

# Forex Market Weekly

## The key is whether the US will include exchange rates in trade negotiations with Japan

- The yen weakened in response to the BOJ's policy; the yen also appreciated due to concerns over US-China trade friction
- Risk-off sentiment is likely to grow due to concerns over the US-China trade war
- The key is whether the US will include exchange rates in trade negotiations with Japan

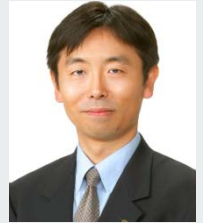
### This week's USD/JPY forecast range

**6 - 10 Aug: Y110.0 – 112.0/\$ (Y111.3 at end-previous week)**

Forex Market View DSFE168  
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.

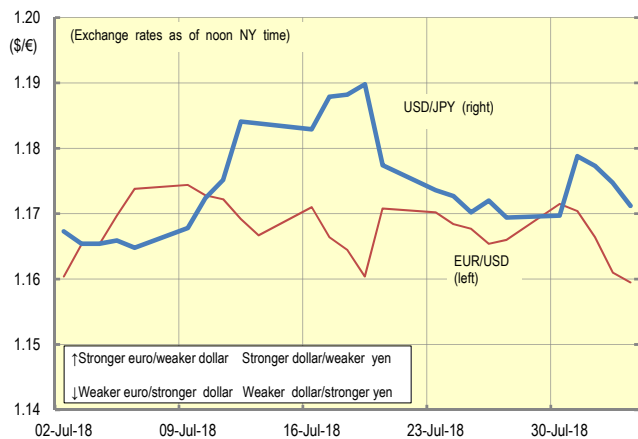


## The yen weakened in response to the BOJ's policy; the yen also appreciated due to concerns over US-China trade friction

### Overview of last week's forex market

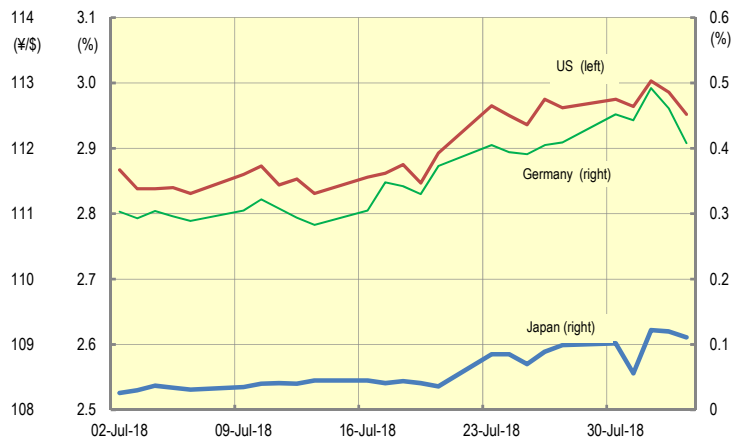
Following its offer on 27 July, the BOJ again offered to buy an unlimited amount of JGBs in the 5- to 10-year zone at a fixed rate of 0.100% on 30 July. The amount of bids reached an all-time high of Y1.64tn, indicating strong concerns about a rise in interest rates after the BOJ's Monetary Policy Meeting (MPM). The euro strengthened after the announcement that Apr-Jun Swedish GDP rose 1.0% q/q, higher than the market consensus. At its MPM on 31 July, the BOJ decided to widen its assumed fluctuation range for long-term interest rates via asset purchases in a more flexible manner. On the other hand, the Bank showed its intention to maintain the interest rate target of "around 0%" as well as the current extremely low levels of short- and long-term interest rates for an extended period of time. Following the decision, Japanese long-term interest rates plunged, which led to a weaker yen. Reflecting media reports that the US and China were trying to resume trade talks, the yen has weakened further. The USD/JPY temporarily rose to the ¥112/\$ level, although the media reported that the Trump administration planned to propose an import tariff of 25% on \$200bn worth of Chinese products (up from the 10% tariff proposed previously). After it turned out that the July US ISM manufacturing PMI fell below forecasts, US long-term interest rates hit a peak and the USD/JPY also declined. As US economic indicators fell short of market estimates across the board—in addition to China announcing a policy of imposing retaliatory tariffs on \$60bn worth of US products—the USD/JPY fell to the 111.0-111.5 level.

