Executive summary

We think CHF/JPY is approaching a top or has already made a top early this year. Fundamental analysis suggest the downward potential for the FX pair is growing. Furthermore, the yen is from a historically perspective very cheap, while the franc is expensive. Assuming freely floating major FX currencies have mean reverting tendencies, the risk/reward of a short position in CHF/JPY seems very attractive.

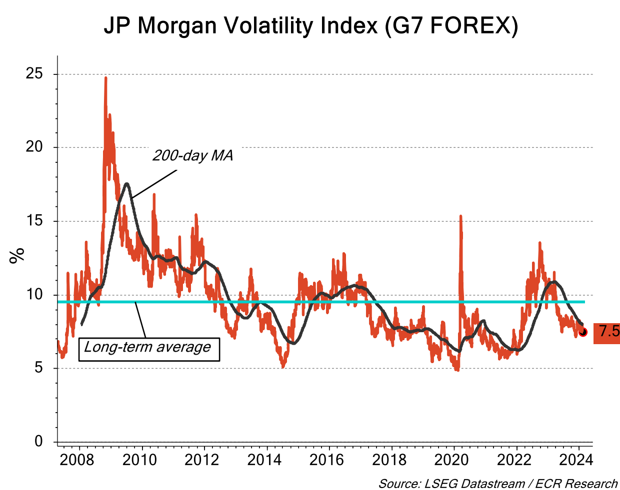
The risks are that from a chart-technical perspective the uptrend has been very strong (and may continue), while current interest rate differentials mean a short position has a negative carry.

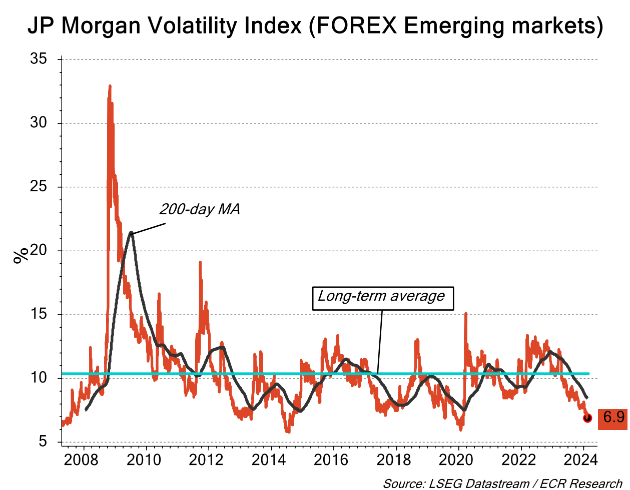
From a chart-technical point of view, a decline below minor support near 168.5 would be a first indication for a (larger) reversal scenario but a firm break below initial support near 160 is needed to confirm that an important top is already in place. Then, our confidence is high that CHF/JPY has begun a much larger bear trend towards at least 150.

Source: LSEG Datastream / ECR Research

Fundamental Analysis

Volatility in the foreign exchange market is low, especially for emerging market currencies. This makes FX carry trades more attractive. A FX carry trade is a strategy in which investors borrow in low interest rate currencies and invest in currencies with higher interest rates. This puts downward pressure on low-interest rate currencies and upward pressure on higher-interest rate currencies. Of the major currencies, the yen and Swiss franc are attractive funding currencies for these carry trades because of their low interest rates. However, relative to the yen, the Swiss franc is becoming increasingly attractive as a funding currency carry trade, despite Swiss interest rates being materially higher than Japanese yen interest rates:



