

Forex Market Weekly

Yen weakens on softening of North Korea's stance

- Risk-on weakening of yen from improving US economic data and softening of North Korea's stance
- North Korea's softens its stance; ready for dialogue to improve relations with South Korea
- Rise in USD/JPY from improving US economic data may lose steam

This week's USD/JPY forecast range

8-12 Jan: Y111.8-113.8/\$ (Y113.1 at end-previous week)

Forex Market View DSFE114

FICC Research Dept.

Chief FX Analyst
Yuji Kameoka
 (81) 3 5555-8764
 yuji.kameoka@daiwa.co.jp

FX Analyst
Mayu Shinooka
 (81) 3 5555-8777
 mayu.shinooka@daiwa.co.jp
 Daiwa Securities Co. Ltd.



Risk-on weakening of yen from improving US economic data and softening of North Korea's stance

Overview of forex market during 25 Dec-8 Jan

With overseas markets celebrating the Christmas holidays, the forex market showed little movement on 25-26 December. Oil prices rose sharply on the explosion of a pipeline in Libya caused by a militant group, accelerating the rise in commodity prices. US long-term rates declined in response to a worsening of US consumer confidence (expectations); both the dollar's effective exchange rate and the USD/JPY declined, while cross-yen rates held firm. Germany's December CPI rose more than expected, and the EUR/USD climbed above 1.20 at end-2017. Oil prices continued rising in January on the cold wave and declining crude oil inventories in the US and the spread of anti-government demonstrations in Iran. A weakening of the dollar pushed the USD/JPY down to as low as 112.05 on January 2, but it rebounded in step with rising US share prices and long-term rates. The USD/JPY climbed up above 113 on better-than-expected improvement in the US economic data (ISM manufacturing PMI and ADP private-sector payroll data), release of the FOMC minutes (which mentioned upward economic impacts from tax cuts), a softening of North Korea's stance (regarding dialogue with the South), and rising global share prices. It rose as high as 113.39 on January 8 after US President Trump indicated he was open to a phone conference with Kim Jong-un subject to certain conditions.

