16 January 2018
Japanese report: 15 January 2018 (DSFX242)

Daiwa Securities

Forex Market Weekly

Strong yen and euro; weak dollar

- Yen strengthens on reduction in BOJ purchases; expected volatility in USD/JPY increases
- EUR/USD rises to 1.22 on expectations of an ECB rate hike
- US economic data comes in below expectations, starts to weaken the dollar

This week's USD/JPY forecast range

15-19 Jan: Y109.8-111.8/$ (Y111.0 at end-previous week)

Forex Market View DSFE116
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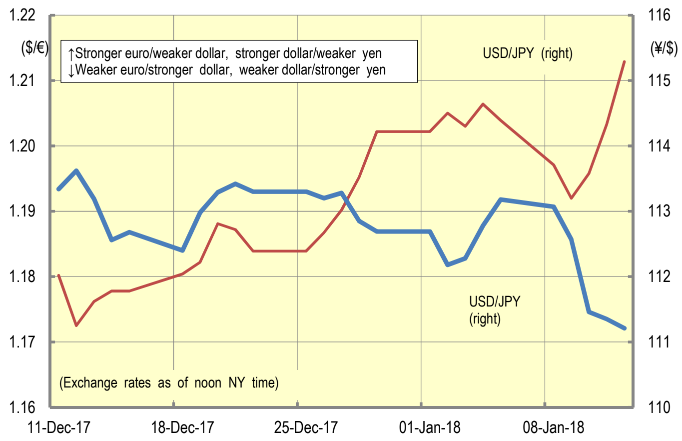
Yen strengthens on reduction in BOJ purchases; expected volatility in USD/JPY increases

Overview of last week's forex market

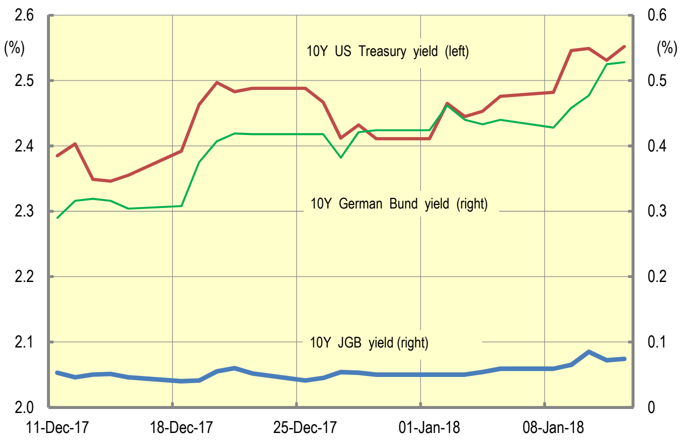
The USD/JPY rose as high as 113.39 on January 8 after US President Trump indicated he was open to a phone conference with Kim Jong-un subject to certain conditions. After the BOJ reduced its superlong JGB purchases on January 9, however, JGB yields increased and the yen strengthened. A summit of high-ranking officials from South and North Korea indicated plans for the North to participate in the Olympics and also produced an agreement on opening a South-North military dialogue, but because North Korea refused to discuss nuclear weapons with the South, saying the weapons were aimed only at the US, the news did not result in a risk-on weakening of the yen. Long-term rates in Japan continued to rise on January 10, and the yen strengthened amid an increase in the expected volatility of the USD/JPY. US long-term rates rose in response to reports that Chinese officials had recommended either reducing or suspending investment in US Treasurys, and this weakened the dollar. Chinese officials denied the reports, bit the dollar rebounded little in reaction, then weakened further on data showing a decline in the December US PPI and an increase in US jobless claims. The US core CPI came in higher than the market expected expectations, resulting in a momentary rebound of the dollar, but the USD/JPY resumed declining, dropping below 111. Meanwhile, the euro rose sharply on expectations of a rate hike sometime this year and of a grand coalition being formed in Germany, and the pound appreciated as well.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