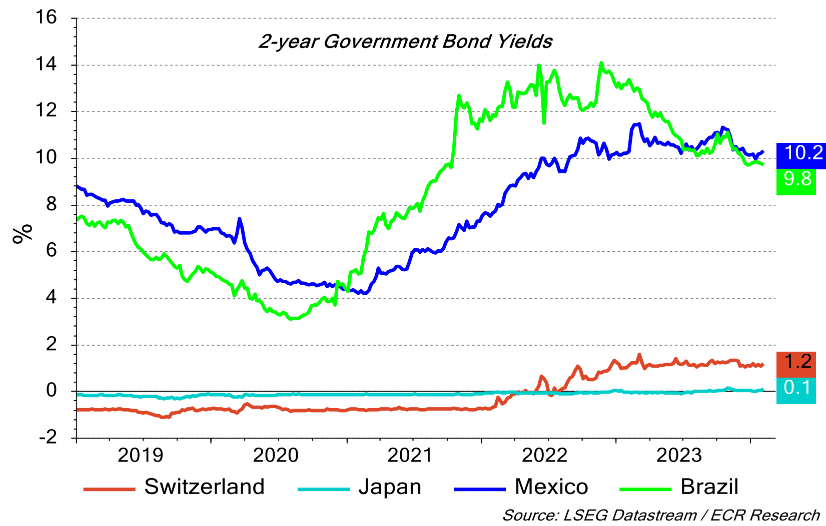


- The franc has become sharply more expensive in recent quarters and Swiss exporters are increasingly affected by this. On the contrary, the yen is historically very cheap and this is stimulating Japanese exports.

- The Swiss central bank (SNB) is expected to cut interest rates this year due to lower inflation, while the Bank of Japan (BoJ) is looking to make monetary policy less accommodative due to higher inflation. Given a wage growth of ‘regular workers’ of 2% for some time now, the BoJ is becoming more convinced that wages will contribute to pull Japan out of deflation in a structural way. Especially if headline inflation declines further and wage growth remain elevated due to the very tight labour market, real wages could turn positive lager this year. This will likely convince the BoJ the economy is strong enough to escape negative interest rates and limit the pace of quantitative easing (or stop QE at all). As we expect the ECB and the Fed will cut interest rates later this year, a tighter BoJ policy could significantly boost the yen.

- Because of lower inflation and the negative effects of the expensive franc, the SNB is now indicating that it sees the expensive franc as a problem, and because of this, we expect the SNB to stop deleveraging its balance sheet by selling foreign assets and using the proceeds to take francs out of the system. In Japan, the situation is exactly the opposite, where the cheap yen is

actually putting additional upward pressure on inflation and the BoJ will welcome a stronger yen as a means of keeping inflation from rising too far.