Chart: Forex Market: USD/JPY, EUR/USD

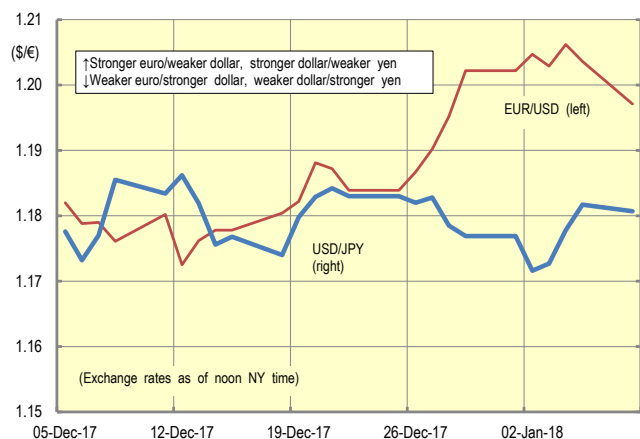


Chart: Bond Market: 10Y Sovereign Bond Yields in Japan, US, and Germany

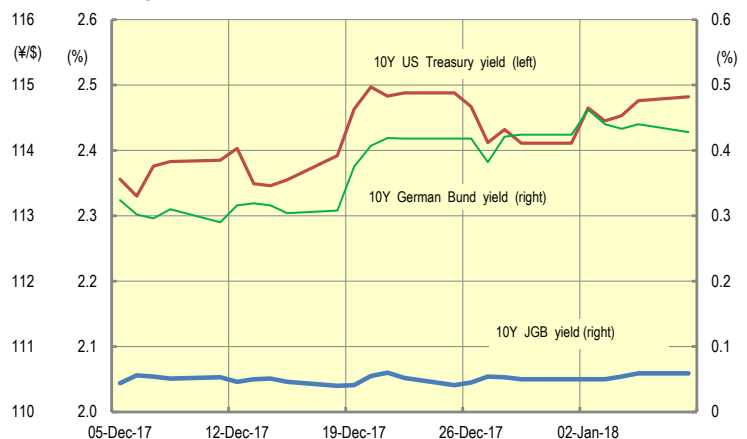
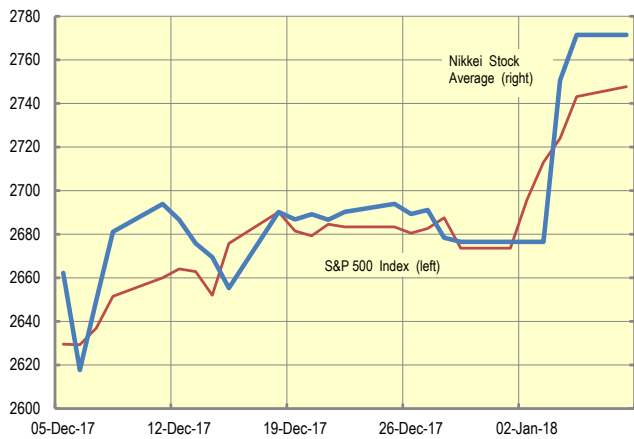
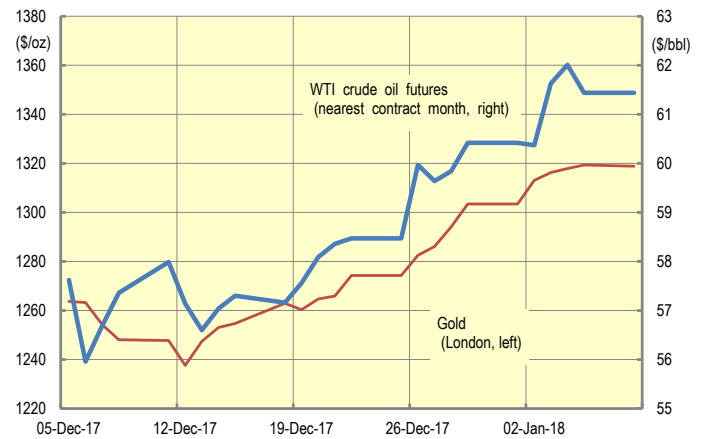


Chart: Stock Market: US S&P 500, Nikkei Stock Average



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



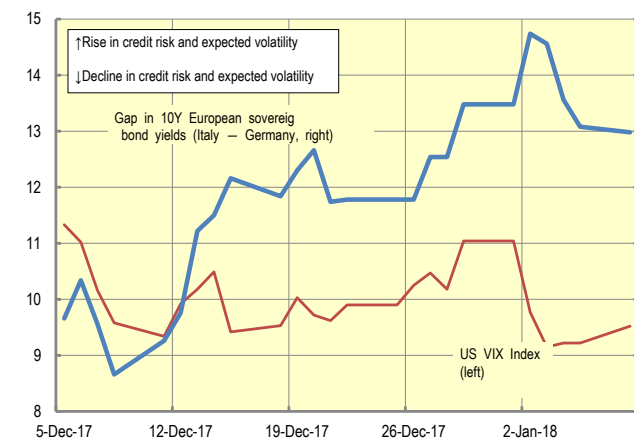
Source: Thomson Reuters; compiled by Daiwa Securities.

North Korea's softens its stance; ready for dialogue to improve relations with South Korea