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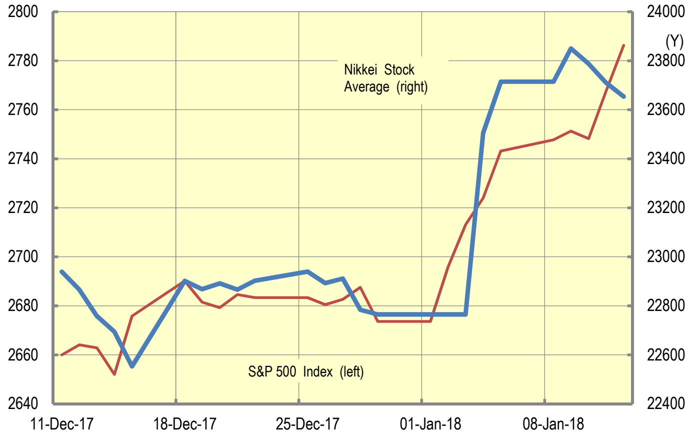
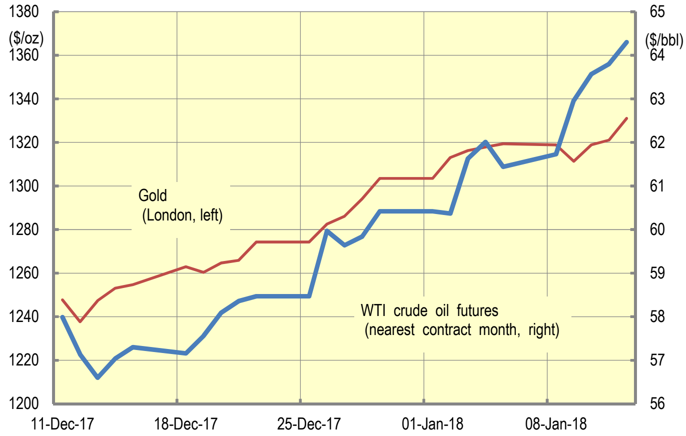
Chart: Stock Market: US S&P 500, Nikkei Stock Average



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



Source: Thomson Reuters; compiled by Daiwa Securities.

EUR/USD rises to 1.22 on expectations of an ECB rate hike

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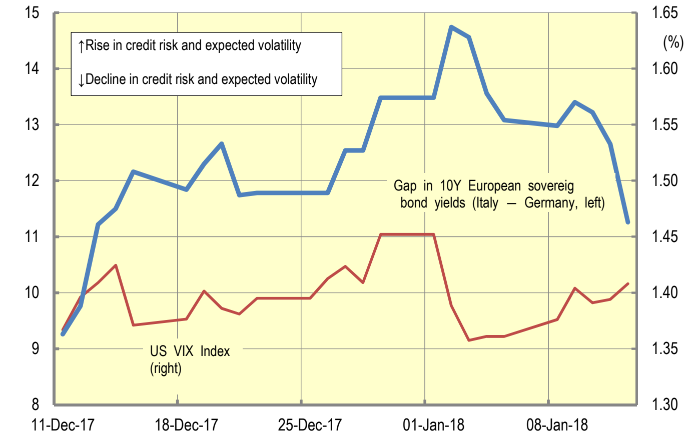
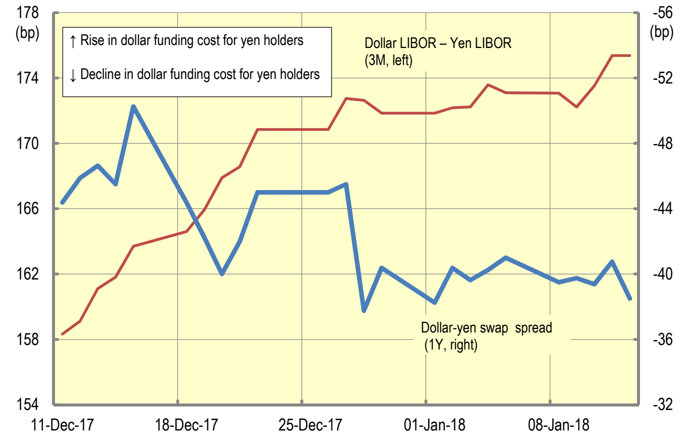
The EUR/USD rose to 1.2211, its highest since September last year, because the minutes of the December ECB meeting included comments, such as "forward guidance could be revisited early in the coming year" and "the relative importance of the forward guidance on policy rates would increase," that increased expectations that the ECB would end asset purchases in September and raise rates by December this year. An agreement on a policy document between Germany's two largest political parties to form a grand coalition also strengthened the euro. With sentiment in the euro zone near a record high, hawkish views are probably gaining influence within the ECB. Compared with the EUR/USD market of a year ago, however, this time the euro's appreciation has been greater, and this is holding down the inflation rate. If the euro continues to strengthen it will probably make it harder for inflation to increase, and there is a possibility that ECB officials will try to curb the market's excessive rate hike expectations.

