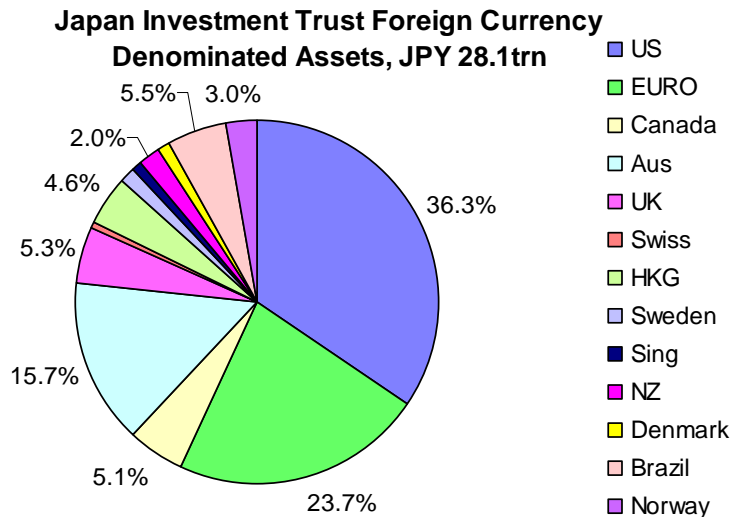
➤ **46.8% of Publicly Quoted Inv Trust total in foreign currency denominated assets as of Oct 2009**

Net New Investment Trust Inflows vs JPY



➤ **But retailers' net new flows 3mth average just JPY 360bn – risk appetite is muted**

