Macro Thesis

Thesis

Although the market consensus anticipates the Bank of Japan (BoJ) policy rate **to reach 1% by 3Q26**, we believe that the normalization path is likely to be more gradual. We think that interest rate hike would happen **around late Q3 or Q4**, which leads to an attractive opportunity to **short JPY against USD** due to USD's status as a safe-haven asset during geopolitical tensions. We anticipate traders panic-selling JPY as BoJ continues holding low interest rate through Q3, leading to a profit for short positions as yen weakens

Drivers for BOJ Policy Rate Decision

CPI	• BoJ Governor Kazuo Ueda has indicated that the primary driver for policy decisions will be the CPI releases in the summer • CPI helps assess Japan's financial situation among current macroeconomic uncertainty
Oil	• Decrease in oil price will ease the inflation in Japan • Allows BoJ to further raise interest rate without the risk of triggering a recession
Stability	• De-escalation in the Middle East would lead to reduced macroeconomic uncertainty • Provides BoJ a clearer path to setting goals and raising rates

Current Macroeconomic Trends

Japan's reliance on energy imports

- ~**95% of its oil** is imported, making the economy particularly exposed to commodity price shocks
- Higher oil prices feed directly into **producer & consumer inflation** through increased transportation, utility, and input costs

Market believes that Japan will maintain a **cautionary outlook** but remain committed to **normalizing their interest rate**

- Japan current faces high import cost due to weak JPY, and further raising interest rate could risk recession

Market Pricing

Market Expectation

- The market expects the spread of USD/JPY to narrow by **Federal rate cuts** and **BoJ policy rate adjustment** by Q3 2026
- The expectation **underestimates** how long the US–Japan yield spread will remain wide for the next 3 months

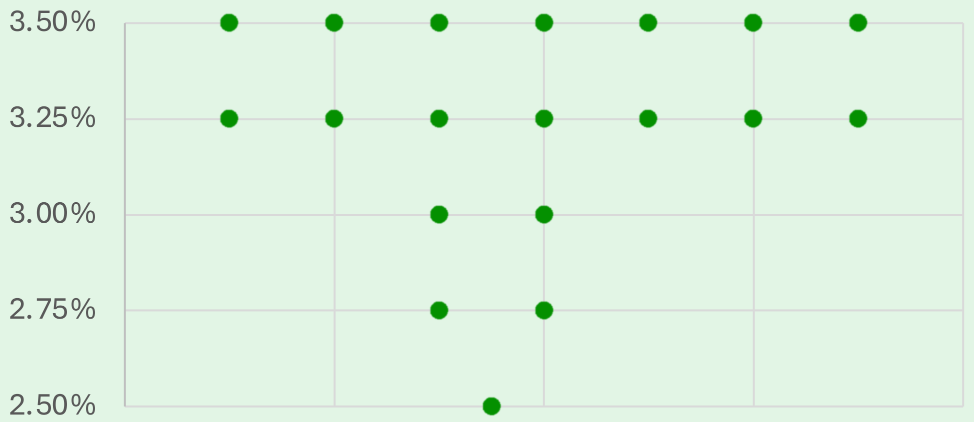
1 160 USD/JPY has been viewed as an **intervention ceiling**

2 Federal rate cuts of at least **25bps** is expected by the end of 2026

3 Market believes Japan's **rate hike** will happen by 26Q3

Dot Plot of Fed Funds Rate – Yearend 2026

Fed will prioritize 2.7% PCE inflation over unemployment



FOMC Summary of Economic Projections and Bondsavvy calculations

BoJ Intervention

2024: Japan spent **$100B+** intervening **when USD/JPY > 160**

- Net short is low (~16k vs. 180k) → yen is fundamentally weak
- Japan imports ~95% of oil → **petrodollar system** established in 1970 so must sell JPY, buy USD → Intervention (selling USD) reduces reserves for energy

Bank of Japan (BoJ) Monetary Policy

- March 19, the BoJ maintained short-term interest rate at 0.75%
- Two new more conservative board members added
- Stronger wage growth is recent for Japan and raising rates now will discourage the recent recovery
- Consumer spending fell 1.0% YoY in 26Q1, missing expectations of a 2.5% increase, signaling weak domestic demand

Catalysts and Risks

Monetary Policy Catalysts

April 28-29 US FOMC Meeting: expect the Fed to **hold rates** due to rising inflation, especially with regards to oil prices

