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No Stopping Yen as Euro Hits Parity in Top Forecast (Update2)
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(Adds today's yen level in 15th paragraph and updates yield gap in 17th paragraph.)

By Matthew Brown

Oct. 4 (Bloomberg) -- The top foreign-exchange forecaster says the Japanese government's current approach to reining in the yen by intervening in currency markets will fail.

"Any attempt to drive the yen lower with intervention is unlikely to succeed unless it is backed up with much more aggressive easing measures from the Bank of Japan," says Shaun Osborne, 47, chief currency strategist at TD Securities Inc. in Toronto.

Osborne earned the top spot among foreign-exchange forecasters for the six quarters ended on June 30, according to data compiled by Bloomberg. He did it by focusing on basics such as economic fundamentals and historical market relationships, an approach that allowed him to look beyond the distortions of short-term swings to correctly predict longer-lasting trends such as the strengthening of the yen, Bloomberg Markets magazine reports in its November issue.

"It's tempting to investigate new methodologies and new ways of analyzing the markets, but by and large, the tried and tested ways eventually win out," says the British-born Osborne.
"While there's been a lot of uncertainty, we've stuck with our basic views on the markets and haven't changed them too often."

Osborne prevailed over rivals at 37 other firms to make TD Securities the most accurate foreign-exchange predictor across eight currency pairs. He predicts that the yen will end the year at 85 per dollar compared with 83.26 as of Oct. 1. The median year-end forecast for the currency pair is 86, according to Bloomberg data.

Euro Forecast

TD Securities predicts that the euro will trade at $1.13 by year-end, compared with $1.38 as of Oct. 1, and drop to parity against the dollar next year. The median forecast for the euro against the dollar is for $1.30 by year-end and $1.28 in 2011, according to Bloomberg data.

Firms participating in the ranking were compared based on seven criteria: six forecasts at the end of each quarter for the close of the next, starting in December 2008, plus one annual estimate, which was made at the end of June 2009 for currency rates as of June 30, 2010. Only firms with at least four forecasts for a particular currency pair were ranked for it, and only those that qualified in at least five of eight pairs were included in the ranking of best overall predictors.

After TD Securities, Standard Chartered Plc's forecasts placed that bank second, Wells Fargo & Co. was third and Credit Suisse Group AG came in fourth. Osborne at TD Securities was ranked fourth last year, while eight of 2009's top 10 performers didn't even make this year's leader board.

Yen Call

Osborne’s call on the direction of the yen catapulted TD Securities to the top of the ranking. He predicted that the Japanese currency was set to strengthen against the dollar starting in mid-2009; the consensus view among analysts was for it to weaken.

The yen appreciated during the next 12 months, advancing almost 9 percent against the greenback to reach 88.43 yen per dollar as of June 30. Osborne had forecast 90 per dollar while the median estimate was for 104; the prediction helped to make him the most accurate forecaster of the dollar-yen pair, with an average margin of error of 2.34 percent.

TD Securities was the second-most-accurate euro-yen, dollar-Swiss franc and euro-Swiss franc forecaster. The firm, a unit of Toronto-Dominion Bank, Canada’s second-largest lender, placed fifth in the euro-dollar ranking.

Risk Aversion

The yen gained in value as investors’ worries about global growth boosted the appeal of the Japanese currency as a haven and dimmed the allure of yen carry trades, in which investors sell funds borrowed in yen to buy assets in riskier, higher- yielding currencies.

“The risk-aversion trend was something we got right,” says Osborne, who joined TD Securities as chief foreign-exchange strategist from Toronto-based Scotia Capital Inc. in 2006. His colleague, foreign exchange strategist Jacqui Douglas, 30, assists him in formulating forecasts for the yen and the currencies of other Group of 10 countries.

The yen strengthened to a 15-year intraday best of 82.88 against the dollar on Sept. 15. That prompted Japan to intervene in exchange markets for the first time since 2004 and sell the currency as part of efforts to stoke the economy by making the country’s exports more competitive. Japan sold 2.12 trillion yen ($25 billion) from Aug. 28 through Sept. 28, the Ministry of Finance said on Sept. 30.

The yen traded at 83.24 per dollar at 9:03 a.m. in London, after reaching 83.16 on Oct. 1, the strongest since Sept. 15.

Yield Gap

The yen is unlikely to lose much ground even with more intervention, Osborne says, given the historically narrow gap between interest rates on U.S. and Japanese bonds.

