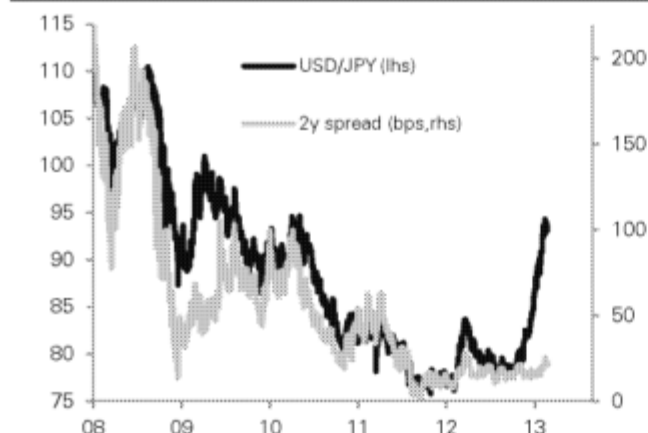
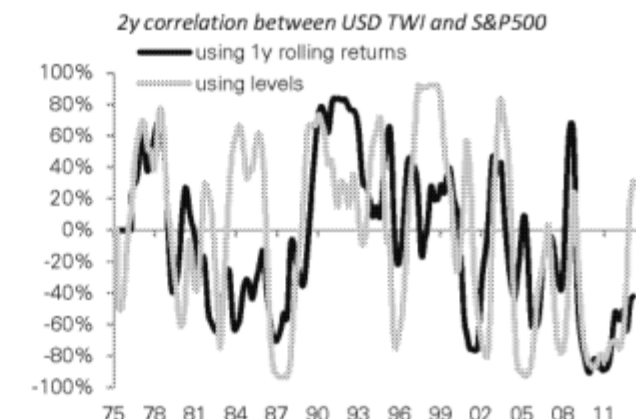


Figure 5: USD/JPY Broken Away From Rate Differentials

Source: Deutsche Bank, EcoWin

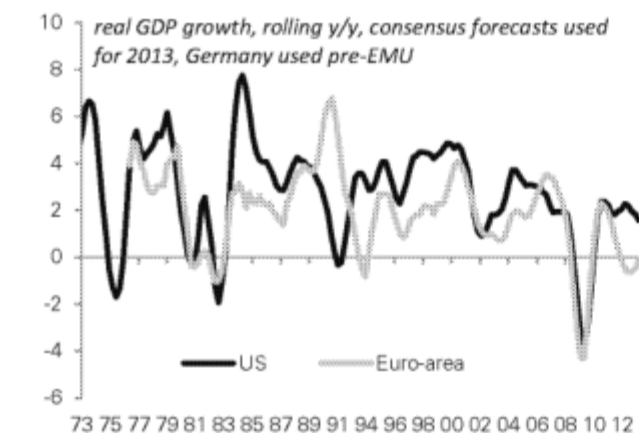
Figure 6: Record Negative Correlation Between Dollar and Stocks Reversing Suggests Regime Change

Source: Deutsche Bank, Bloomberg

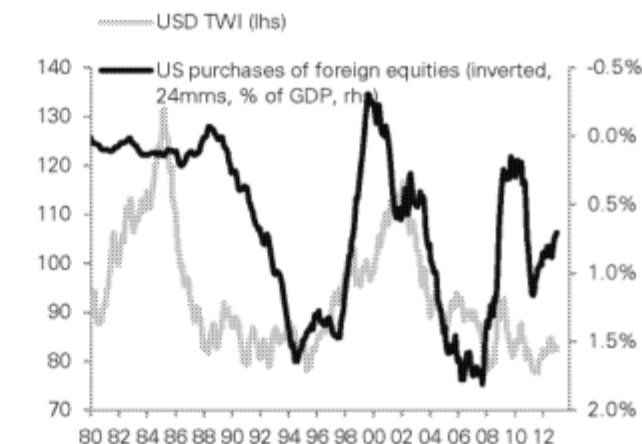
The significance of the USD/JPY turn higher should not be understated. It is perhaps the only currency pair that has captured all the major macro themes since the 2008: an aversion to crisis-prone regions, ultra-easy Fed policy, the Euro-area crisis, and the investment boom in China. All these have until recently been positive for the yen against the dollar, and indeed contributed to the all-time high seen in the yen. The fact that the yen has now so decisively turned lower suggests markets are entering a new regime.

The notable shifts in market behaviour include the complete breakdown of the relationship between relative interest rates and USD/JPY (see Figure 5) and the declining correlation between the dollar and equities, such that the dollar is no longer weakening in "risk-on" periods (see Figure 6).

On the macro side, 2011 marked the period when US growth more clearly established a lead over Euro-area growth (see Figure 7). Since then, US investors have reduced their buying of foreign equities (see Figure 8). This capital flow is perhaps the most important one to track the beginning of dollar uptrends (see Exchange Rate Perspectives, December 2012). The end of 2012 has likely seen the low in real US yields, which has trended down since 2008 (see Figures 9,10). This suggests the Fed is unlikely to do further easing measures. And even if it

Figure 7: US Growth Firmly Above Euro-Area's

Source: Deutsche Bank, EcoWin

Figure 8: US Investors Buying Less Abroad

Source: Deutsche Bank, Bloomberg