

Liquid Insight

Case for a higher EUR/JPY

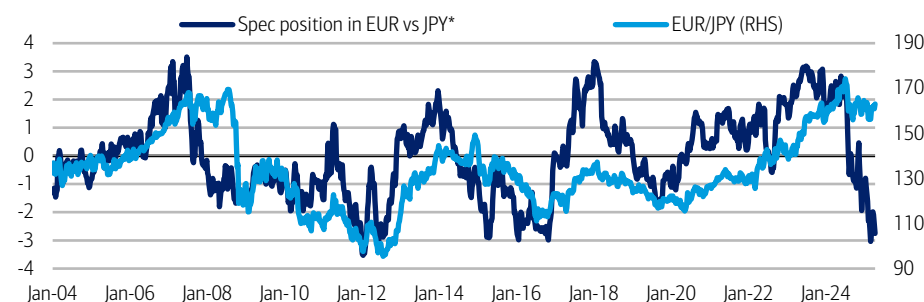
Key takeaways

- JPY's rise looks less persistent than EUR's: 1) stretched JPY long; 2) JPY's dispersed performance across market regime;
- 3) EUR's rise has accompanied an idiosyncratic story; 4) falling expectations for BoJ hikes vs surviving structural outflows.
- Watch US-Japan trade negotiations as key catalyst.

By Shusuke Yamada

Chart of the day: Spec positioning* vs EUR/JPY

EUR/JPY resilient despite c.a. 3SD difference in EUR and JPY positioning



Source: BofA Global Research, Bloomberg

Difference in Z-score since 2004 in non-commercial traders' position between EUR and JPY at CME

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JPY's rise more fragile than EUR's

Both JPY and EUR have gained c.a. 12% against USD year-to-date as the market seeks alternatives to USD. However, we think underlying dynamics differ and JPY's rise looks more fragile than EUR's: 1) JPY's rise has accompanied a bigger rise in speculative positioning and increasing focus on a potential US-Japan currency deal; 2) EUR's rise has been more persistent than JPY's across market regimes; 3) EUR's rise has been supported by an idiosyncratic story of German fiscal expansion; 4) JPY's rise has accompanied diminishing market focus on Bank of Japan (BoJ) rate hikes while structural outflows from Japan has gone out of market radar despite underlying flows surviving the market turmoil so far.

We think JPY's rise is more fragile than EUR's and a progress on US-Japan negotiations can lead to a reassessment of EUR/JPY's directionality to the upside (see: [Japan Viewpoint: US-Japan negotiations – potential policy and market implications 17 April 2025](#)). Risk is a severe slowdown in global growth, leading to a compression in EU-JP yield spreads and a stall or reversal in Japan's outflows. A trade friction between the US and Europe is another concern. A tail-risk is a bilateral "hard" currency deal between the US and Japan, but we think it unlikely.

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Rates and Currencies Research
Global

Global Rates & Currencies Research
MLI (UK)

Shusuke Yamada, CFA
FX/Rates Strategist
BofA Japan
+81 3 6225 8515
shusuke.yamada@bofa.com

Adarsh Sinha
FX and Rates Strategist
Merrill Lynch (Hong Kong)
+852 3508 7155
adarsh.sinha@bofa.com

Janice Xue
Emerging Asia FI/FX Strategist
Merrill Lynch (Hong Kong)
+852 3508 8587
janice.xue@bofa.com

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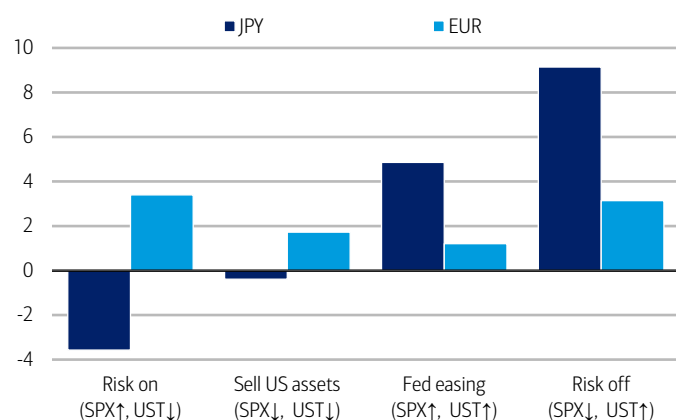
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JPY's rise looks less persistent than EUR's