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



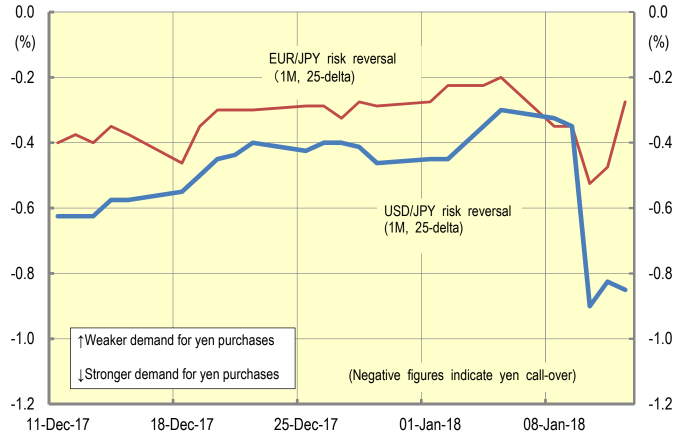
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



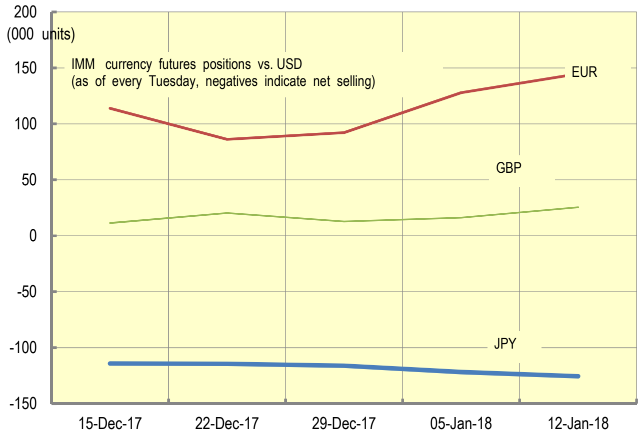
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

US economic data comes in below expectations, starts to weaken the dollar

Oil price decline stalls, even though the US decided to continue with sanctions relief for Iran

President Trump decided to continue with sanctions relief for Iran based on the comprehensive nuclear agreement that Iran signed with the major powers in 2015, but he seeks a separate nuclear agreement within the next 120 days, without which he said the US would withdraw from the agreement. This latest announcement did not have much downward impact on oil prices, probably because there is still a risk of the US reintroducing sanctions on Iran (and thereby restricting oil supplies). In addition, demand for heating oil in the US has been stronger this year than usual because of a cold wave, and with the volume of oil refined increasing and crude oil inventories dropping considerably, crude oil prices are unlikely to fall. Once the pace of oil inventory declines slows and the oil price turns to a declining trend, it will probably put downward pressure on the USD/JPY by way of downward impacts on US long-term rates and share prices.

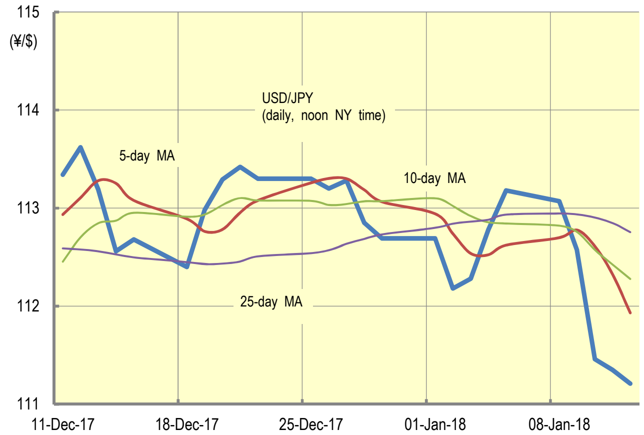
US economic data comes in below expectations, starts to weaken the dollar

