Forex Market Weekly

Risk of yen appreciation on US/China trade war concerns

- USD strengthened with EUR dropping after ECB meeting
- Long-term Treasury yields down despite FOMC lifting rate hike outlook
- OPEC output hike agreement could lead to cheaper oil, stronger yen

This week's USD/JPY forecast range

18 - 22 Jun: Y108.8-110.8/$ (Y110.7 at end-previous week)

Forex Market View DSFE154
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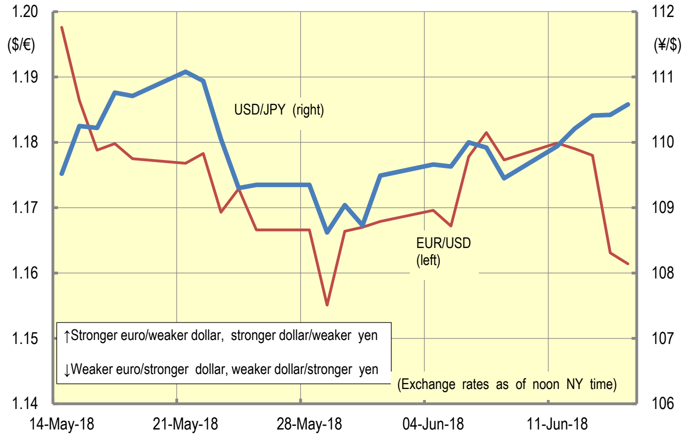
USD strengthened with EUR dropping after ECB meeting

Overview of last week's forex market

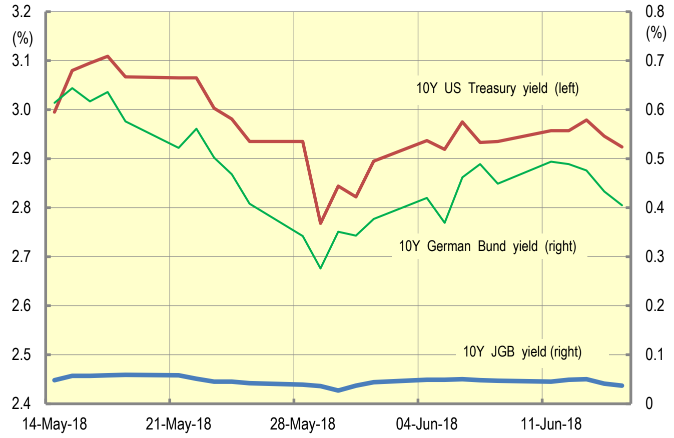
The yen depreciated against a wide range of currencies on 11-12 June, possibly due to a stronger risk appetite amid expectations for reduced geopolitical risks ahead of the US-North Korea summit. This summit produced a comprehensive agreement in which the US promised North Korea various security guarantees and North Korea pledge to work toward full denuclearization. However, yen depreciation quickly stalled when it became clear that the two sides did not spell out the exact process for denuclearization. The dollar rose ahead of the FOMC meeting on 12-13 June. With the Fed raising interest rates by 25 basis points and revising upward federal funds rate target range, Treasury yields and the USD/JPY moved higher, but US equities fell, which led to a retreat for the USD/JPY. The USD/JPY dropped to 109.90 following reports that the US was preparing punitive tariffs on Chinese goods. Meanwhile, the ECB said it would reduce its monthly purchases of government and private debt to EUR15.0bn for the final three months of 2018 and completely exit from its crisis-era quantitative easing policy at the end of December. However, the euro fell as the ECB also indicated that a rate hike is unlikely before the summer of 2019. The USD/JPY turned up as dollar buying spread and stronger-than-expected US retail sales also provided a tailwind for dollar. A stronger yen in currency cross trading is possible if the US follows through with its threat to impose a 25% tariff on Chinese imports on 6 July worth USD34.0bn.