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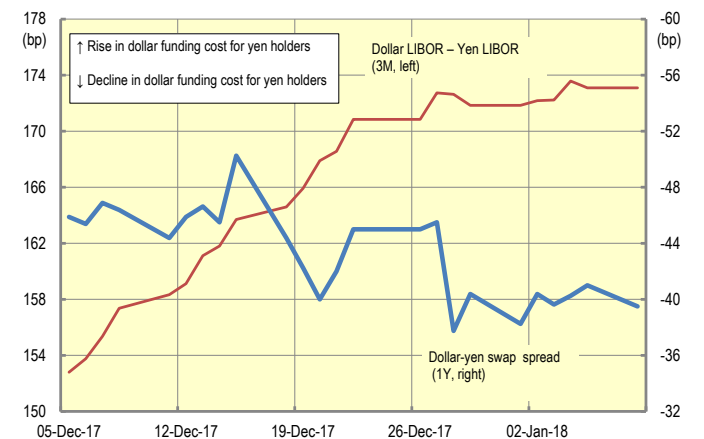
In his New Year's speech, North Korean leader Kim Jong-un threatened the US, saying that the US can never fight a war with North Korea, that the entire US territory was within range of North Korea's nuclear ballistic missiles, and that he always had a nuclear button on his desk, but also indicated a willingness to engage in dialogue to improve relations with South Korea, saying that there was no need for North-South relations to worsen any more than they already are and that it was important to ease military tensions and work together to create an environment for peace. An Inter-Korean communication channel was reopened for the first time in nearly two years on January 3, and there were apparently discussions regarding North Korea's participation in the Olympics. The softening of North Korea's stance with seen by the market as a reduction of geopolitical risks and has contributed to rising global share prices and a weakening of the yen in cross-yen pairs since the beginning of the year. The US government is watching the South-North dialogue from the sidelines, seeing it as dependent on the two countries. Although it sees some positives from the move, it is also suspicious that the North aims to rupture relations between the US and South Korea, and it will not take the talks seriously unless North Korea starts to dismantle its nuclear program. Unless North Korea launches another missile, an easing of geopolitical risks should work to weaken the yen. If North Korea participates in the PyeongChang Olympic Games, it would probably raise expectations of an improvement in South-North relations and an easing of military tensions. There is probably still a risk of North Korea hardening its stance, however, if the US and South Korea hold joint military exercises after the Olympics (the Paralympics on March 9-18).

Chart: : Gap in European Sovereign Bond Yields, VIX index



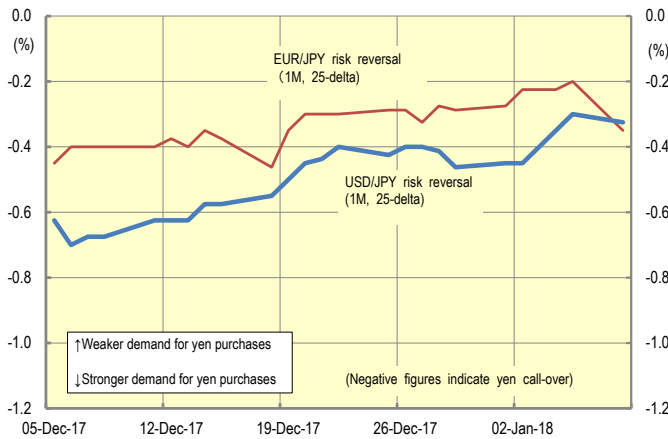
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



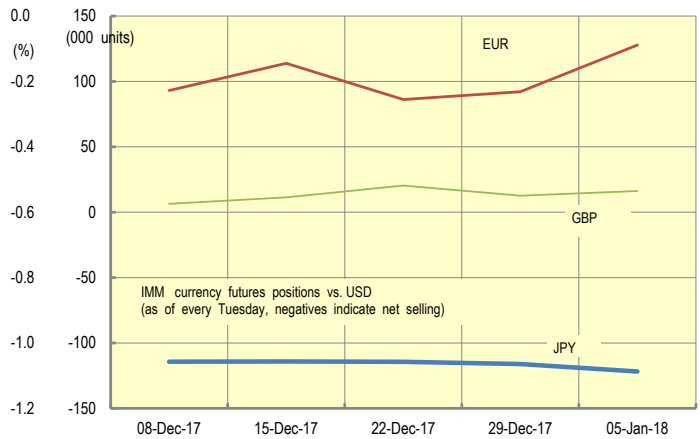
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Risk Reversal on Currency Options



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Net Position of Currency Futures



Source: Thomson Reuters; compiled by Daiwa Securities.

Rise in USD/JPY from improving US economic data may lose steam

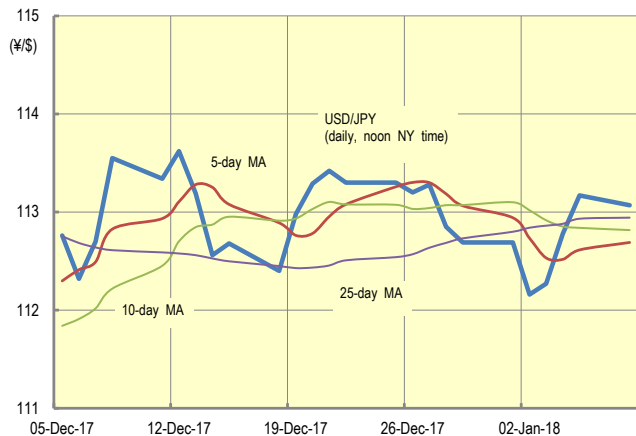
Rise in USD/JPY from improving US economic data may lose steam

