

Forex Market Weekly

Will there be a pause in risk-on yen weakening?

- FX market swings between concerns over US-China tariffs and negotiation expectations
- Focus turns next to China's trade policy response to the US
- Euro may also move, depending on the direction of coalition talks in Italy

This week's USD/JPY forecast range

9-13 Apr: Y105.5-107.5/\$ (Y106.9 at end-previous week)

Forex Market View DSFE137
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.



FX market swings between concerns over US-China tariffs and negotiation expectations

Overview of last week's forex market

Early last week, the March US ISM manufacturing PMI came in below market expectations, leading to a decline in US stocks and interest rates, as well as a fall in the USD/JPY down to 105.65. Later, amid a stock market rebound in Asia, Europe, and the US, the USD/JPY rose by about Y1 to the mid-106 level. The USD/JPY's decline was limited after the USTR announced before 6 AM Japan time on April 4 an additional 25% tariff on about 1,300 products imported from China, amounting to about \$50 billion worth of imports, but when China announced before 5 PM an additional 25% tariff on 106 products imported from the US, also amounting to about \$50 billion worth of imports, the USD/JPY momentarily dropped below 106. However, US and Chinese officials indicated a willingness to solve their trade dispute through negotiations, the US administration indicated it has no plans for additional measures against China, and a large decline in crude oil inventories pushed oil prices higher, putting the market into risk-on mode and extending gains for US stocks. The USD/JPY rose to 107.50, its highest since end-February, but topped out there on news that the US president instructed USTR to consider additional tariffs on China amounting to \$100 billion. A weakening of US job growth in March led to a decline in stock prices and interest rates, pushing the USD/JPY back below 107.

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

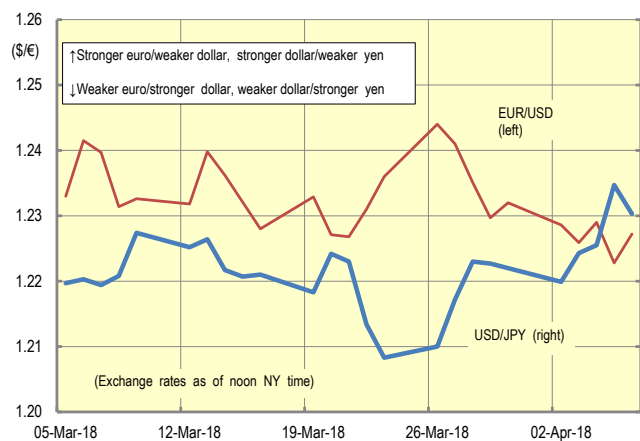


Chart: Bond Market: 10Y Sovereign Bond Yields in Japan, US, and Germany

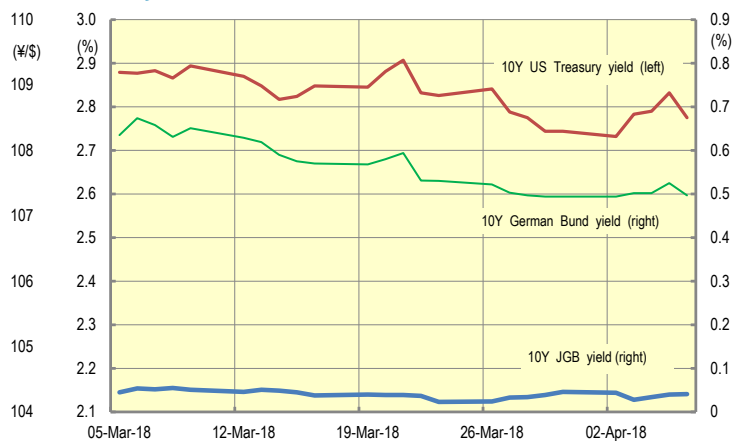
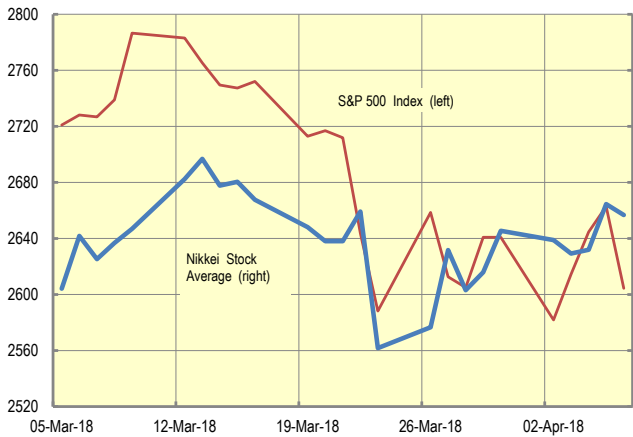
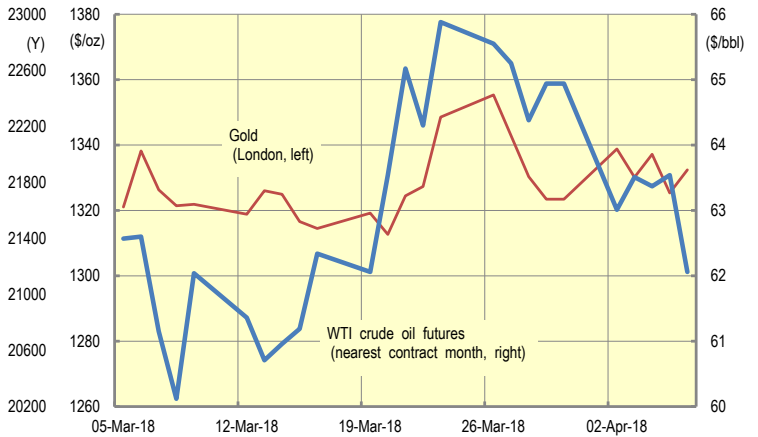