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



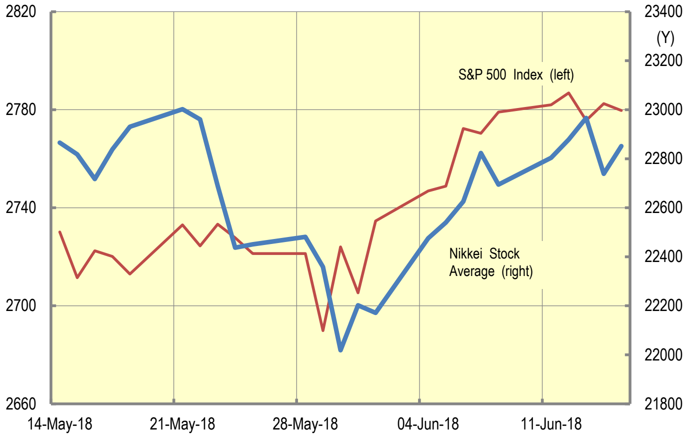
Source: Thomson Reuters; compiled by Daiwa Securities.

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



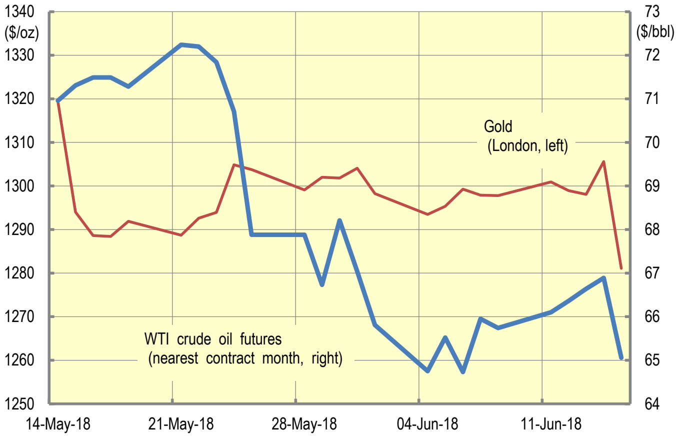
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



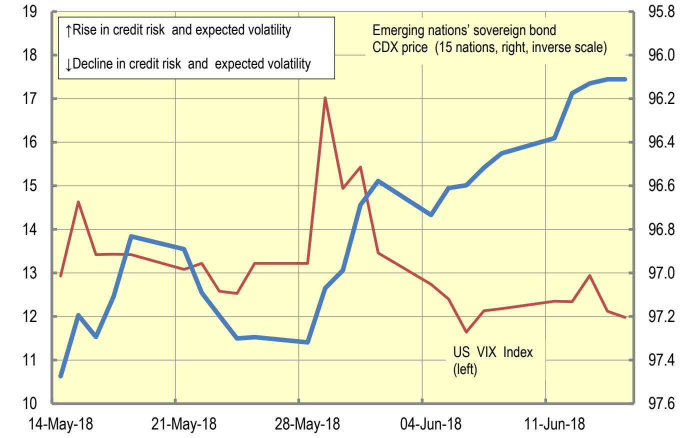
Source: Thomson Reuters; compiled by Daiwa Securities.

Long-term Treasury yields down despite FOMC lifting rate hike forecasts

Fed lifts rate hike outlook, but long-term Treasury yields fall

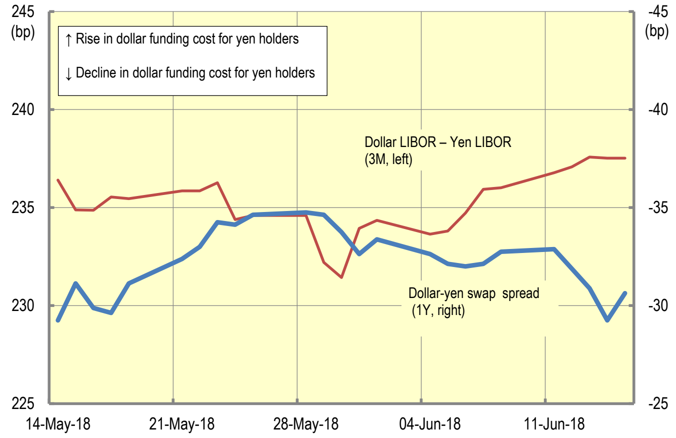
The FOMC raised interest rates by 25 basis points and revised upwards its federal fund rate forecasts for end-2018 and end-2019. The median end-2018 federal funds rate forecast increased from 2.125% to 2.375% and the largest number of members now expect two more rate hikes this year. However, this was actually a modest change as it was attributed to just one member changing his forecast from 2.125% to 2.375%. The median end-2019 fed funds rate forecast increased to 3.125%. The number of members making this projection increased from two at the March meeting to four, which is the same number of members now projecting 2.875%. Real GDP and core PCE inflation projections were revised upward for only 2018, with no changes made to these projections for 2019 and 2020, likely because recent US economic indicators have improved and FF rate forecasts only reflect the recent modest increase for its interest rate hike projections. That said, if the federal funds rate quickly approaches the level that members consider the neutral level, the negative impacts on economic growth could quickly emerge. Possibly due to weakened expectations for a prolonged rate hiking cycle, long-term Treasury yields fell and acted as a USD/JPY drag.

