

FX Morning Adviser

Japan's Inflation Outlook

FX

Global

Adjusted Japanese core CPI decelerates, but energy prices up

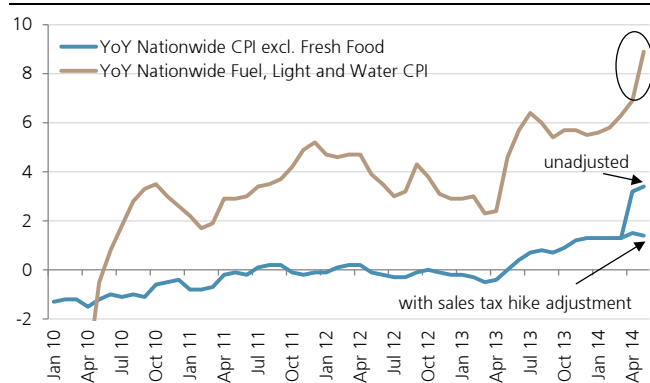
After adjusting for the effect of the April sales tax hike (subtracting 2.0% points from May CPI and 1.7% points for April CPI), last Friday's nationwide core CPI, which excludes fresh food prices, decelerated slightly to 1.4% y/y from 1.5% y/y in May. This deceleration was less than UBS Economics had anticipated, due primarily to rising energy costs, with fuel, light and water CPI up 8.9% y/y and 4.2% m/m (Figure 1).

Although we continue to expect inflation growth to slow, UBS Economics now believes inflation below 1% an unlikely scenario, in-line with comments on 23 June by Bank of Japan Governor Kuroda (see "Rate of inflation not less than 1%," 27 June 2014 by Daiju Aoki). As such, UBS Economics has revised upward its 2014 calendar year inflation forecast up 0.1%, to 2.7% y/y (unadjusted for sales tax hike impact) and now views the risk of additional BoJ easing to be a 5% probability event in Q3'14, 20% in Q4'14 and 45% in 2015, with a 30% chance of no additional easing.

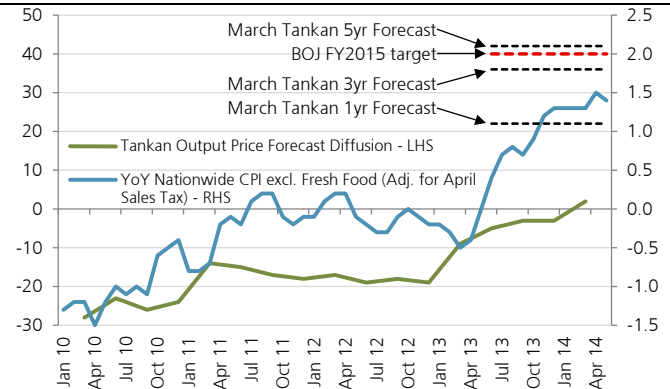
Tankan survey provides additional forward-looking data

With Friday's CPI data suggesting a reduced chance of additional easing, investors will now focus on this week's release of the quarterly Tankan survey, with particular attention paid to the new "Inflation Outlook of Enterprises" survey of output prices, first added in the March Tankan report. As a forward looking indicator, the one year "All Enterprise, All Industries" inflation forecast (1.1% y/y as of March) may weigh more heavily on the BoJ inflation outlook and market sentiment than historical CPI data. With only one reading released thus far, it is impossible to measure the predictive accuracy of this data release, but other existing Tankan inflation surveys have appeared accurate. The Tankan All Enterprises All Industries output price diffusion index, which measures changes in three month inflation expectations, has led historical CPI by 2-3 months (Figure 2). The March reading crossed into the positive territory for the first time since 2008, suggesting the inflation outlook continues to pick-up, albeit gradually.

Based on the new long-term output price inflation forecasts however, it would appear that corporate Japan is less optimistic than the BoJ, with one year inflation expected at 1.1% y/y (compared to FY2015 BoJ target of 2.0% y/y). The last survey suggests that Japanese enterprises do not believe inflation will cross the 2.0% threshold for another 3-5 years. As such, although this week's Tankan outlook may improve, it could still be a long way from the BoJ's own outlook. Additional easing remains our base case view.

Figure 1: Nationwide Core and Fuel CPI


Source: Bloomberg, UBS Calculations

Figure 2: Tankan Forecasts & Nationwide Core CPI


Source: Bloomberg, BoJ Tankan Survey, UBS Calculations

Technical FX

EURUSD	BEARISH	The latest upside moves appears to be just a recovery phase within a downtrend. Resistance should hold at 1.3677. There's scope for resumption of downside to test support at 1.3477 and then 1.3248.
USDJPY	BEARISH	Further selling increases the scope for a move lower to re-test critical support at 100.76. A breach of which would open 99.96. Resistance is at 102.36 ahead of 103.02.
GBPUSD	BULLISH	With the trending indicators bullish, there's scope for further upside to eventually test significant resistance at 1.7332. Setbacks in the interim will be limited in time and extent, with first support at 1.6923.
USDCHF	BULLISH	The latest setback doesn't yet change the bullish picture and any further downside should find supports at 0.8870 and 0.8831. Resistance is at 0.8975 ahead of 0.9082.
AUDUSD	BEARISH	Strong resistance focus is at 0.9461. While this holds, there's scope for extension of the range trading that has been in place since April. Support is at 0.9322 ahead of 0.9203.
USDCAD	BEARISH	The pair is under selling pressure and the subsequent weakness brings our focus on the critical support area marked at 1.0650 and then 1.0601. Resistance is at 1.0752.
EURCHF	NEUTRAL	The important near-term directional triggers are at 1.2192 and 1.2141. A closing breakout through one of these levels will determine the next leg.
EURGBP	BEARISH	The recent recovery has seen test of resistance at 0.8032, and as bearish conditions in place, there's scope for rejection and resumption from here to break through support at 0.7959 and then onto test critical 0.7755.
EURJPY	BEARISH	Support focus is at 137.71, as bearish conditions persist, a break through this level would extend the downtrend to 136.23. Resistance is at 139.18 ahead of 140.09.