- Non-commercial traders' record yen long position stands out. The difference between EUR and JPY positions in respective Z-scores since 2004 is at -2.8 (Chart of the day). The measure has not exceeded plus/minus 3 so often in the past. This time is unusual as the stretched positioning has not accompanied a notable price action in EUR/JPY. Discussion with our clients indicate the market has been increasingly focused on a potential US-Japan currency deal (more below).
- EUR's rise year-to-date has been more persistent than JPY's across market regimes. Exhibit 1 breaks market regime into four. JPY's performance has been more dispersed with its rise during risk-off and rising Fed easing expectations, its fall during risk-on, and its muted reaction to dual declines in US equities and bonds (market selling US assets). EUR has risen across all four regimes, including the one when both US equities and Treasuries fell. EUR could be a better alternative to USD.
- EUR's rise this year has accompanied a clear positive news for the currency, German fiscal expansion, which our European team sees as a game changer (see: [Liquid Insight: EUR in a less USD world 09 April 2025](#)). Japan's fiscal situation is clearly worse than Europe's, which may be limiting scope for fiscal expansion and its presence as an alternative reserve currency.
- Meanwhile, the market has changed its focus on JPY from BoJ rate hikes to the impact of US trade policies (see: [FX and Rates Sentiment Survey: No smile for the dollar 11 April 2025](#)). Our economists changed their call for the next BoJ hike from Jun 2025 to Apr 2026 (see: [Global Economic Viewpoint: Surfing the tariff wave 21 April 2025](#)). Japan's structural outflows, the idiosyncratic theme for JPY for the past few years, has gone out of the market's radar, but underlying flows have survived the market volatility so far (Exhibit 2).

Exhibit 1: JPY and EUR performance year-to-date by US market regime (sum of daily % changes)

EUR's rise appears more consistent while JPY's performance more dependent on market regime

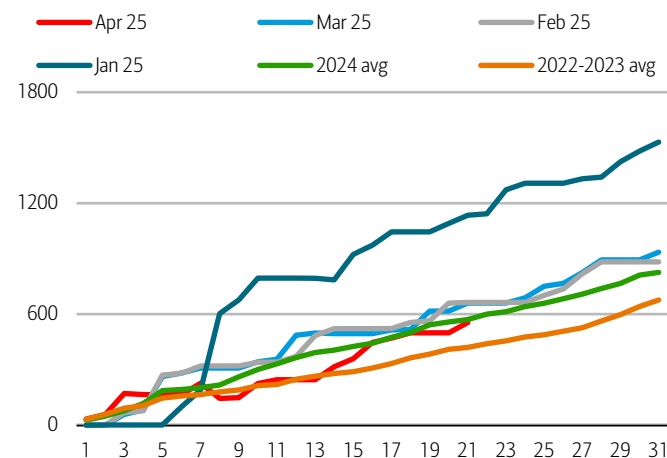


Source: BofA Global Research, Bloomberg

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Exhibit 2: Estimated net (average) cumulative inflow to major foreign asset Toshins by month (¥bn)

Retail investors have not slowed down investment in foreign equities



Source: BofA Global Research, Bloomberg

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US-Japan negotiations as a key catalyst

In our latest note, we argued that the risk is skewed toward a positive scenario for USD/JPY of an early US-Japan deal without a hard currency clause (see: [Japan Viewpoint: US-Japan negotiations – potential policy and market implications 17 April 2025](#)). Our argument is below:



1. Both governments may be incentivized to strike an early deal – Japan’s Ishiba administration would want a deal before the Upper House election on Jul 20 (Exhibit 4). An early deal could also benefit the US government after the market shock and as concern over stagflation looms.
2. A hard currency deal to realign USD/JPY may not be common ground for both. Giving up autonomy in currency and monetary policy would be too costly for the Japanese government. It could lead to significant selling in US Treasuries and USD by Japanese private investors, exacerbating the market turmoil. A currency deal could also be seen as less tangible than deals on specific products, such as LNG, rice and meat by the US government.