Chart: US VIX Index and Emerging Market CDS



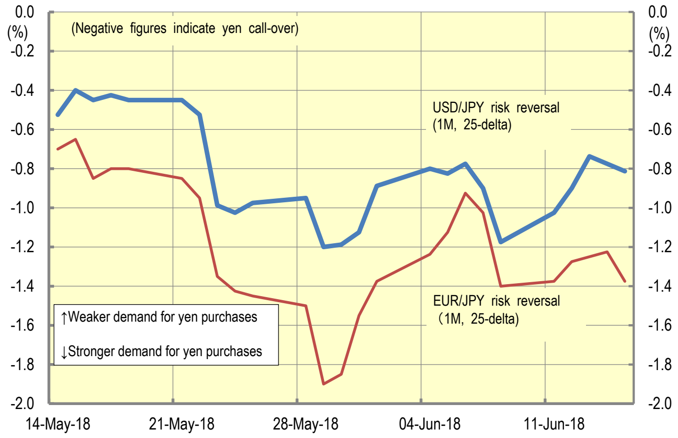
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



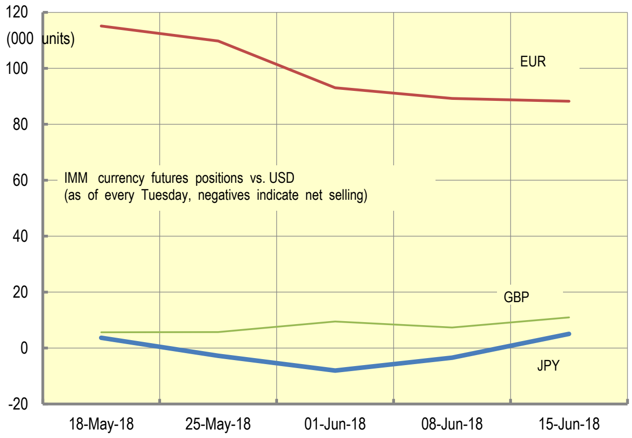
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

Heightened risk of yen appreciation amid US/China trade war concerns

US President Donald Trump announced the introduction of 25% tariffs on Chinese high-tech and intellectual property-related goods imported into the US. The first round of 25% tariffs will hit $34.0bn in Chinese goods starting from 6 July. The USD/JPY decline following this announcement was limited, possibly because some market participants are holding out hope that trade negotiations with China will continue and the implementation of tariffs can be avoided. Still, there has been a strong-yen inclination in currency cross trading. The US is apparently putting the finishing touches on a list of Chinese goods that could be subject to additional tariffs worth about $100.0bn and will probably determine whether to implement such tariffs in an incremental manner while watching China's response. Meanwhile, China is hammering out retaliatory tariffs on US goods. We believe that trade friction between the US and China is more likely to worsen than improve. Europe is also hardening its opposition to America's protectionist policies, further increasing the risk of yen appreciation.

OPEC output hike agreement could lead to cheaper oil, stronger yen

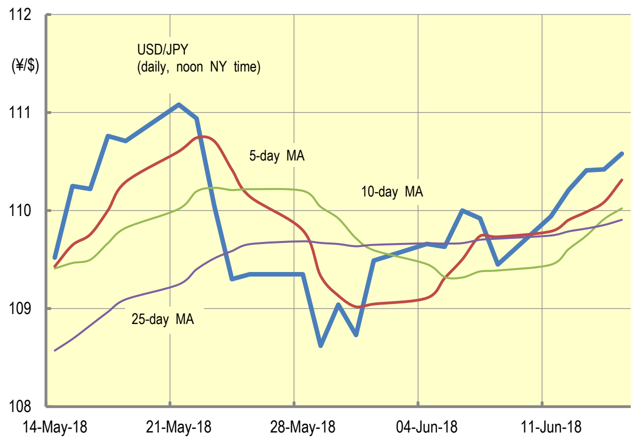
Will output hike agreement lower oil price, boost yen?

