

FX Viewpoint

Currencies
Global

CAD and JPY: Potential switch?

- ◆ The CAD has started to reverse some of its recent resilience...
- ◆ ...and this may continue, especially if labour markets soften and markets pare BoC tightening expectations
- ◆ The JPY's "safe haven" behaviour could be triggered

CAD – from over to under?

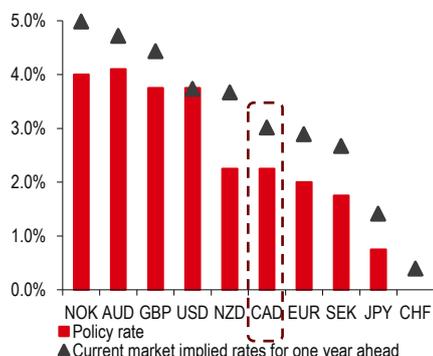
The CAD has outperformed most G10 peers during the Middle East conflict. This outperformance is beginning to ease, and we expect the momentum to moderate further in the weeks ahead. While **elevated oil prices should provide some support for the CAD**, particularly against energy-importing G10 currencies, we think **relative monetary policy could be a more influential driver (Chart 2)**.

CAD strength may ease in the weeks ahead...

Specifically, **our economists expect the Bank of Canada (BoC) to remain on hold through 2026 and 2027**, while recognising there are hawkish risks to the rate path if energy disruption persists and inflation expectations rise significantly. With markets currently pricing in around two BoC rate hikes this year (*Bloomberg*, 26 March 2026), the balance of risks looks skewed to the downside for the CAD in the near term, especially if labour market conditions soften further.

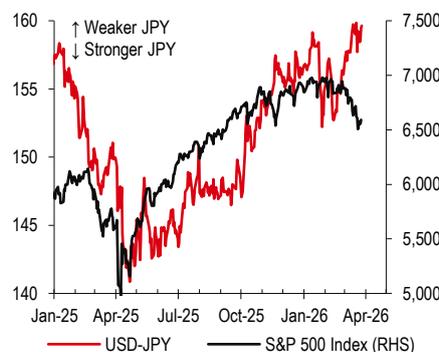
...if labour markets soften and markets pare BoC tightening expectations

1. G10 policy rates vs implied rates for one year ahead



Source: Bloomberg, HSBC

2. USD-JPY and risk appetite



Source: Bloomberg, HSBC

JPY – from under to over?

The JPY's recent weakness is broadly understandable, reflecting **terms-of-trade headwinds from higher energy prices and Japan's sizeable net oil and gas deficit** (c2.7% of GDP in 2025). However, the bigger risk is a shift in the JPY's behaviour (Chart 2). This could happen **if global financial conditions tighten abruptly, in addition to higher equity volatility and falling US Treasury yields**. Historically, in such situations **USD-JPY has declined in the majority of cases** (85% of weekly observations since 2006 based on our analysis).

The JPY's weakness reflects the macro backdrop, but this could change

The key swing factor will be how US Treasury yields move. If yields continue to rise alongside higher oil prices, USD-JPY is likely to go higher, despite the ongoing FX intervention risk. Conversely, **if risk aversion intensifies and US Treasury yields fall, potentially driven by mounting growth concerns, the JPY could rebound quickly**.

The JPY tends to outperform when risk aversion intensifies



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