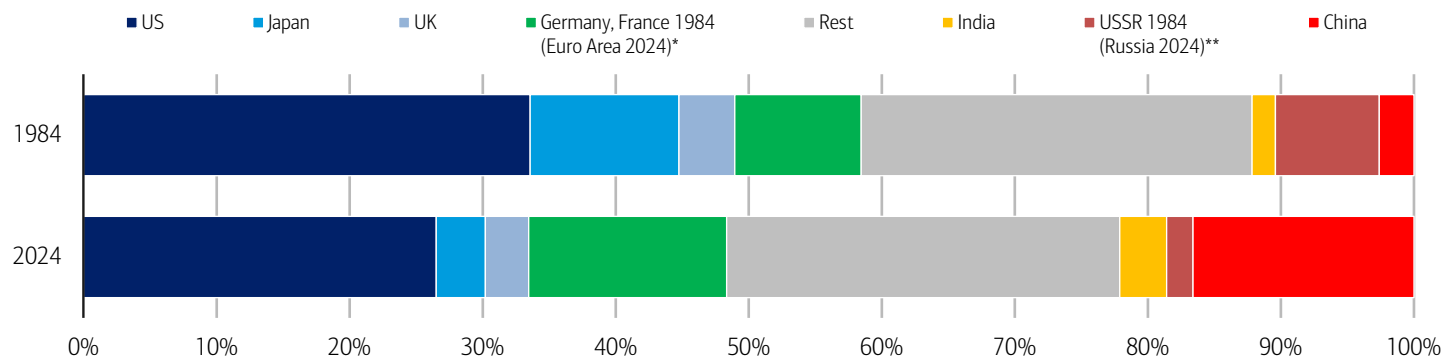
We also note that 2025 is different from 1985. Five countries of the Plaza Accord comprised more than 50% of the world GDP (Exhibit 3). Today, the US, Europe and Japan represent a smaller share of the world GDP with the European Union being a multilateral entity with a presumably more complex decision-making structure than a sovereign. With a higher hurdle for a multilateral accord, a bilateral deal risks disturbing the yen market.

3. Measures that could be more easily agreed on would mostly lead to capital flows from Japan to the US: Japan increasing imports from and investment in the US.

This positive scenario could be positive for G10/JPY as well on reduced general risk premium (Exhibit 1). Finance Minister Kato is expected to meet Treasury Secretary Bessent on Apr 24, according to media reports. Japanese negotiators, led by Economic Minister Akazawa, are also scheduled to meet their US counterparts. We closely monitor these meetings.

Exhibit 3: World GDP share (%)

US allies represent a smaller share of the world GDP today vs 1984



Source: BofA Global Research, Haver, Ministry of Economy, Trade and Industry (METI), United Nations

* West Germany and France for 1984, Euro Area for 2024

** Soviet Union for 1984, Russia for 2024

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Political and fiscal risk for JPY into summer

We also think the risk is skewed to a weaker JPY for Japan’s upper house election although it is too early as a market theme. A US-Japan deal could increase the Ishiba administration’s approval ratings from a depressed level but it is uncertain how much. While the government has decided to not compile a supplementary budget at this time, political parties may call for economic measures to offset the impact of increased US tariffs – a US-Japan deal could reduce tariff rates but the effective rate is still likely to be higher than before and legislators would be asked to “respond” by their constituents.

Unlike Germany, a scope for Japan’s fiscal expansion may be limited or it risks a higher fiscal risk premium, given Japan’s distinctively high debt to GDP ratio (Exhibit 5). Simply put, political and fiscal risk could increase around the Upper House election.

EUR/JPY higher

We recommended buying 1-year EUR/JPY call last month (see: [Liquid Insight: Flows and trades for Japan's new fiscal year 25 March 2025](#)). We think this trade still makes sense from a perspective of positioning, prospect for a US-Japan deal, and structural factors driving the two currencies (German fiscal expansion, Japan's structural outflows).

Risks

Risk is a severe slowdown in the global economy, leading to a compression in EU-JP yield spreads and a stall or reversal in Japan's capital outflows. A trade friction between the US and Europe is another concern. A tail-risk is a bilateral "hard" currency deal between the US and Japan but we think it unlikely.

