Forex Focus: A Losing Battle For The Bank Of Japan

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LONDON (Dow Jones)--This is one battle the Bank of Japan will still lose.

The central bank's attempt to weaken the yen against the dollar this week with more monetary easing may be more politically palatable than direct market intervention and even more cleverly designed to undermine the Japanese currency more over time.

But, its success is likely to be limited.

The dollar's weakness is still driven largely by U.S. policy expectations rather than anything else.

The yen will also still find support from continued strong safe haven flows in its direction as well as from Japan's continued current account surplus.

Sure, the Bank of Japan's decision to cut its target interest rate to zero and to introduce a Y5 trillion package of temporary asset purchases Tuesday shows its determination to prevent the yen from rising any more, despite the essential failure of last month's massive market intervention on September 15.

The further monetary easing also suggests that the central bank is now working more in harmony with the Ministry of Finance in the hope that together they can overcome Japan's persistent deflationary pressures.

A fall in the country's two-year government bond yields to a 5-year low and a decline in 10-year yields to a 7-year low certainly suggested that the central bank's move should help to reduce support for the yen.

Also, if the central bank decides to intervene against the dollar again, the looser monetary policy should help to increase the chances of at least some success.

There was talk late Tuesday in New York of Japanese players close to the government, in the market buying dollars but nothing concrete was confirmed.

However, the Bank of Japan's move has come only weeks before the U.S. Federal Reserve is expected to pursue its own increase in monetary easing.

Over the last few weeks, as the U.S. recovery has faltered badly, the Fed has made it plain that it is on standby to increase quantitative easing if needed. Fed Chairman Ben Bernanke upped the ante even more with a speech late Monday pointing to the success of the central bank's initial QE exercise and suggesting that more easing could help the economy avoid a double dip recession.

Of course, the size and extent of the Fed move will have some bearing on just how much the dollar is depressed.

However, the chance of the yen making a sustained decline against the dollar, and bringing some relief for Japanese exporters, will also depend on safe haven flows.

In recent months, the yen has remained very much in favor, as concerns over the global economic recovery has encouraged investment flows out of riskier asset markets, including the dollar, and into safe havens, such as the yen.

See how the dollar has continued decline against the yen since the Sept. 15 intervention:

http://www.dowjoneswebservices.com/chart/view/4687

The yen will also continue to find support from Japan's continued strong current account surplus, which ensures underlying support for the Japanese currency regardless of what the Bank of Japan and the Ministry of Finance are cooking up on policy.

Early Wednesday, the yen was holding very steady against the dollar--with the U.S. currency trading at Y83.15 at 0645 GMT compared with Y83.18 late Tuesday in New York.

The dollar was still under pressure elsewhere from expectations of further quantitative easing by the Fed next month.

The euro rose to $1.3853 from $1.3835 and to Y115.23 from Y115.11.

Bloomberg TNI FRX POV

Reuters USD/DJ

Thomson P/1066 or P/1074

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