FOREX FOCUS: A Good New Year For The Yen

By Nicholas Hastings
A DOW JONES NEWSWIRES COLUMN

FOREX FOCUS: A Good New Year For The Yen

LONDON (Dow Jones)--The yen will start 2011 on a high note.

A topping out of U.S. Treasury yields should keep it rising against the dollar, while the failure of European leaders to agree on a long-term solution to the sovereign debt crisis will keep it well supported against the euro.

Even the continued speculation of further monetary tightening in China will work in the yen's favor--pushing it up against more risky currencies.

This is in stark contrast to the yen's performance in the final weeks of 2010.

Then, the prospect of higher growth in the U.S. and the possible end to quantitative easing were enough to drive U.S. yields sharply higher.

Given the close correlation between yield differentials and the performance of the yen against the dollar, the Japanese currency found itself under steady selling pressure.

But, as the year draws to a close, U.S. yields are showing signs of topping out and support for the U.S. currency is starting to wane.

Fears that the new fiscal easing in the U.S. will push the U.S. budget deficit even higher, at a time when most other governments are cutting spending, could also undermine the dollar in the long-term.

As far as the euro is concerned, the yen could also find itself breaking out of the narrow trading range that has prevailed over the last three months.

Developments in recent weeks have shown that despite a European Union-led bail out for Ireland, pressures on other peripheral debtors in the euro zone persist.

Of particular concern for euro investors is the inability of EU leaders to agree to some longer-term debt solutions and the growing signs that the core nations, i.e. Germany and France, are running out of the political will to continue subsidizing their poorer neighbors at the level needed to prevent a crisis in the single currency itself.

As the existence of the euro is called more into question, the yen will increasingly be seen as an attractive alternative to both the deficit-damaged dollar and the euro.

China is also contributing to the yen's rosy outlook.

Beijing's decision on Friday to increase Chinese bank reserve requirements once again, rather than hiking interest rates themselves, may have been disappointing.

However, speculation over another Chinese rate hike will continue.

Recent trade data, showing nearly a 38% increase in imports over the last year, illustrated the strength of the country's domestic demand. New consumer price figures are also expected to show the strength of inflation, with consumer prices rising even faster than economists had expected.

Any further monetary braking by China will only lower market expectations for global growth, making the yen attractive not only against commodity currencies in particular but also against risky asset markets in general as investors once again turn towards safe havens.

Bloomberg	TNI FRX POV
Reuters	USD/DJ
Thomson	P/1066 or P/1074

December 10, 2010 06:32 ET (11:32 GMT)