Exhibit 4: Political calendar

Both US and Japanese governments likely want to strike a deal before Jul

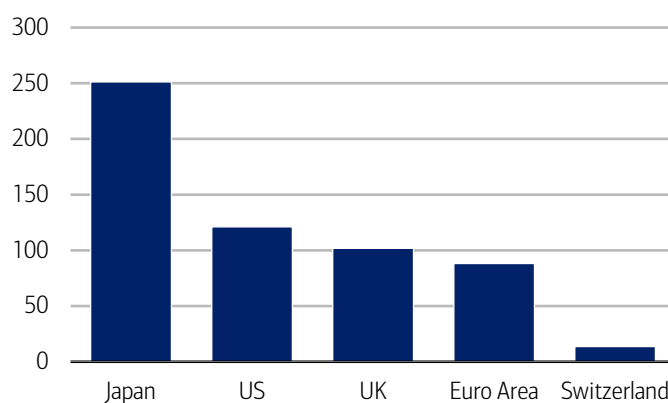
Date	Event
Apr 24	Fin Min Kato may meet Treasury Secretary Bessent
May 20-22	G7 Finance Ministers and Central Bank Governors meeting
Jun 15-17	G7 summit
Jun 22	End of ordinary diet session (extension possible)
Jun 22	Tokyo metropolitan diet election
Jul 4	US Independence Day
Jul 8	90 days since Apr 9
Jul 20	Upper House election
Jul 25	Scheduled end of US House session

Source: BofA Global Research

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Exhibit 5: General government debt outstanding as % of GDP

Japan's public debt stands out, limiting scope for fiscal expansion and diminishing JPY's presence as an alternative reserve currency



Source: BofA Global Research, Haver

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Notable Rates and FX Research

- **Global Macro Year Ahead 2025** – [Stretching the rubber band](#), 24 November 2024
- **Global Rates Year Ahead 2025** – [Continental Drift](#), 24 November 2024
- **G10 FX Year Ahead 2025** – [Policy Uncertainty](#), 26 November 2024
- [Euro's safe hands](#) **Liquid Cross Border Flows**, 14 April 2025

Rates, FX & EM trades for 2025

For a complete list of our open trade recommendations as well as our trade recommendations closed over the past 12 months, see the reports below:

[Global FX weekly: The bond market can intimidate everybody 11 April 2025](#)

Global Rates Weekly: The art of the repeal 11 April 2025

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Research Analysts

US

Ralph Axel
Rates Strategist
BofAS
+1 646 743 7011
ralph.axel@bofa.com

Paul Ciana, CMT
Technical Strategist
BofAS
+1 646 743 7014
paul.ciana@bofa.com

John Shin
FX Strategist
BofAS
+1 646 855 2582
joong.s.shin@bofa.com

Mark Cabana, CFA
Rates Strategist
BofAS
+1 646 743 7013
mark.cabana@bofa.com

Bruno Braizinha, CFA
Rates Strategist
BofAS
+1 646 743 7012
bruno.braizinha@bofa.com

Meghan Swiber, CFA
Rates Strategist
BofAS
+1 646 743 7020
meghan.swiber@bofa.com

Europe

Ralf Preusser, CFA
Rates Strategist
MLI (UK)
+44 20 7995 7331
ralf.preusser@bofa.com

Ruben Segura-Cayuela
Europe Economist
BofA Europe (Madrid)
+34 91 514 3053
ruben.segura-cayuela@bofa.com

Mark Capleton
Rates Strategist
MLI (UK)
+44 20 7995 6118
mark.capleton@bofa.com

Athanasios Vamvakidis
FX Strategist
MLI (UK)
+44 20 7995 0279
athanasios.vamvakidis@bofa.com

Sphia Salim
Rates Strategist
MLI (UK)
+44 20 7996 2227
sphia.salim@bofa.com

Kamal Sharma
FX Strategist
MLI (UK)
+44 20 7996 4855
ksharma32@bofa.com

Ronald Man
Rates Strategist
MLI (UK)
+44 20 7995 1143
ronald.man@bofa.com

Michalis Rousakis
FX Strategist
MLI (UK)
+44 20 7995 0336
michalis.rousakis@bofa.com

Pac Rim

Adarsh Sinha
FX and Rates Strategist
Merrill Lynch (Hong Kong)
+852 3508 7155
adarsh.sinha@bofa.com

Janice Xue
Emerging Asia FI/FX Strategist
Merrill Lynch (Hong Kong)
+852 3508 8587
janice.xue@bofa.com

Shusuke Yamada, CFA
FX/Rates Strategist
BofAS Japan
+81 3 6225 8515
shusuke.yamada@bofa.com

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