Retail Sector Diversifying from Major Developed Markets

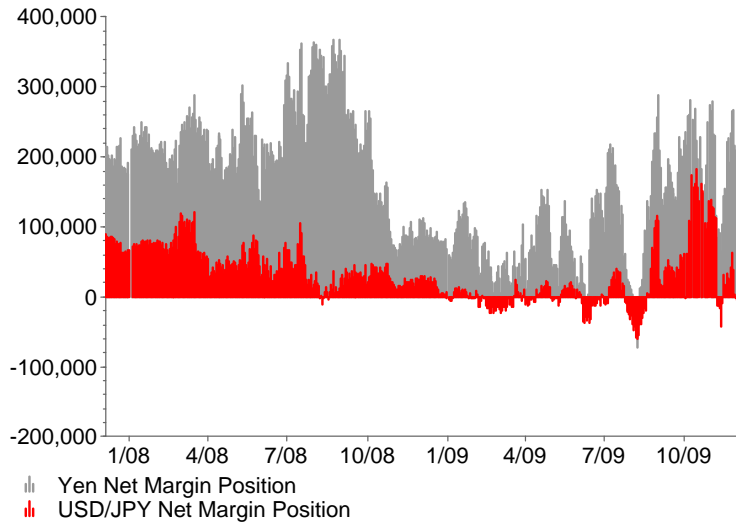


➤ In December 2004 USD assets was 47% of total

➤ Emerging markets benefit most – Brazil in particular

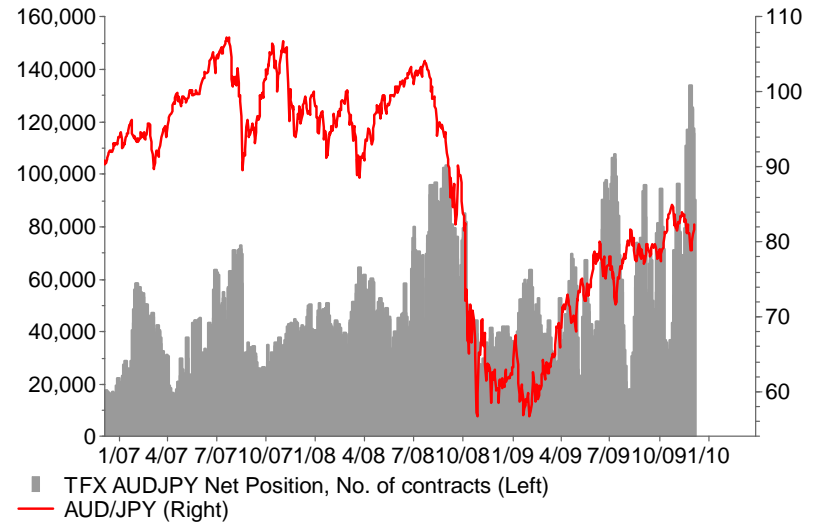
Retail Margin Flows Chasing Yield Again

Overall TFX Margin Position vs USD/JPY



➤ Retail FX Margin traders shift to directional focus in USD/JPY

AUD/JPY vs TFX Margin Position



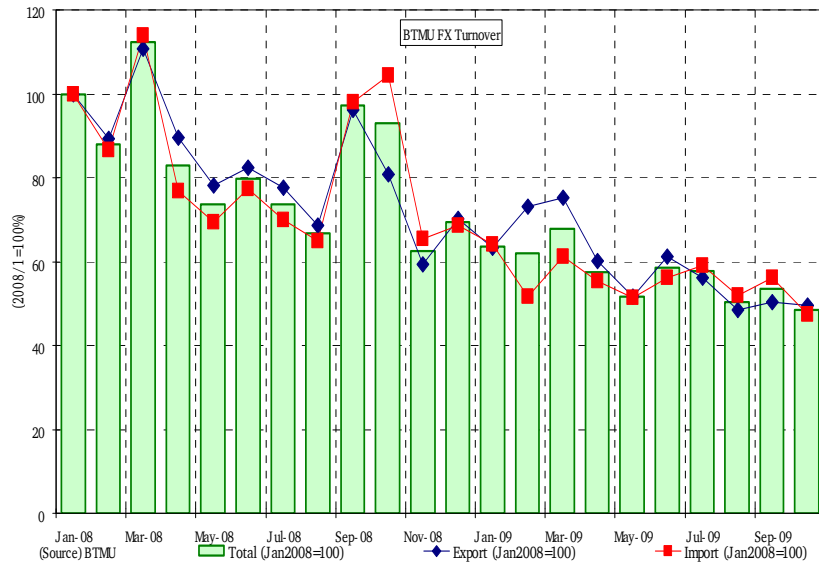
➤ Yield focus still firm with AUD/JPY which accounts for 61% of total TFX yen short positions

Japanese Corporate Flows



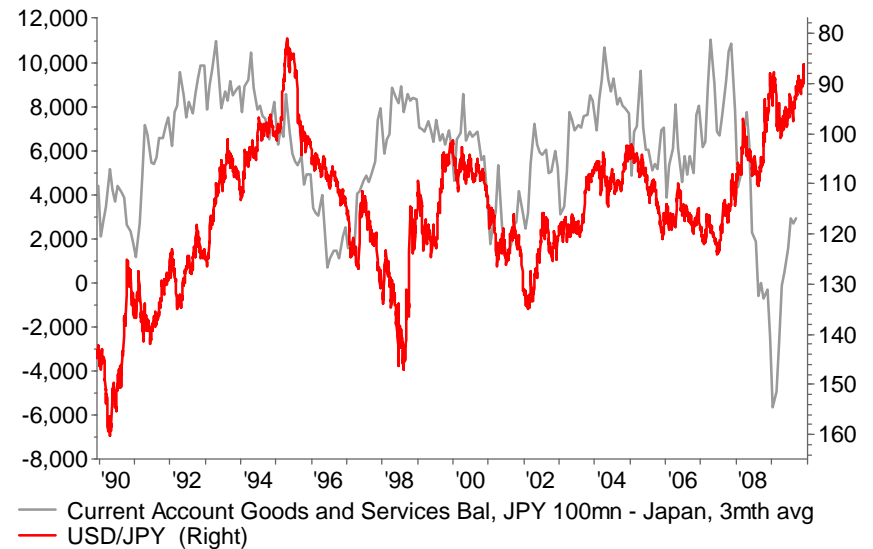
Japanese Corporate Hedging Activity Yet to Pick Up

BTMU Internal Corporate Flow Monitor (Index Jan 2008)



➤ Internal Corporate flows yet to replicate upturn in exports, Oct 2009 a new post-crisis low