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



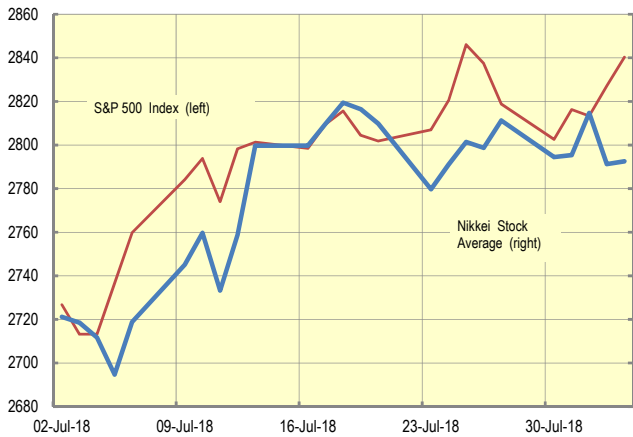
Source: Thomson Reuters; compiled by Daiwa Securities.

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



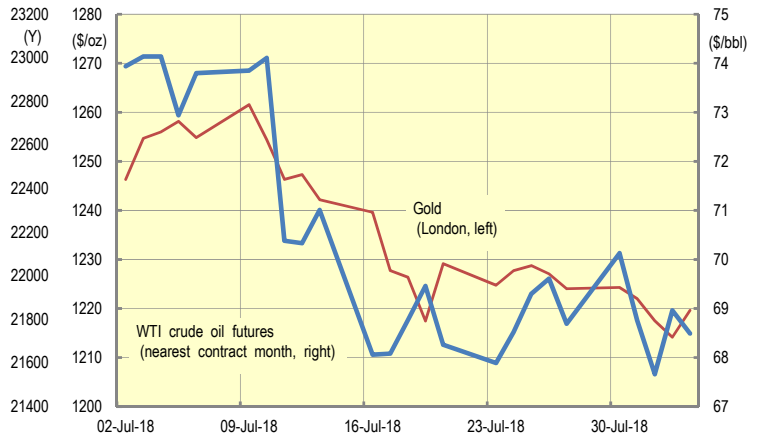
Source: Thomson Reuters; compiled by Daiwa Securities.

**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.

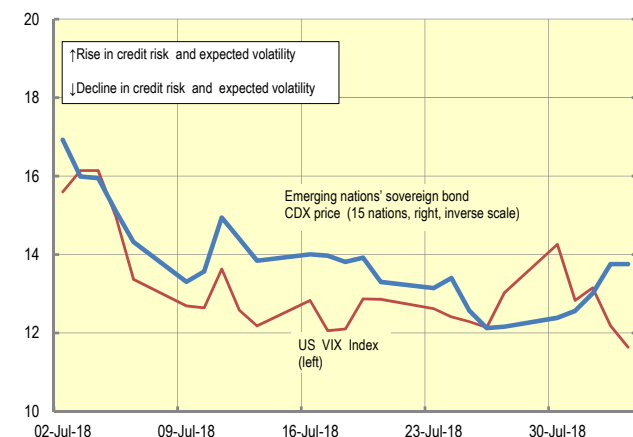
**Risk-off sentiment is likely to grow due to concerns over the US-China trade war**

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Reportedly, the Trump administration is considering imposing an import tariff of 25% (up from 10%) on \$200bn worth of Chinese products. It is unclear whether this is a countermeasure based on a judgment that China is inducing the yuan to weaken. However, the US is poised to correct current trade practices by putting more pressure on China. China has indicated a policy of imposing retaliatory tariffs in response to the reports. As China has a sense of mistrust toward the US, which broke the US-Sino trade agreement in May 2018, it has little intention of compromising on the US's hard-line stance. If the US softens its stance (e.g., removes the additional tariff), China would make concessions. Recently, China has strengthened its aggressive fiscal policy and announced a fine-tuning (easing) monetary policy stance. This may be a manifestation of China's stance of making no concessions to the US as well as its measures to cope with financial deleveraging and downward pressure on the economy and prices.