Chart: Stock Market: US S&P 500, Nikkei Stock Average



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



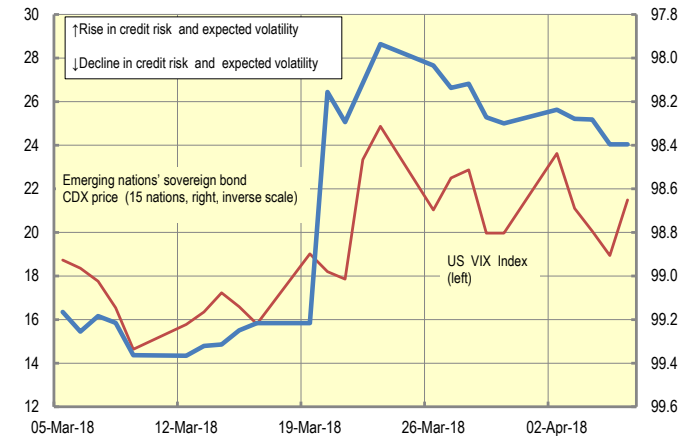
Source: Thomson Reuters; compiled by Daiwa Securities.

Focus turns next to China's trade policy response to the US

Focus turns next to China's trade policy response to the US

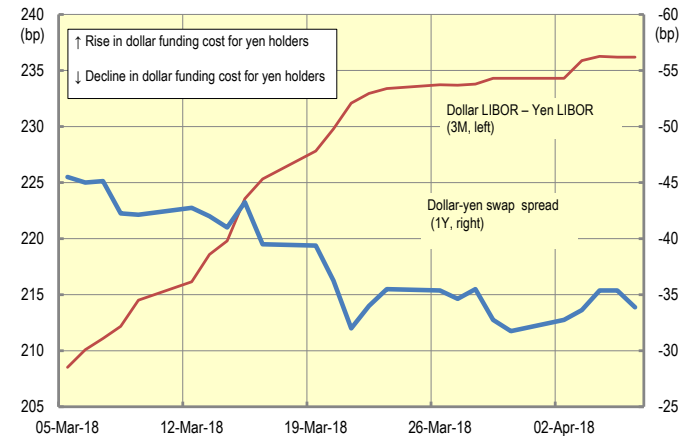
After the US government announced punitive tariffs on about 1,300 products from China, the Chinese government announced retaliatory tariffs on 106 products from the US. The value of China's imports from the US subject to the tariffs was also about \$50 billion, with soybeans and aircraft bearing the brunt of the damage. If China puts an additional 25% tariff on 106 products, it will result in total taxes of \$12.5 billion, more than 20 times the \$610 million of retaliatory tariffs it had announced in response to the US tariffs on steel and aluminum. Remarks from the US administration that it had no plans for further measures dampened worries over a trade war, however, causing the dollar to strengthen and the yen to weaken. After news that the US president instructed USTR to consider additional tariffs on China amounting to \$100 billion, however, the USD/JPY retreated.

