

# YEN'S STRENGTH AND EURO'S WEAKNESS

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## *Strong Yen and Weak Euro: A Common Background*

Recently, the Japanese yen and the euro are moving in opposite directions. The yen has jumped to 101 a dollar, whereas the euro was down to almost one to one parity with the dollar. The recent yen's movement, however, seems to share a common background with the euro's weakness.

Many market participants thought they should raise the proportion of the yen in their global portfolio from the past underweight level to a neutral level because Japan demonstrated a relatively sturdy recovery and its domestic stock market became bullish. In lieu of buying the yen, they have sold off the euro and euro-denominated assets because the Euroland's main economic indicators have been set back in contrast to the previous forecasts. Furthermore, both German and French governments have hesitated to implement strong restructuring measures after being severely criticized for extensive fiscal reforms including a large-scale pension cut. Therefore, the yen's rising trend has been reinforced by the euro's drastic decline.

Japan wants to restrain the yen's value because a strong currency makes the country's exports less competitive and erodes manufacturers' overseas earnings, potentially undermining one of the key components of Japan's economic recovery. However, as of now, the modest intervention by the Bank of Japan (BOJ) ultimately showed little outcome because efforts to curb the yen's appreciation against the dollar cannot be successful without the help from monetary authorities in the U.S. and the Euroland.

## *Yen Around 102~104*

However, the yen's psychological resistance line, the 100 level, is likely to be maintained, facing the slow economic recovery. The July-September gross domestic product report which was released in December shows a larger-than-expected 1.0% drop. Even though Japan's economy is picking up, private consumption is still sluggish and facility investment needs more time to rebound. In fact, as for now, market participants have been somewhat overestimating the intrinsic value of the yen and yen-denominated assets, not taking into consideration that Japan's immediate self-sustained recovery may gear up only in the first half of next year. Therefore, investors will no longer feel enthusiastic about the yen for a while, as Japan's bullish stock market is going through a correction. In addition, the BOJ will flexibly supply liquidity to the short-term money market, thus inducing the interest rates to gradually fall toward the zero level.

On the euro's side, economic figures such as German and French industrial production data are expected to eventually rebound from the earlier part of next year. In fact, many investors in foreign exchange market have experienced substantial decline in their euro-denominated assets, so the recent overselling sentiment may change if they begin to share a perception that the downward correction has lasted for an enough period of time, especially vis-à-vis the expected economic rebound.

In conclusion, as market players adjust positions, the yen will edge up and down in the 102~104 yen/dollar range and the euro between \$1.03~1.04 in the coming weeks. **VIP**