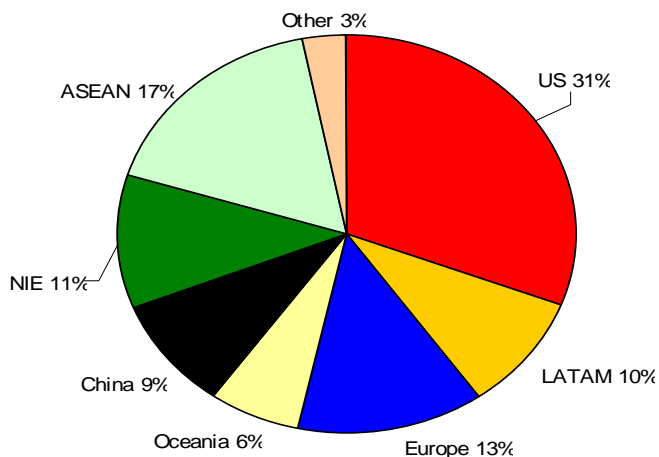
Japan Trade Balance vs USD/JPY



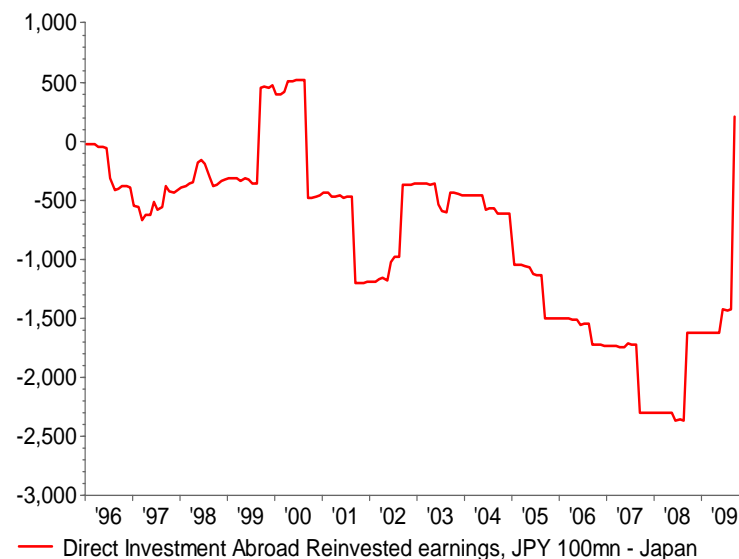
➤ Annual export growth to Asia rebounding most notably

HIA Repatriation Impact Evident but Yen Impact Modest

Retained Foreign Earnings FY 2007
JPY 20,321bn



Direct Investment - Reinvested Earnings



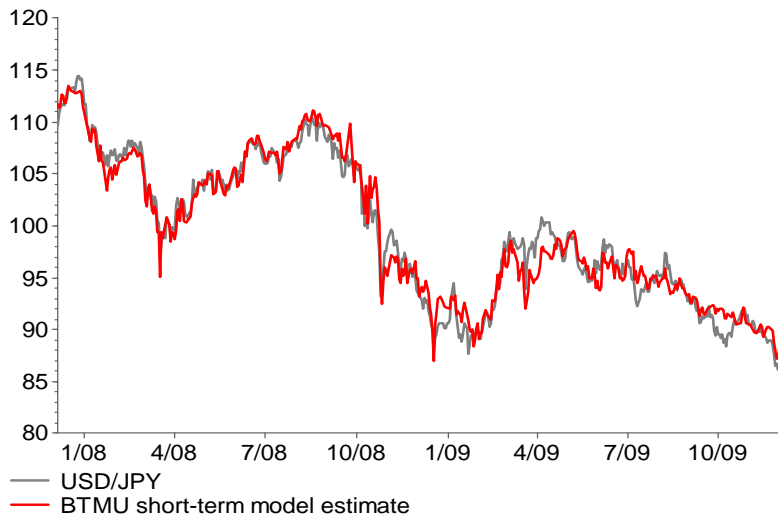
	Japan	Ireland	Hungary	Hong Kong	Singapore	Malaysia	Vietnam	UK	Mexico	Poland	Australia
Income tax rate	N/A	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	10.00%	0.00%
Corporate tax rate	40%	12.50%	16.00%	17.50%	18.00%	26.00%	28.00%	28.00%	28.00%	19.00%	30.00%
Total	40.00%	12.50%	16.00%	17.50%	18.00%	26.00%	28.00%	28.00%	28.00%	29.00%	30.00%
Tax rate differential with Japan	N/A	-27.50%	-24.00%	-22.50%	-22.00%	-14.00%	-12.00%	-12.00%	-12.00%	-11.00%	-10.00%

