The Yen Takes On A Haven Role

Inquiring minds have wanted to know at various times over recent years why either the yen or the euro were worth anything after numerous and florid attempts to destroy both. Putting aside the snippy, “Because I said so!” answer, the yen had value because its implied real short-term rates were high. The euro had value because of an even odder pair of reasons: In the event of a breakup, the stronger economies’ legacy currencies (the Deutsche mark, Finnish markka and Dutch guilder) would firm on their own while the weaker economies’ legacy currencies (Greek drachma, Portuguese escudo, Italian lira and Spanish peseta) would see short-term interest rates rise.

Or, you could just go with the “Because I said so!” answer for tweeting and television soundbite purposes.

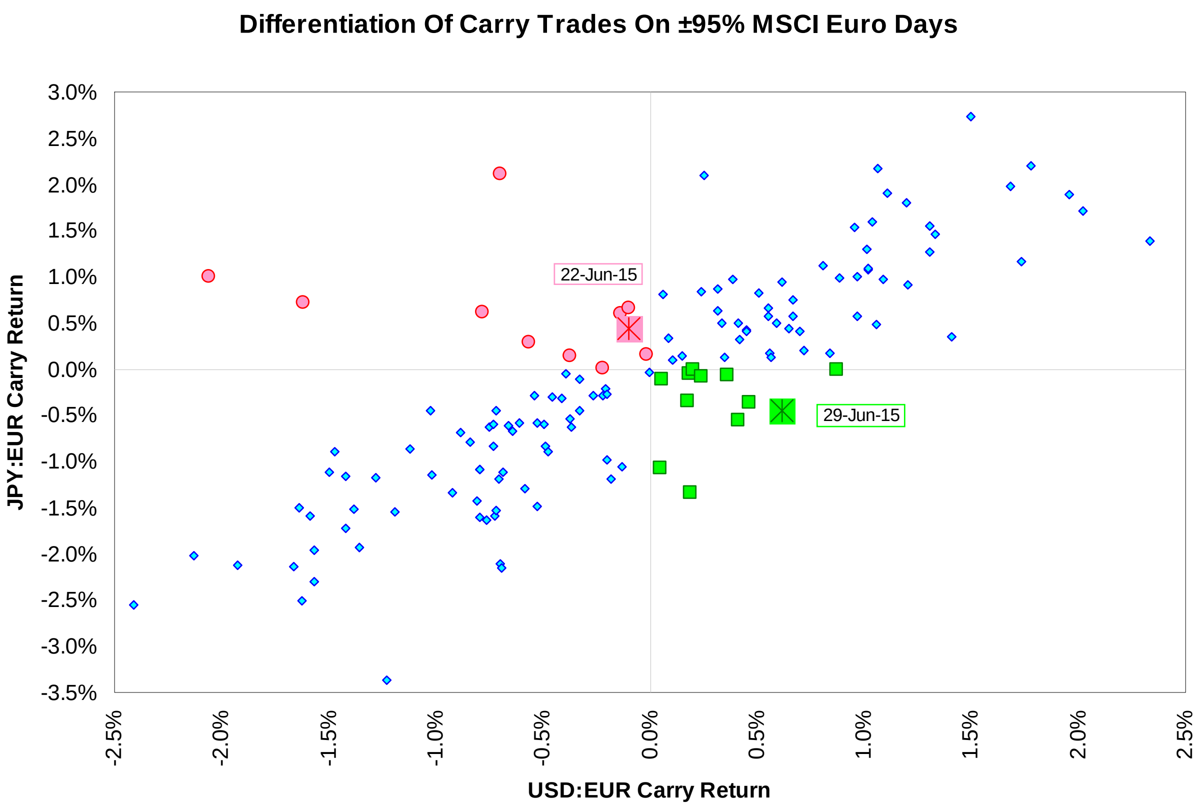
Flight Into The Yen

One of the factors dampening market reactions to the ongoing Greek situation is most traditional haven markets have become so overpriced they make little sense as the destination for flight capital. Gold remains in a downtrend, Eurozone sovereign debt rejected the most extreme aspects of negative interest rates back in April, U.S. Treasuries are facing the real possibility of having to deal with rising short-term interest rates and high-yielding equities such as REITs and utilities have been moving lower in anticipation of those same rising rates. Most clearing firms probably look askance at the CHF as a haven currency after January’s demolition derby.

The JPY is showing signs of becoming a haven currency after the Bank of Japan signaled in June its desired decline had moved far enough. This haven attribute can be seen in the very sparse data sample below of days when the MSCI Euro index moved outside of a ±95% confidence interval since the first inklings of Eurozone sovereign debt problems in October 2009.

The USD:EUR and JPY:EUR carry returns on those days are mapped against one another. On 118 of the 142 data points, marked in blue, the two carry trades had the same sign. On 12 days, marked in green, the EUR strengthened against the USD and weakened against the JPY. This happened most recently when Eurozone equities sold off on June 29, 2015.

On another 12 days, marked in pink, the EUR strengthened against the JPY and weakened against the USD. This happened most recently when Eurozone equities rallied strongly on June 22, 2015.



The most significant deterrent to any increase in U.S. short-term rates by the Federal Reserve has been and will continue to be a too-strong USD; the definition of what is “too strong” will be made at the time and will carry all of the intellectual heft of my “Because I said so!” A continuation of the possibly emergent role of the JPY as a haven will lower this impediment to the Federal Reserve’s desired first rate hike.