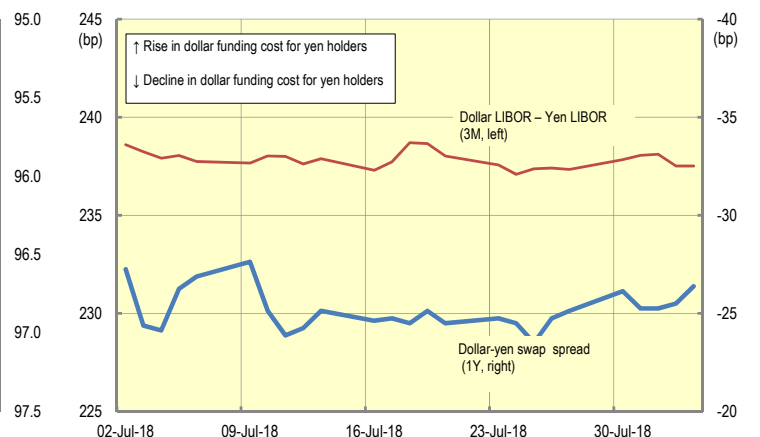
If US Treasury Secretary Steven Mnuchin (who is part of the moderate faction within the administration) tries to resume negotiations, it would be difficult to resume talks unless the hard-line faction changes its stance. Even if President Trump has no intention of invoking a third round of large tariffs against China and uses the proposal as a tool to win concessions, concerns about a global economic downturn caused by the US-China trade war are likely to grow, and risk-off pressure will likely increase toward September when we see the possibility of a tariff imposition (public comments to be collected by 5 September in the case of a change in the tariff rate). If risk-off sentiment strengthens and increases concerns about the US economy, it should be easier to buy the yen than the dollar.

**Chart: US VIX Index and Emerging Market CDS**



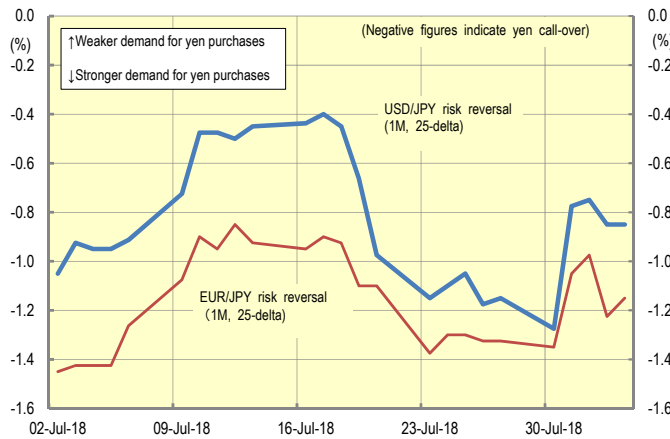
Source: Thomson Reuters; compiled by Daiwa Securities.

**Chart: LIBOR Gap and Currency Swap Spread**



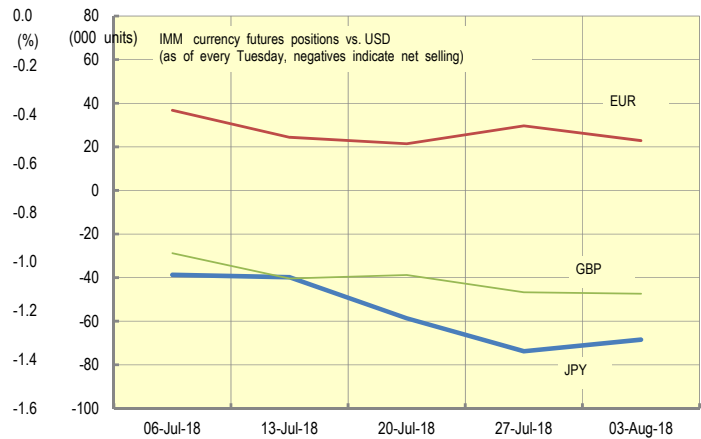
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

### The key is whether the US will include exchange rates in trade negotiations with Japan

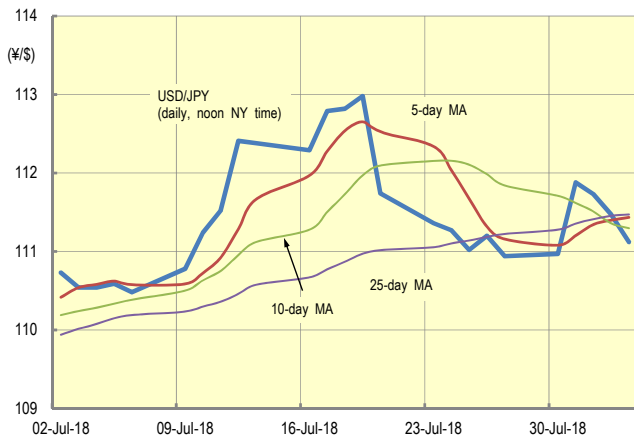
#### The key is whether the US will include exchange rates in trade negotiations with Japan