USD/JPY Outlook



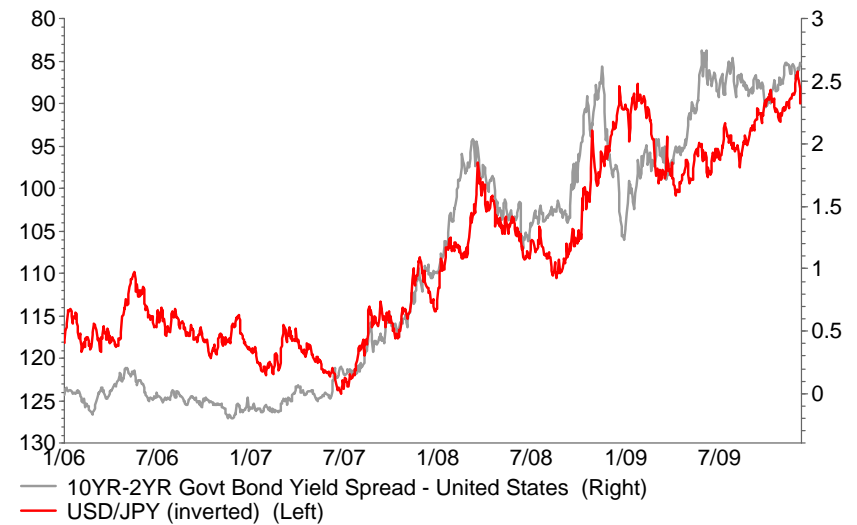
Fed Policy Turn in 2010 will Prompt USD/JPY Rebound

USD/JPY Short-term Model



➤ Yield based short-term model implied fair value at approximately 90.00.

10-yr-2yr US Yield Spread vs USD/JPY



➤ Fed induced flattening will mark turn for USD/JPY

Yen Carry Unwind Complete & Retail Investor Outflows to Re-emerge

Short-term Lending vs USD/JPY

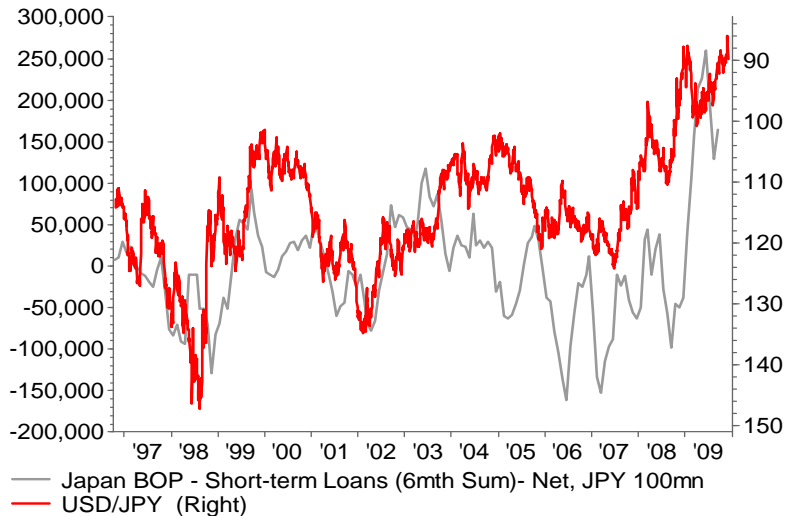
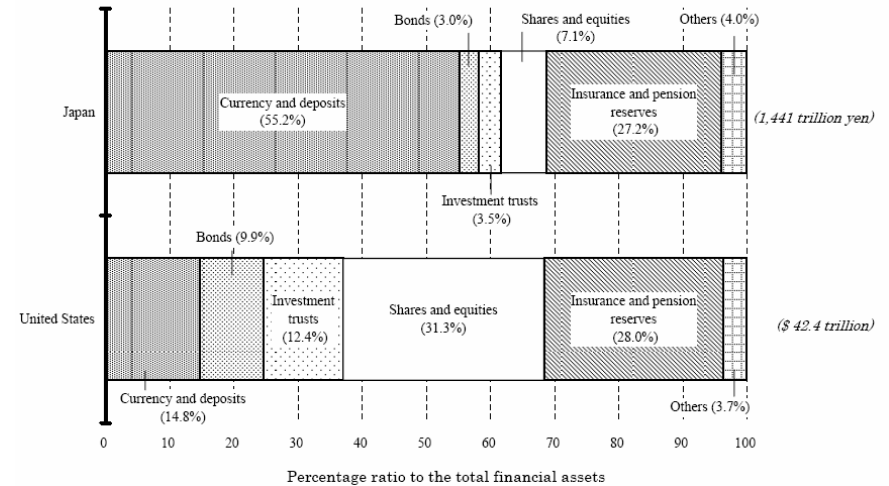


Chart 2 Financial assets held by households (End of June 2009)



Source :BOJ

➤ Massive reversal (JPY 31trn) appears complete

➤ Impact of Financial Big Bang (1998) interrupted by Financial Crisis

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