Over the two weeks spanning the new year, there were many US economic data announcements beating market expectations. December US auto sales increased more than expected, while the ADP private-sector payroll numbers showed their highest growth since March. In the US ISM manufacturing index, increases in the new orders, production, supplier deliveries, and inventory indices contributed to growth in the PMI, indicating strength in both domestic and external demand. The US Citi Economic Surprise Index (CESI) declined after peaking at 84.5 on December 22, 2017, then rose to 80.7 on January 4, but has resumed a declining trend because the December jobs data was weaker than the market expected. Over the 15 year period since 2003, the CESI has only exceeded 90 on three occasions, December 2003, March 2011, and January 2012, and it is very likely that its peak this time will be in the 80s. There are likely to be fewer instances where stronger-than-expected US economic data pushes the USD/JPY higher.

Noteworthy currency: BRL

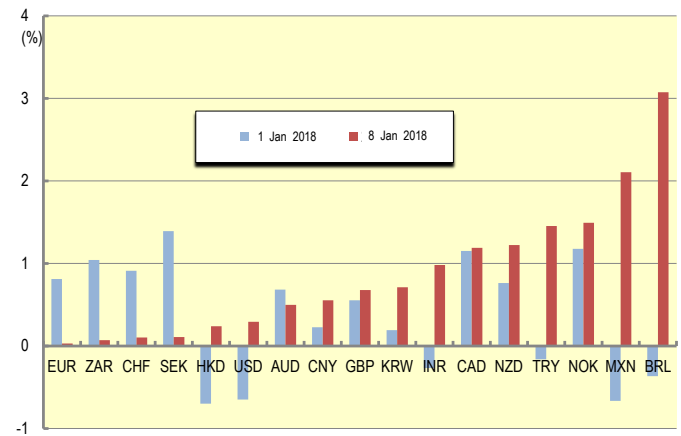
Emerging market currencies have remained strong amid the market's risk-on mood. The Brazilian real has been moving in response to economic indicators while Congress has been out of session, thereby suspending any progress on pension reform legislation. November retail sales are due to be announced on January 9, and the market expects an acceleration of y/y growth, from 2.5% in October to 3.8% in November. With the end of the rate-cut cycle drawing near, numbers confirming strong consumption would probably strengthen the real. Additionally, the November inflation rate will be announced on January 10, and the market expects it to come in at 2.8% y/y, the same as in October and below the bottom of the band (3%) of the inflation target (4.5%). If it comes in at least that high, it would probably spark some real buying.

Chart: USD/JPY and Moving Average



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Weekly Currency Performance (vs. yen)



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Weekly Schedule for Major Economic Indicators/events

8-Jan	Nov German manufacturing sector orders Nov eurozone retail sales
9-Jan	Nov German industrial production Nov German trade statistics Nov eurozone unemployment rate ● High-level meeting between South and North Korea (Panmunjeom)
10-Jan	Dec China CPI
11-Jan	Oct-Dec German GDP Dec US PPI
12-Jan	Dec US CPI Dec US retail sales Dec China trade statistics

Source; Compiled by Daiwa Securities.

Notes: Dates based on JST. ● denotes political event.

Chart: Weekly Forex Forecasts

	25 Dec 2017-8 Jan 2018 (actual)		8-12 Jan 2018 (forecasts)	
	Range	Weekend	Range	Weekend
USD/JPY	112.0-113.4	113.0	111.8-113.8	112.8
EUR/JPY	134.1-136.7	135.2	133.5-136.0	134.8
EUR/USD	1.184-1.209	1.197	1.185-1.205	1.195

Noteworthy currencies and factors

BRL	BRL may strengthen if brisk consumption and moderate inflation are confirmed
GBP	GBP would weaken if output slows down and trade deficit widens
SEK	Undershoot of inflation rate vs. market consensus would have greater impact

Source; Compiled by Daiwa Securities.

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- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

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