PPI index hit 3.4% 0.7% increase, above 0.3% expected

Powell (**inflation > unemployment**) likely to in chair position due to Warsh confirmation issues

Market not pricing in rate cut for April meeting; now **12%** chance of hike to 3.75-4%

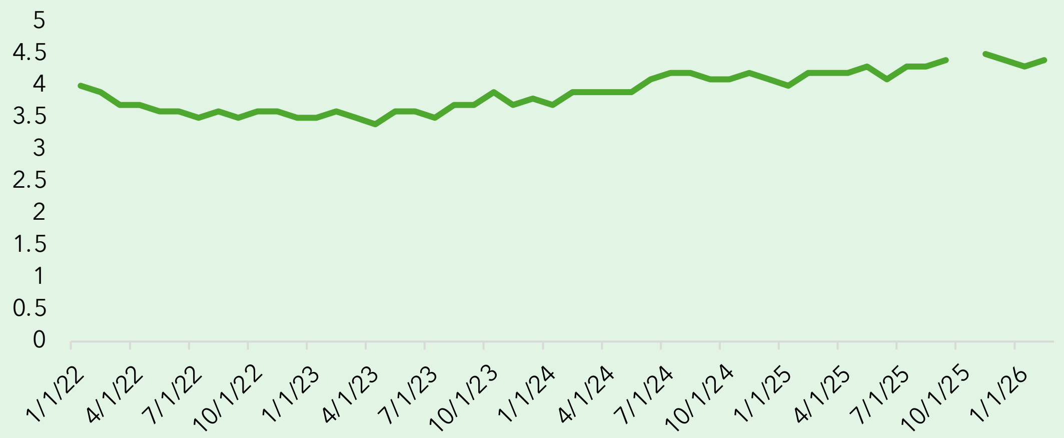
Risks

- Current dollar appreciation is dependent on war; President Trump promises quick end
- June 15-16 BOJ Meeting: Japan may continue rate-hike cycle (Takata = hawkish) if oil prices drop
- Potential BOJ intervention: Spent $68 million buying yen using dollars in 2022 to prop up Yen
- Rising US unemployment: 92,000 jobs lost in February; unemployment rate rose to 4.3%; Kevin Warsh leans dovish

Geopolitical Catalysts

- Iran War set to continue, leading oil prices to continue rising
    - Repeated **missile hits** (South Pars Gas Field, Fujairah Oil Industries Zone, Ras Laffan Industrial City); will escalate given 3/21 ultimatum issued
    - **Dollar appreciates** as war stretches beyond anticipated timeline and US lacks coalition support
    - Investors valuing **USD over Yen as safe-haven** due to US history of energy independence
- Japanese reliance on foreign oil**: 95% imported**; recent Bank of Japan meeting noted that economic slowdown could occur if oil fails to stabilize

Total US Unemployment Rate, 1/1/22 – 1/1/26



Trade Setup

Trade Structure

- **Direction**: Long USD/JPY | Instrument: Spot FX
- **Implementation**: borrow JPY → sell JPY → buy USD, hold for time window → convert to/buy JPY
- **Time Horizon**: 3-months
- Entry: 157.634 | Stop Loss: 156.720 | Target: 159.841
- Risk/Reward Ratio: 2.207/0.914 = 2.415
- **Carry**: 3.5%–3.75% - 0.75% = ~+3.0% annually, translating to 3.0% * (90/365) ~0.74% over 3-month period

Macro Rationale

Long USD/JPY

- Fed expects keep rates higher for longer (sticky inflation)
- BoJ likely to remain behind curve on tightening
- Positive carry supports holding position

3-month window

- Positioned before more dovish Warsh
- USD/JPY already strong

Quantitative Rationale

- **Entry: ~157.634**
  - Middle of pivot (157.329-157.837)
  - Enter after confirmation
- **Stop Loss: ~156.720**
  - Below pivot zone (157.329-157.837)
- **Target: ~159.841**
  - Near upper resistance zone (159.638-159.943)
  - Realistic with midday rates
- **Risk/Reward**
  - Risk = Entry – Stop Loss (157.634 -156.720 = 0.914)
  - Reward = Target – Entry (159.841-157.634 = 2.207)
  - Win rate = 1/(1+R:R) (1/(1+2.415) = 29.28% meaning trade only needs to be correct ~30% of time to break even