Chart: US VIX Index and Emerging Market CDS



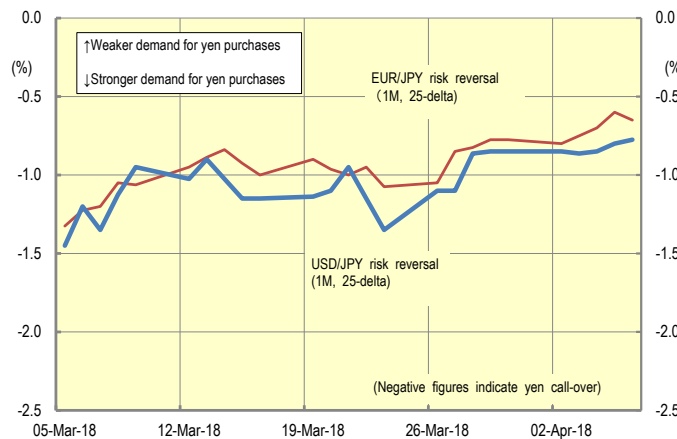
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



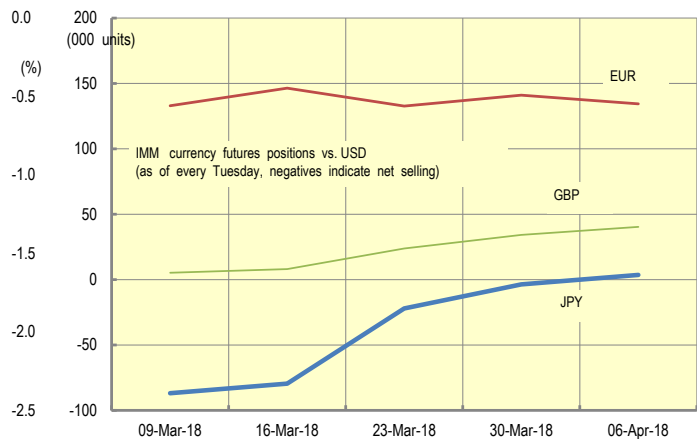
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

China's decision to take retaliatory measures equal in amount to those of the US accords with WTO rules, but a desire to demonstrate that it would not cave in to foreign pressure was probably a major reason it did so. China's Vice Minister of Finance said that China would not cave in to foreign pressure, but also said that foreign pressure would encourage China's development and reform. The ball in the US-China trade negotiations is now in China's court. There is a possibility that US-China trade negotiations will result in China expanding access to its market by lowering some tariffs and easing restrictions on inbound foreign investment. If it does, the market's reaction should be a risk-on weakening of the yen, but the question is whether the Trump administration deems China's trade policy response to be sufficient to avoid the tariffs. There may be a pause in the risk-on yen weakening because of uncertainty over China's policy response.

Euro may also move, depending on the direction of coalition talks in Italy

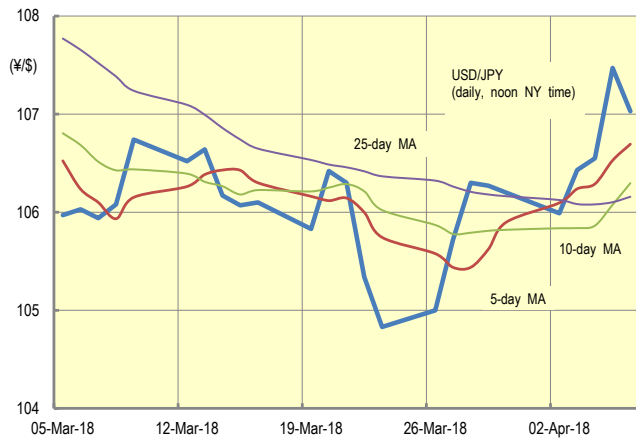
Euro may also move, depending on the direction of coalition talks in Italy