Amid lower oil production in Venezuela (economic crisis) and expectations for reduced production in Iran (restarting of US sanctions), OPEC members are likely to discuss relaxing its output cuts at the 22 June meeting. Trump has criticized OPEC's coordinated output cuts as producing excessively high crude oil prices and apparently called on Saudi Arabia to lift production before announcing he was pulling the US out of the Iran nuclear deal. According to the International Energy Agency, OPEC had 3.4 million barrels/day of spare production capacity as of May with Saudi Arabia accounting for 60% of this amount. With Saudi Arabia increasing its oil production in May versus April to the agreed upon production cut level, production volumes from Russia in early June apparently pushed output above the agreed production cut level. There is a good chance that the OPEC will agree to increase production at its next meeting with Saudi Arabia and Russia supporting the production increase. If there is an agreement to incrementally increase production to near 1.5 million barrels/day, the yen would likely strengthen as cheaper oil prices work to lower interest rates overseas.

Noteworthy currency: GBP

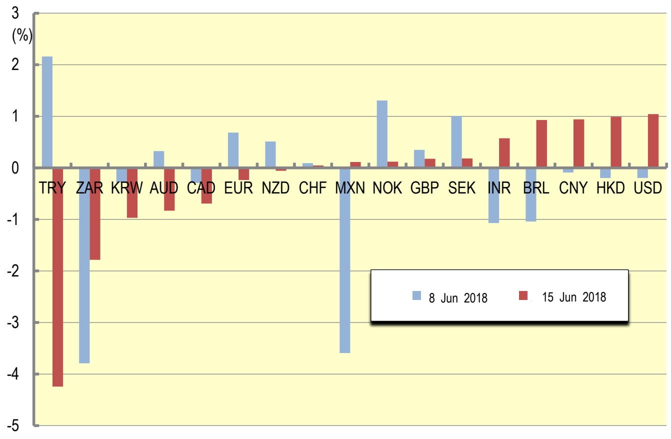
Expectations are that when the Bank of England's Monetary Policy Committee meets on 21 June it will make no changes to interest rates, citing insufficient data for making a rate hike decision. At the May meeting the committee took an optimistic view of the slowing economy, describing sluggish conditions as a temporary and indicating its intention to ascertain if that is in fact the case. Our focal point for the June meeting is the Bank's assessment of the economy and any hints at the possible timing for a rate hike. There is no need to rush to hike rates as the inflation target should start to recover during the three-year forecast period assuming multiple rate hikes are implemented. Close to a majority of market participants expect the next hike to come at the August meeting. If the BOE is more confident in its view that recent economic sluggishness was a one-off, and if it hints at a rate hike in August, the GBP would likely strengthen (and vice versa).

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

19-Jun	○	Minutes of RBA MPM (5 Jun)
		May US housing starts
		ECB Forum on Central Banking (till 20th, Portugal)
20-Jun		Jan-Mar US balance of payments
		May US existing home sales
21-Jun	○	MPM at Brazilian central bank
	○	BOE MPC meeting
		Jun Philadelphia Fed's Business Outlook Survey Index
22-Jun		Jun eurozone PMI (Markit)
		OPEC General Meeting (Vienna)
24-Jun	●	Turkish presidential and congressional elections

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

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

	11 - 15 Jun 2018 (actual)		18 - 22 Jun 2018 (forecasts)	
	Range	Weekend	Range	Weekend
USD/JPY	109.2-110.9	110.7	108.8-110.8	109.5
EUR/JPY	127.6-130.4	128.4	126.2-128.7	127.0
EUR/USD	1.154-1.186	1.161	1.150-1.170	1.160

Noteworthy Currencies and factors

GBP	If bullish economic assessment or Aug rate hike is implied, pound would strengthen
TRY	Presidential and congressional elections are close races; situation would remain uncertain even after elections

Source; Compiled by Daiwa Securities.

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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.

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

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

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Credit ratings are Moody's Investors Service ("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.

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[Fitch]

The Name of the Credit Rating Agencies group, etc

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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.

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May 2018

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 materials presented along with this cover letter, 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.

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.
Financial instruments firm:chief of Kanto Local Finance Bureau (Kin-sho) No.108
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The Financial Futures Association of Japan
Japan Investment Advisers Association
Type Ⅱ Financial Instruments Firms Association