Risk and Reward Framework

Total Reward = **Price Change** + Carry

Expected Upside

- Wide policy **rate differential persists**: Fed 3.50–3.75% vs BoJ ~0.75% → ~275–300bps (+) carry
- Positive carry drives structural USD demand and trend persistence
- Fed **SEP median 3.4%** (2026) supports limited spread compression
- BoJ normalization stays gradual + conditional, reducing near-term tightening risk

Potential Downside

- Key risk: repricing of rate differentials (Fed easing/BoJ tighten)
- BoJ highlights yen weakness pushing inflation higher leading to tighter policy implementation
- Authorities signalled readiness to intervene around 160 mark
- Carry unwind / deleveraging
- Middle East conflict ends; Japan reclaims its "safe haven" title

Start (Entry: 157.634)

- Near upper bound of recent H.10 range, consistent with trend continuation and positive carry capture

Target Level (Current: 159.841)

- Increasing rate differential & USD demand
- Driven by persistent carry flows and worsened Middle East Conflict

Stop (156.720)

- Near lower bound of H.10 range, signalling trend breakdown; implies spread compression and weakening carry dynamics

Probability Analysis

- Bull case: Fed–BoJ rate divergence persists, supporting positive carry and stable positioning; USD/JPY increases
- **P/L:** If target met, **1.4%** + 0.74% *upside*
- Likelihood: High

- Moderate risk: Temporary downside from Fed repricing; temporary yield compression
- **P/L:** 0.74% *upside*
- Likelihood: Medium

- Tail Risk: BoJ surprise tightening or FX intervention triggers sharp, nonlinear yen strength via forced carry trade unwinds
  P/L: -0.58% - large *downside*
- Likelihood: Low

Appendix

Works Cited

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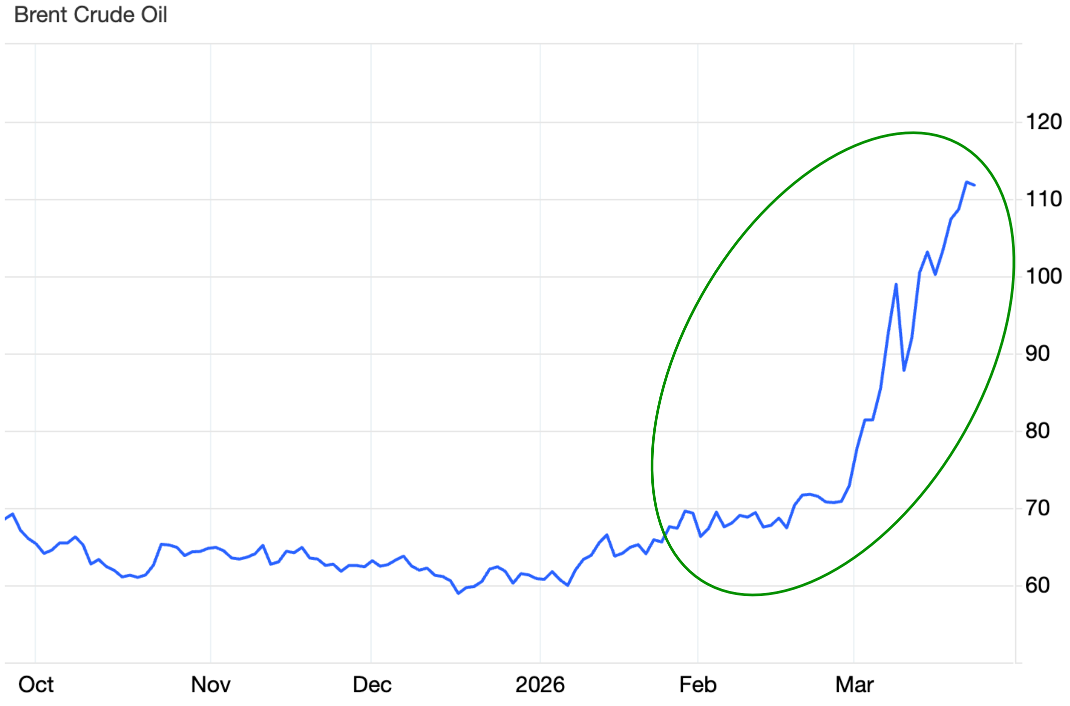
Information on Missile Strikes and Oil Prices



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