***NOTE:** The trend for each currency pair as defined in the table is determined by our proprietary model and is independent of our discretionary interpretation of price action

Source: UBS FX Strategy

Key Events

Country	GMT	Release/Event	Freq.	UBS	Prev/Rev	Cons.	Actual
New Zealand	22:45	Building Permits (May)	m-o-m	n/a	1.90%	-2.50%	-4.60%
<i>Japan</i>	<i>23:50</i>	<i>Industrial Production (May P)</i>	<i>m-o-m</i>	<i>1.20%</i>	<i>-2.80%</i>	<i>0.90%</i>	<i>0.50%</i>
<i>Japan</i>	<i>23:50</i>	<i>Industrial Production (May P)</i>	<i>y-o-y</i>	<i>3.20%</i>	<i>3.80%</i>	<i>1.50%</i>	<i>0.80%</i>
Australia	00:30	TD Securities Inflation (Jun)	m-o-m	n/a	0.30%	n/a	0.00%
Australia	00:30	TD Securities Inflation (Jun)	y-o-y	n/a	2.90%	n/a	3.00%
Australia	01:00	HIA New Home Sales (May)	m-o-m	n/a	2.90%	n/a	-4.30%
New Zealand	01:00	ANZ Business Confidence (Jun)	Index	n/a	53.5	n/a	42.8
Australia	01:30	Private Sector Credit (May)	m-o-m	0.50%	0.50%	0.40%	0.40%
Australia	01:30	Private Sector Credit (May)	y-o-y	4.70%	4.60%	4.70%	4.70%
New Zealand	03:00	Money Supply M3 (May)	y-o-y	n/a	5.30%	n/a	5.20%
Japan	04:00	Vehicle Production (May)	y-o-y	n/a	3.40%	n/a	6.10%
Japan	05:00	Housing Starts (May)	y-o-y	n/a	-3.30%	-10.50%	
Japan	05:00	Annualized Housing Starts (May)	units mn	n/a	0.906	0.909	
Japan	05:00	Construction Orders (May)	y-o-y	n/a	104.90%	n/a	
Japan	05:00	Small Business Confidence (Jun)	index	n/a	46.6	n/a	
Germany	06:00	Retail Sales (May)	m-o-m	0.60%	-0.90%	0.80%	
<i>Germany</i>	<i>06:00</i>	<i>Retail Sales (May)</i>	<i>y-o-y</i>	<i>n/a</i>	<i>3.20%</i>	<i>1.00%</i>	
Sweden	07:30	Wages Non-Manual Workers (Apr)	y-o-y	n/a	2.60%	n/a	
Sweden	07:30	Household Lending (May)	y-o-y	n/a	5.20%	n/a	

Norway	08:00	Credit Indicator Growth (May)	y-o-y	n/a	5.60%	5.60%
Norway	08:00	Retail Sales W/Auto Fuel (May)	m-o-m	n/a	0.50%	-0.30%
Euro Area	08:00	M3 Money Supply (May)	y-o-y	n/a	0.80%	0.80%
UK	08:30	Money Supply M4 (May)	m-o-m	n/a	-0.20%	-0.10%
UK	08:30	M4 Money Supply (May)	y-o-y	n/a	-0.60%	-0.30%
UK	08:30	Net Consumer Credit (May)	GBP bn	n/a	0.7	0.7
UK	08:30	Net Lending Sec. on Dwellings (May)	GBP bn	n/a	1.7	1.6
UK	08:30	Mortgage Approvals (May)	lvl	n/a	62.9K	61.8K
Euro Area	09:00	CPI Estimate (Jun)	y-o-y	0.50%	0.50%	0.50%
Euro Area	09:00	CPI Core (Jun A)	y-o-y	n/a	0.70%	0.70%
Canada	12:30	GDP (Apr)	m-o-m	n/a	0.10%	0.20%
Canada	12:30	GDP (Apr)	y-o-y	n/a	2.10%	2.30%
United States	13:45	Chicago Purchasing Manager (Jun)	index	63.5	65.5	63.0
United States	14:00	Pending Home Sales (May)	m-o-m	2.50%	0.40%	1.20%
United States	14:00	Pending Home Sales (May)	y-o-y	-8.50%	-9.40%	-9.60%
United States	14:30	Dallas Fed Manf. Activity (Jun)	index	n/a	8	10
United States	16:10	Fed's Williams Speaks				

Source: UBS Global Economics, Bloomberg LP, Reuters LP, Reuters, Market News International