

30 August 2010

Flash Comment

Japan: BoJ expands quantitative easing

- Bank of Japan at an emergency meeting today expanded quantitative easing to stem the recent appreciation of JPY. However, its size was slightly disappointing and if risk sentiment in the market deteriorates further, today's move will not be enough to stabilize JPY.
- If today's move is not successful, we expect further monetary easing and eventually direct intervention in the FX market.

Details

At an emergency meeting called this morning Bank of Japan (BoJ) decided to expand its quantitative easing, hoping it will help stem the recent JPY appreciation. Quantitative easing was expanded by introducing a new 6-month credit facility in addition to the existing 3-month credit facility introduced in December last year. The limit for the new 6-month credit facility will be JPY10trn. The limit for the current 3-month credit facility is JPY20trn. The interest rate on both credit facilities is the O/N target policy rate currently at 0.1%.

In the policy statement BoJ argued that there is increasing downside risk to the economy because of "...increasing uncertainty about the future, especially the US economy" and "unstable foreign exchange and stock markets recently."

Board member Miyako Suda dissented from the introduction of the 6-month credit facility. Suda also dissented from the increase in the 3-month credit facility in March earlier this year, so this is not a big surprise.

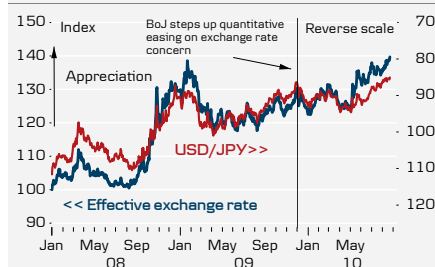
Impact:

Today's move by BoJ can certainly not be regarded as an aggressive one and is probably the least that could be expected. That said, Japan is again trying to draw a line in the sand on JPY and if today's measures are not successful there will be additional quantitative easing and possible even intervention in the FX market.

We do not expect intervention as it is regarded as ineffective as long as it is not done in a coordinated fashion and there is little support from the US and Europe. However, intervention could prove the final solution for Japan even if Japan has to do it alone. The current leadership contest within the ruling Democratic Party of Japan (DPJ) has in our view increased the likelihood of an intervention in the FX market in coming weeks if JPY fails to stabilise. The DPJ leadership is contested by current Prime Minister Kan and Ozawa and will be decided upon on 15 September. It should be remembered that the decision whether to intervene or not is a political decision (taken by the Finance Ministry) and the current Prime Minister Kan's leadership ability will to a large degree be judged by his ability to stabilize JPY.

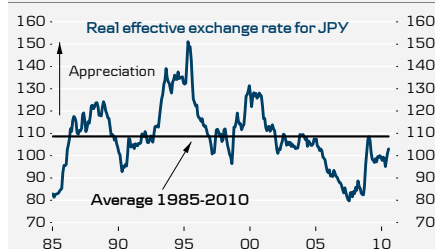
Tomorrow the government will announce new stimulus measures. However, it will be a modest stimulus package mainly demonstrating that there is little room to ease fiscal policy because of Japan's large public debt. In our view the decision to call the emergency meeting and not wait until next week's scheduled monetary meeting was

USD/JPY and effective exchange rate again at levels critical for Japan



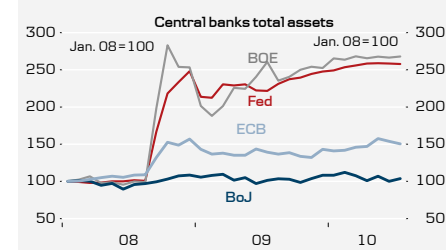
Source: Reuters Ecowin, Danske Markets

JPY is not significantly overvalued despite recent appreciation



Source: Reuters Ecowin, Danske Markets

Quantitative easing has been modest in Japan



Source: Reuters Ecowin, Danske Markets

Senior Analyst
Flemming J. Nielsen
+45 45128535
flemm@danskebank.dk

probably made in order to maximise the market impact.

JPY initially weakened to 85.91 against USD on the announcement of the emergency meeting, but as BoJ's response was a disappointment USD/JPY has moved back towards 85.00. While today's policy response should act to stabilise the JPY-crosses - and on the margin reduce further JPY upside - market risk appetite remains the key driver. This week will see the release of both the ISM indicator and non-farm payrolls in the US and with risks skewed to the downside on both numbers we could see renewed JPY demand and renewed downside pressure on USD/JPY and EUR/JPY. Only if risky assets do *not* see a renewed strong sell-off and USD rates do *not* continue the trend lower we expect today's policy response to be successful in stabilizing USD/JPY in the 85-90 range. To truly cap the downside risks in USD/JPY and EUR/JPY it will likely take further policy responses and in the end perhaps even a direct intervention.

Disclosure

This research report has been prepared by Danske Research, which is part of Danske Markets, a division of Danske Bank. Danske Bank is under supervision by the Danish Financial Supervisory Authority.

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high quality research based on research objectivity and independence. These procedures are documented in the Danske Bank Research Policy. Employees within the Danske Bank Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and to the Compliance Officer. Danske Bank Research departments are organised independently from and do not report to other Danske Bank business areas. Research analysts are remunerated in part based on the over-all profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Danske Bank research reports are prepared in accordance with the Danish Society of Investment Professionals' Ethical rules and the Recommendations of the Danish Securities Dealers Association.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors upon request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

First date of publication

Please see the front page of this research report for the first date of publication. Price-related data is calculated using the closing price from the day before publication.

Disclaimer

This publication has been prepared by Danske Markets for information purposes only. It has been prepared independently, solely from publicly available information and does not take into account the views of Danske Bank's internal credit department. It is not an offer or solicitation of any offer to purchase or sell any financial instrument. Whilst reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and no liability is accepted for any loss arising from reliance on it. Danske Bank, its affiliates or staff may perform services for, solicit business from, hold long or short positions in, or otherwise be interested in the investments (including derivatives), of any issuer mentioned herein. The Equity and Corporate Bonds analysts are not permitted to invest in securities under coverage in their research sector. This publication is not intended for retail customers in the UK or any person in the US. Danske Markets is a division of Danske Bank A/S. Danske Bank A/S is authorized by the Danish Financial Supervisory Authority and is subject to provisions of relevant regulators in all other jurisdictions where Danske Bank A/S conducts operations. Moreover Danske Bank A/S is subject to limited regulation by the Financial Services Authority (UK). Details on the extent of our regulation by the Financial Services Authority are available from us on request. Copyright (C) Danske Bank A/S. All rights reserved. This publication is protected by copyright and may not be reproduced in whole or in part without permission.

This publication has been prepared by the correspondent of Auerbach Grayson & Company Incorporated ("AGC") named above on the date listed above.

We are distributing this publication in the U.S. and any U.S. person receiving this report and wishing to effect transactions in any security discussed herein, should do so only with a representative of Auerbach Grayson & Company Incorporated. Additional information on recommended securities is available on request.