The yield spread between U.S. two-year Treasury notes and securities of similar maturities in Japan was 27 basis points today, or 0.27 percentage point. It averaged 3.24 percentage points from 1990 through late August.

While the best forecasters were more accurate in the latest ranking than in last year’s, the average margin of error remained almost twice that of 2006, before the global financial crisis took hold. TD Securities was 4.10 percent off the mark across the eight currency pairs compared with 5.62 percent for last year’s leader, Landesbank Baden-Wuerttemberg, and 2.66 percent for 2006’s top forecaster, HBOS Plc.

“This new world is one of much higher volatility and more-frequent extremes,” says Callum Henderson, global head of foreign-exchange research at Standard Chartered in Singapore.

“The market’s focus has shifted to a significant extent on at least three occasions from the end of the first quarter 2009 to the present day.”

More Market Swings

Currency volatility averaged 14.1 percent in the 18-month period covered by the survey, according to the JPMorgan G7 Volatility Index. That compares with an average of 8.8 percent from 2003 through 2007.

Higher volatility has made it harder to trade currencies profitably in recent years, Osborne says. Foreign-exchange funds tracked by the Parker BlackTree Currency Index are little changed so far this year, based on the index’s reading of 181.71 in late September compared with 181.44 at the end of last year.

The gauge, which follows 22 funds that manage about $15 billion, fell 1.7 percent in 2009 after returning a combined 76 percent during the previous six years, when more-stable markets benefited such strategies as the carry trade.

The euro’s value against the dollar was the most difficult currency pair to predict in the 18 months covered by the ranking. It swung from a near-two-year low in March 2009 to a 15-month high in December 2009 and back to a four-year low in June 2010 amid the Greek debt crisis.

Euro-Dollar ‘Nightmare’

Nordea Bank AB, the top forecaster for the pair, was 4.88 percent wide of the mark on average, the most for a category leader in this year’s ranking.

“Trying to call the bottom in March 2009 was a nightmare,” says Niels Christensen, chief currency strategist in Copenhagen at Nordea Bank, Scandinavia’s biggest bank. “You were looking at all the gauges of risk sentiment, of the crisis and the shortage of liquidity you could find. It was almost impossible to quantify.”

Christensen’s team looked at credit-default swaps tied to sovereign debt, which investors use to protect themselves against a decline in a nation’s creditworthiness, and at bank bonds for signs that the market was about to turn.

The team called for a stronger euro at the end of the second quarter of 2009, when the 16-nation currency was trading at about $1.40. Christensen, 49, who has been studying foreign exchange for 22 years, predicted that the euro would rise to $1.50 by Dec. 31, 2009, at a time when the median forecast was $1.42. The European currency peaked at $1.5144 on Nov. 25, 2009.

Decline and Rebound

After declining against the dollar in the first five months of 2010 during the Greek crisis, the euro rebounded as investors switched the focus of their concerns from Europe’s fiscal deficits to slowing growth in the U.S. Reports showed that America’s economy added fewer jobs than forecast in June and July. In August, the unemployment rate climbed to 9.6 percent even as U.S. companies added more jobs than economists expected.

"The U.S. soft patch kind of snuck up on everyone," says Nick Bennenbroek, 39, Wells Fargo's head of currency strategy, who has been with the bank since 2007. The euro will end the year at $1.28 before falling to $1.17 in 2011, according to Wells Fargo forecasts as of that date.

'Direction and Rationale'

Nordea Bank forecasts $1.32 and $1.17 for those periods, while Standard Chartered predicts $1.40 and $1.32.

Lower accuracy hasn't diminished the importance of forecasting for clients, says Standard Chartered's Henderson, who joined the bank in 2004 after two years at Bank of America Corp. and four years at Citigroup Inc.

"The purpose may have changed slightly in that in the past, when we were in the period of what Alan Greenspan called the Great Moderation in terms of volatility, people looked for forecasts to be pinpoint accurate," Henderson says.

Today, with that kind of precision harder to attain, he says, the focus is more on the reasoning behind a particular currency call. "People are looking first and foremost at the direction and the rationale," he says.

--With assistance from Bo Nielsen in Copenhagen and Keith Jenkins in London. Editors: Beth Williams, Dave Liedtka

To contact the reporters on this story:
Matthew Brown in London at +44-20-3216-4059 or mbrown42@bloomberg.net.

To contact the editor responsible for this story:
Daniel Tilles at +44-20-7673-2649 or dtilles@bloomberg.net.