

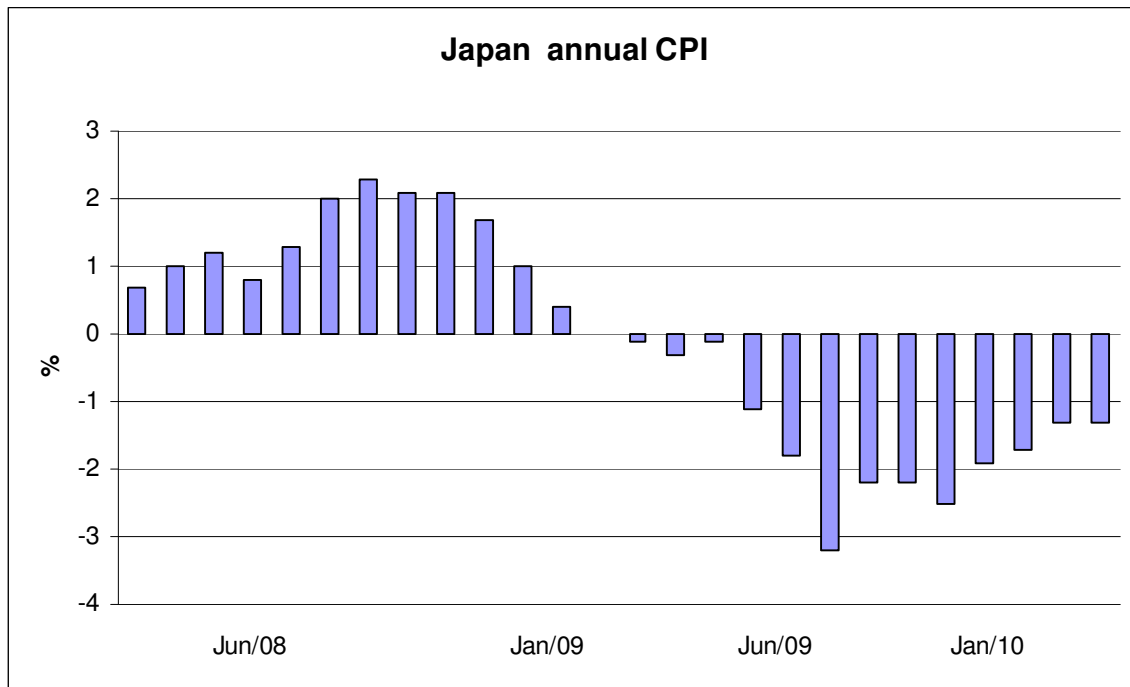
BOJ expected to raise CPI forecast

On April 30th, Japan is scheduled to release March CPI and the BOJ will conclude a one-day policy meeting. March CPI is expected to rise by 0.3% compared to 0.1% decline last month with the annual inflation rate declining by 1.2%. This would mark the 13th straight month that Japan's annual inflation rate has declined. Japan's annual inflation rate has been positive for only four months since 1998. The March CPI report is expected to confirm that rate of decline slowed but deflationary pressures continue in Japan and the. The Japanese government has pressured the BOJ to take aggressive actions to combat deflationary pressures. In March the BOJ doubled its lending program but stopped short of taking additional measures to combat deflation like buying government bonds to increase the money supply and liquidity.

Recent Japanese economic data points to improving Japanese economy. Japan reported that exports climbed 43.5% in March. This marked the fourth straight month of improving exports sales. The BOJ's March Tankan business sentiment survey confirmed improving business confidence and a smaller decline in anticipated CAPEX spending. The improvement in Japan's economic outlook makes it more difficult for the BOJ to justify additional easing monetary policy and contributes to a moderate drop in Japanese government pressure for the BOJ to ease policy. The moderate weakening of the JPY makes monetary conditions less tight and may help reduce deflationary pressure. USD/JPY bottomed at 86 last November and is currently trading near 94.

At April BOJ policy meeting the BOJ elected to hold policy steady and refrain from additional monetary ease. The BOJ policy statement said that the economy has been picking up but there is not yet sufficient momentum to support a self-sustaining recovery. The BOJ policy statement also said overcoming deflation is a critical challenge. Japan's Finance Minister Kan wants Japan's inflation to rise by 1 to 2% and the BOJ to establish an inflation target. BOJ governor Shirikawa said it would be wrong to focus on inflation. The BOJ is expected to raise its CPI growth forecast at the April 30th policy meeting. According to a MarketWatch report the BOJ will raise its CPI forecast for this fiscal year to 0.2% from flat. The upgrade of BOJ CPI forecast would be the first in three years confirming that the BOJ believes Japan is starting to emerge from deflation. The BOJ is also expected to upgrade its growth forecast. The BOJ upgrade of its CPI and growth forecast will help the BOJ deflect government pressure for additional easing. The BOJ will leave monetary policy unchanged and pledge additional easing if warranted.

The JPY may briefly benefit from the BOJ upgrade of its inflation and growth forecast. The impact however may be short-lived as the BOJ is expected to continue to maintain accommodative policy. The BOJ is the only major central bank to have recently taken additional easing measures doubling the size of its auction to ¥20trln in March. The BOJ exit from easy monetary policy remains distant. JPY is vulnerable to speculation that the Federal Reserve will raise rates ahead of the BOJ. The BOJ is expected to leave monetary policy unchanged for the remainder of 2010. The Fed is likely to begin tightening before year end. USD/JPY may be heading towards 100 pressured by widening yield differential and JPY re-emerges as the preferred funding currency. Recent JPY price direction has re-linked with risk sentiment and the direction of equities. A big jump in risk aversion could discourage selling of the JPY as a funding currency and would derail the move towards 100. The JPY surged Tuesday supported by a spike in risk aversion as stocks tank on news that S & P downgraded Portugal's debt rating and the Greek debt to junk.



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