In Italy, which currently has a hung parliament, with no political party owning a majority in either the upper or lower legislative chamber, President Sergio Mattarella has initiated coalition talks among the parties. The Five Star Movement, the single party that won the most seats in the March general election, is negotiating with the center-left Democratic Party and the center-right League, but has ruled out a coalition with the League and a center-right block formed by Forza Italia. The League, the single party with the second most votes, is willing to negotiate with the Five Star Movement, but Forza Italia is against joining with the Five Star Movement. The Democratic Party is against joining a coalition. The focus now is on policy cooperation between the Five Star Movement and the League, the prospects of a coalition between the League and Forza Italia's center-right block, and whether the Democratic Party will participate in a coalition. Possible coalitions include (1) the Five Star Movement and the League, (2) the Five Star Movement and the Democratic Party, and (3) the Center-right Block and the Democratic Party. It is likely the market would react negatively by pushing Italian government bond yields higher and weakening the euro to (1), which is seen as critical of fiscal austerity, large corporations, and the euro, and react positively by pushing the euro higher to (3), which is seen as having centrist policies.

Noteworthy currency: SEK

Sweden announces its March CPI and CPIX on April 12. Expectations that the Riksbank will delay the planned rate hike path at its April meeting because inflation has remained below the 2% target caused the SEK to weaken against the euro in February-March. This time, however, inflation is expected to get closer to the target (the market forecast for March is a CPI of +2.0% and CPIX of +2.1%), and some expect the central bank to delay adjusting its rate hike path. The EUR/SEK has been flat since the start of April. If March inflation is close to 2% as expected or higher, the SEK is likely to rise slightly, but if inflation is not as high as expected the SEK is likely to weaken again.

Chart: USD/JPY and Moving Average



Source: Thomson Reuters; compiled by Daiwa Securities.

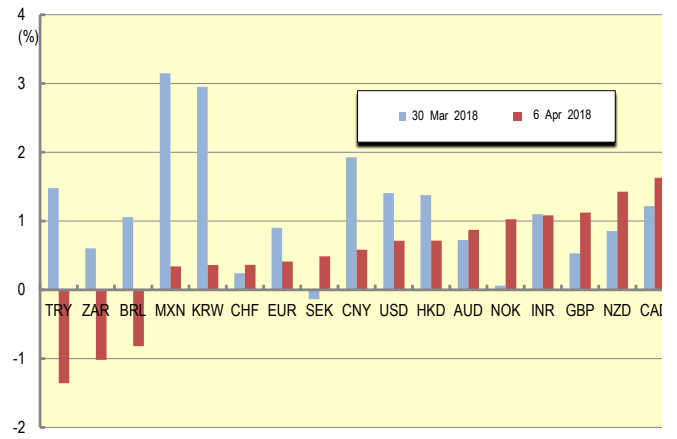
Chart: Weekly Schedule for Major Economic Indicators/events

- 9-Apr Feb German trade statistics
- 10-Apr Mar US PPI
- 11-Apr Mar China CPI
- Mar US CPI
- 12-Apr ○ Minutes of FOMC meeting (20-21 Mar)
- 13-Apr Mar China trade statistics
- Apr US University of Michigan's Consumer Sentiment Index

Source; Compiled by Daiwa Securities.

Notes: Dates based on JST. ○ indicates monetary policy-related events.

Chart: Weekly Currency Performance (vs. yen)



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

	2-6 Apr 2018 (actual)		9-13 Apr 2018 (forecasts)	
	Range	Weekend	Range	Weekend
USD/JPY	105.6-107.5	106.9	105.5-107.5	106.3
EUR/JPY	129.9-131.7	131.3	129.0-132.0	130.5
EUR/USD	1.221-1.235	1.228	1.215-1.235	1.225
SEK	If CPI is in line with estimate or higher, currency would strengthen			

Source; Compiled by Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

In order to ensure the fairness and transparency in the markets, Credit Rating Agencies became subject to the Credit Rating Agencies' registration system based on the Financial Instruments and Exchange Act. In accordance with this Act, in soliciting customers, Financial Instruments Business Operators, etc. shall not use the credit ratings provided by unregistered Credit Rating Agencies without informing customers of the fact that those Credit Rating Agencies are not registered, and shall also inform customers of the significance and limitations of credit ratings, etc.