The first meeting of the latest Japan-US trade talks will be held in Washington, D.C. on 9 August. While the US has been demanding a free trade agreement (FTA), Japan is expected to deny that request. The current structure is likely to remain unchanged. While the US is expected to request tighter regulations on automobile exports to the US (i.e., a reduction in exports), Japan is likely to fend off such a request by increasing direct investment in the US. When the US announced on 27 March that it had reached an agreement on FTA renegotiations with South Korea, an appendix was added (having no binding force, as it is not directly related to the subject of sanctions) in which the South Korean government promised that it would avoid won depreciation guidance (exchange rate manipulation) and which tried to link the trade agreement with currency clauses. One of the focal points is whether the US would require Japan to agree to an exchange rate clause in the course of trade talks. Assuming that the US would make some sort of request, we presume the US may demand that Japan agree to “avoid issuing de facto guidance for yen depreciation via the BOJ’s excessive momentary easing” as Japan is not intervening directly in foreign exchange rates (yen-selling intervention).

#### Noteworthy currencies: AUD and NZD

Monetary policy meetings are scheduled this week in Oceania—on 7 August at the RBA and on 9 August at the New Zealand central bank. The status quo is expected for policy at both banks. In Australia, headline CPI rose by 2.1% y/y in 2Q, higher than the 1.9% growth in 1Q. However, this was weaker than the estimate, and growth in the underlying inflation rate slowed from 2.0% to 1.9%. The market’s view is unchanged that the policy interest rate will be maintained for the time being. At New Zealand’s central bank, “maximizing sustainable employment” has been added as a mandate under the new government since March 2018. The unemployment rate, released on 1 August, rose to 4.5% in 2Q (from 4.4% in 1Q). However, as supply/demand conditions in the labor market remain tight, neither a rate hike nor a rate cut is expected. There is little possibility that the market will factor in the two upcoming meetings.

**Chart: USD/JPY and Moving Average**



Source: Thomson Reuters; compiled by Daiwa Securities.

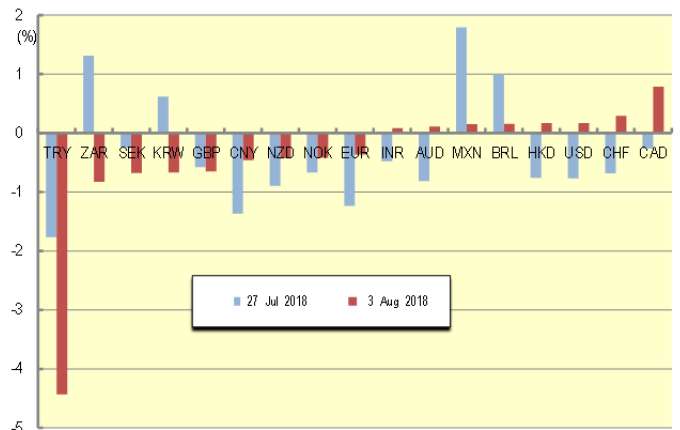
**Chart: Weekly Schedule for Major Economic Indicators/events**

- 6-Aug Jun German manufacturing orders
- 7-Aug ○ RBAMPM  
Jun German industrial production, trade statistics
- 8-Aug Summary of Opinions at BOJ's MPM on 30-31 Jul  
**Jul China trade statistics**
- 9-Aug ○ MPM at New Zealand's central bank  
Jul China CPI  
Jul US PPI  
● **Japan-US trade talks (in Washington, D.C.)**
- 10-Aug Apr-Jun Japan GDP (1st preliminary)  
Apr-Jun UK GDP  
**Jul US CPI**

Source: Compiled by Daiwa Securities.

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

**Chart: Weekly Currency Performance (vs. yen)**



Source: Thomson Reuters; compiled by Daiwa Securities.

**Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors**

	30 Jul - 3 Aug 2018	2018 (actual)	6 - 10 Aug 2018 (forecasts)	
	Range	Weekend	Range	Weekend
USD/JPY	110.7-112.2	111.3	110.0-112.0	110.6
EUR/JPY	128.6-131.2	128.7	127.5-130.0	127.7
EUR/USD	1.155-1.175	1.157	1.150-117.0	1.155

Noteworthy currencies and factors

AUD	As higher inflation rate was not conformed, policy likely to be unchanged in the near term
NZD	While labor supply/demand conditions remain tight, unemployment rate worsened; current policy would be maintained

Source: Compiled by Daiwa Securities.

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- 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.
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#### [Standard & Poor's]

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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)

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

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#### [Fitch]

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**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

Memberships: Japan Securities Dealers Association

The Financial Futures Association of Japan

Japan Investment Advisers Association

Type II Financial Instruments Firms Association