In the US, new unemployment claims increased for a fourth consecutive week. The cold wave probably had a temporary "chilling" effect on new hires. The fact that the number of job openings in November dropped to its lowest in six months while job growth was muted in December suggests that the cold wave was not the cause, however. It is possible that US corporations' appetite for new hires is beginning to peak. The ISM nonmanufacturing and new orders indices both declined in December, and the employment slowdown may continue from January. A growing number of US economic data indicators are coming in below market expectations, and this is starting to weaken the dollar. The y/y decline in the dollar's effective exchange rate has increased considerably, however. It will be interesting to see whether the weaker dollar pushes US inflation higher and leads to an increase in US long-term rates.

Noteworthy currency: TRY

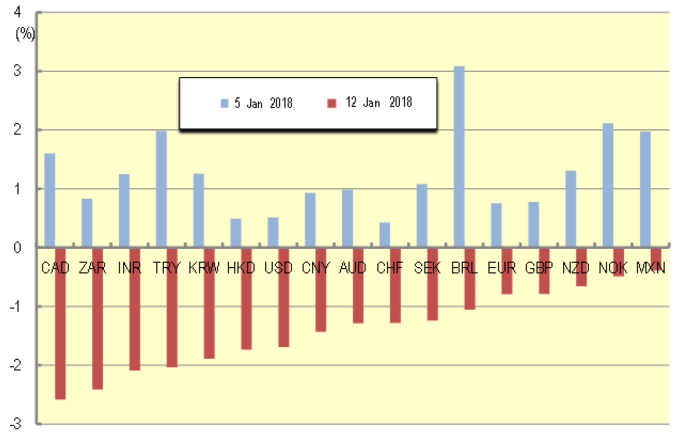
Turkey's central bank holds a monetary policy meeting on January 18. The key question is whether they keep policy on hold in response to risk-on moves and the recent decline in inflation, or they instead remain wedded to continued tightening. At the previous policy meeting, they raised rates less than the market expected, resulting in a negative surprise. The central bank probably needs to continue tightening to restore its credibility. Because it will take time for it to regain credibility even if it does hike rates, we think a significant rebound of the lira is unlikely, but if it does not hike rates we think the lira is likely to weaken significantly, based on the central bank having made defense of the lira a secondary priority. We expect the central bank to raise its late liquidity window rate by 50bp.

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

15-Jan		Nov eurozone trade balance
16-Jan		Dec UK CPI
		Jan NY Fed's Empire State Manufacturing Index
17-Jan		Dec US industrial production, capacity utilization rate
18-Jan	○	Beige Book (Fed)
		Dec Australian jobs report
		Dec China 70 cities housing prices
		Oct- Dec China GDP
		Dec China industrial production, retail sales
	○	MPM at Bank of Korea
	○	MPM at Turkish central bank
		Dec US housing starts
		Jan Philadelphia Fed's Business Outlook Survey Index
	○	MPM at South African central bank
20-Jan		Jan US University of Michigan's Consumer Sentiment Index
		One year since start of Trump administration

Source; Compiled by Daiwa Securities.
Notes: Dates based on JST. ○ indicates monetary policy-related events.

Chart: Weekly Forex Forecasts

	8-12 Jan 2018 (actual)		15-19 Jan 2018 (forecasts)	
	Range	Weekend	Range	Weekend
USD/JPY	110.9-113.4	111.0	109.8-111.8	110.8
EUR/JPY	133.0-136.4	135.4	133.5-136.5	134.6
EUR/USD	1.191-1.219	1.219	1.205-1.225	1.215

Noteworthy currencies and factors

TRY	Even if rate hike is decided, TRY would strengthen slightly. If rate hike is postponed, substantial currency depreciation would be likely

Source; Compiled by Daiwa Securities.

IMPORTANT

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

• 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.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.
Registered: Financial Instruments Business Operator
Chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships: Japan Securities Dealers Association
The Financial Futures Association of Japan
Japan Investment Advisers Association
Type II Financial Instruments Firms Association