■ The Significance of Registration

Registered Credit Rating Agencies are subject to the following regulations:

- 1) Duty of good faith.
- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
- 3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

In addition to the above, Registered Credit Rating Agencies are subject to the supervision of the Financial Services Agency ("FSA"), and as such may be ordered to produce reports, be subject to on-site inspection, and be ordered to improve business operations, whereas unregistered Credit Rating Agencies are free from such regulations and supervision.

■ Credit Rating Agencies

[Standard & Poor's]

The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: S&P Global Ratings ("Standard & Poor's")

The name and registration number of the Registered Credit Rating Agency in the group: S&P Global Ratings Japan Inc. (FSA commissioner (Rating) No.5)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating Information" (<http://www.standardandpoors.co.jp/unregistered>) in the "Library and Regulations" section on the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

Assumptions, Significance and Limitations of Credit Ratings

Credit ratings assigned by Standard & Poor's are statements of opinion on the future credit quality of specific issuers or issues as of the date they are expressed and they are not indexes which show the probability of the occurrence of the failure to pay by the issuer or a specific debt and do not guarantee creditworthiness. Credit ratings are not a recommendation to purchase, sell or hold any securities, or a statement of market liquidity or prices in the secondary market of any issues.

Credit ratings may change depending on various factors, including issuers' performance, changes in external environment, performance of underlying assets, creditworthiness of counterparties and others. Standard & Poor's conducts rating analysis based on information it believes to be provided by the reliable source and assigns credit ratings only when it believes there is enough information in terms of quality and quantity to make a conclusion. However, Standard & Poor's does not perform an audit, due diligence or independent verification of any information it receives from the issuer or a third party, or guarantee its accuracy, completeness or timeliness of the results by using the information. Moreover, it needs to be noted that it may incur a potential risk due to the limitation of the historical data that are available for use depending on the rating.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of March 7th, 2017, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

[Moody's]

The Name of the Credit Rating Agencies Group, etc

The name of the Credit Rating Agencies group: Moody's Investors Service, Inc. ("MIS")

The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website (https://www.moody.com/pages/default_ja.aspx))

Assumptions, Significance and Limitations of Credit Ratings

Credit ratings are Moody's Investors Service, Inc.'s ("MIS") current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. MIS defines credit risk as the risk that an entity may not meet its contractual, financial obligations as they come due and any estimated financial loss in the event of default. Credit ratings do not address any other risk, including but not limited to: liquidity risk, market value risk, or price volatility. Credit ratings do not constitute investment or financial advice, and credit ratings are not recommendations to purchase, sell, or hold particular securities. No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such rating or other opinion or information, is given or made by MIS in any form or manner whatsoever.

Based on the information received from issuers or from public sources, the credit risks of the issuers or obligations are assessed. MIS adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MIS considers to be reliable. However, MIS is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of May 13th, 2016, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Moody's Japan K.K. (https://www.moody.com/pages/default_ja.aspx)

[Fitch]

The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: Fitch Ratings ("Fitch")

The name and registration number of the Registered Credit Rating Agency in the group: Fitch Ratings Japan Limited (FSA commissioner (Rating) No.7)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Outline of Rating Policies" in the section of "Regulatory Affairs" on the website of Fitch Ratings Japan Limited (<https://www.fitchratings.co.jp/web/>)

Assumptions, Significance and Limitations of Credit Ratings

Ratings assigned by Fitch are opinions based on established criteria and methodologies. Ratings are not facts, and therefore cannot be described as being "accurate" or "inaccurate". Credit ratings do not directly address any risk other than credit risk. Credit ratings do not comment on the adequacy of market price or market liquidity for rated instruments. Ratings are relative measures of risk; as a result, the assignment of ratings in the same category to entities and obligations may not fully reflect small differences in the degrees of risk. Credit ratings, as opinions on relative ranking of vulnerability to default, do not imply or convey a specific statistical probability of default.

In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The assignment of a rating to any issuer or any security should not be viewed as a guarantee of the accuracy, completeness, or timeliness of the information relied on in connection with the rating or the results obtained from the use of such information. If any such information should turn out to contain misrepresentations or to be otherwise misleading, the rating associated with that information may not be appropriate. Despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

For the details of assumption, purpose and restriction of credit ratings, please refer to "Definitions of ratings and other forms of opinion" on the website of Fitch Rating Japan Limited.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of May 13th, 2016, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Fitch Rating Japan Limited (<https://www.fitchratings.co.jp/web/>)

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

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