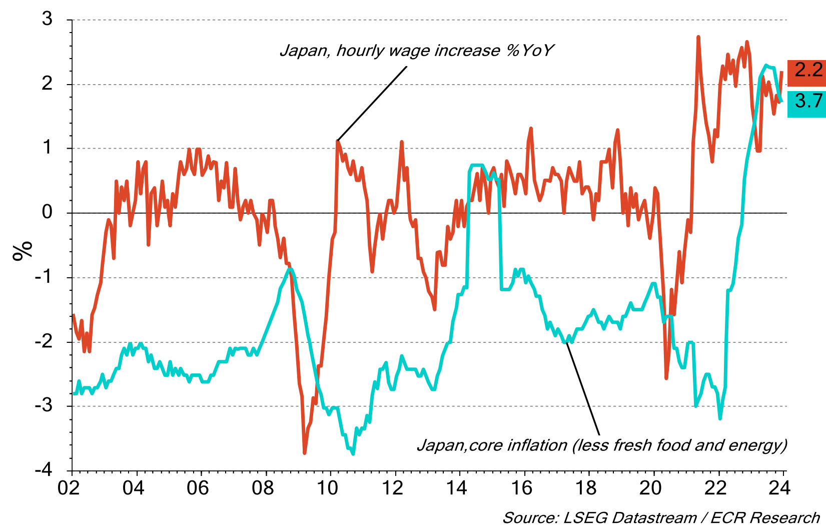


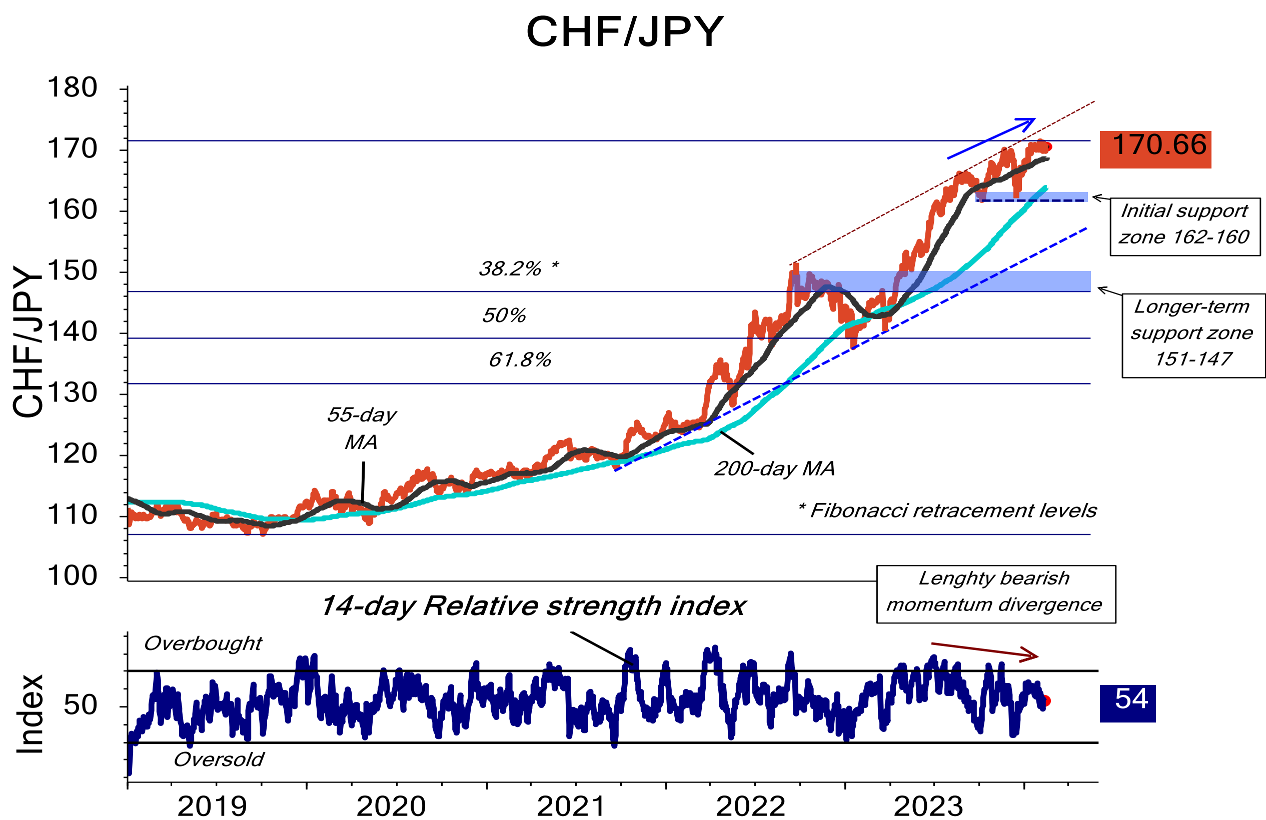
Chart-technical analysis

The rally of the past years can serve as textbook example of a strong upward trend with consecutive higher lows and higher highs. Objective measures of trend direction - the FX pair trades above both the rising 55-day and 200-day moving averages – indicate that this uptrend is still dominant.

At the same time, CHF/JPY hovers close to the upper end of the rising trend channel from recent years (read: strong overhead resistance). Also, the latest uptrend phase has started to show signs of bullish exhaustion, which increases the risk of a multi-month corrective process / decline. For example, note the longer standing negative momentum divergence (14-day RSI), which suggests that the latest rally has lost strength. However, this warning signal must be confirmed by a decline.

» In concrete terms, a decline below the 55-day moving average (currently near 168.5) to a significant degree (on a weekly closing basis), would signal another pullback towards the initial chart support zone 162-160. Still, provided that the FX pair stays at least above 160, we regard the longer-term outlook as (mildly) bullish. An eventual rally decisively above this month's all-time high peak at 172 would be a clear indication that CHF/JPY will extend its lengthy uptrend. If we extrapolate the rising trend channel, a further rise towards 175-180 in subsequent months or quarters can certainly not be ruled out in such scenario (experience has taught us that strong trends can often last longer than many think, and have greater odds of continuing than of reversing).

» To the contrary, a firm drop below 160 indicates at least medium-term topping and foreshadows a much larger falling phase, on balance towards the next potential support zone 151-147 (among others, this bearish target zone holds the 38.2% Fibonacci retracement of the preceding multi-year rise since 2019).



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