Daiwa Securities

Forex Market Weekly

US economic indicators may cause further yen appreciation

- Currencies in a risk-off market reflecting many international conflicts
- Once risk-off sentiment strengthens, yen appreciation should outweigh dollar appreciation
- July US retail sales may fall short of market consensus, which could lead to a stronger yen

This week's USD/JPY forecast range

13 - 17 Aug: Y109.5 – 111.5/$ (Y110.9 at end-previous week)

Forex Market View DSFE170
FICC Research Dept.

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

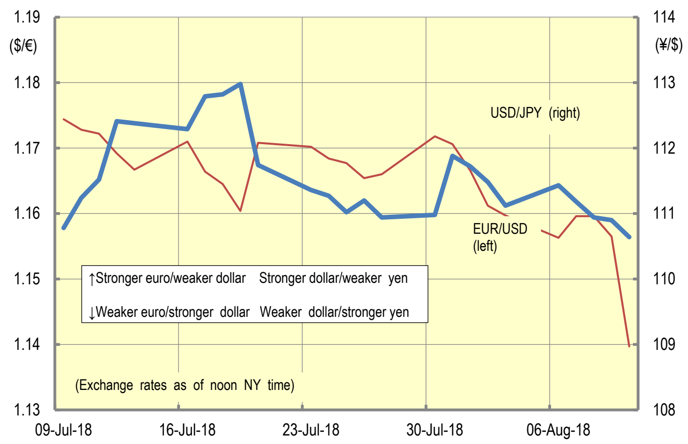
FX Analyst
Mayu Shinooka
(81) 3 5555-8777
mayu.shinooka@daiwa.co.jp
Daiwa Securities Co. Ltd.

Currencies in a risk-off market reflecting many international conflicts

Overview of last week's forex market

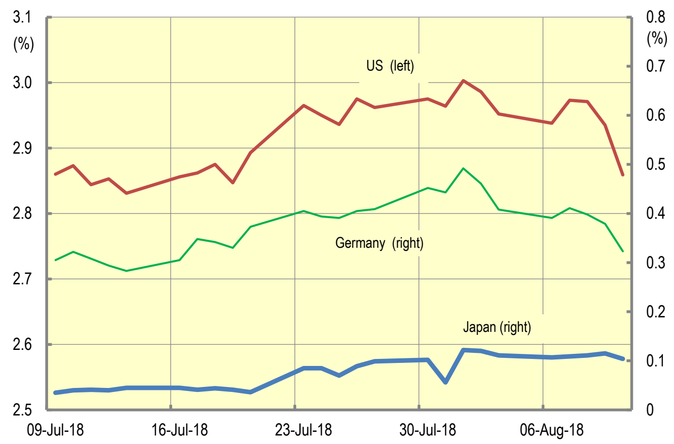
On 6 August, Italian Deputy Prime Minister Luigi Di Maio stated that respecting the European Union's fiscal rules was not a priority for Italy's new government. This remark led to further depreciation of the euro/appreciation of the dollar. Amid the rise in the dollar versus a broad range of currencies, the USD/JPY rose to Y111.53. Following the rebound of Chinese stocks on 7 August, a broad range of currencies conversely rose against the dollar, alongside the rise in cross-yen pairs. After the USD/JPY retreated, the rate rebounded amid an uptrend in US share prices. Although the United States Trade Representative (USTR) announced that the US would impose a 25% tariff on an additional $16bn worth of imports from China from 23 August, cross-yen pairs and the USD/JPY were solid as China's July exports exceeded the market estimate. However, they gradually retreated due to risk-off driven yen appreciation. The USD/JPY declined after China announced a plan for around the same amount of retaliatory tariffs on imports from the US. In addition to further weakening of the pound due to concerns about a Brexit without a formal agreement, the Turkish lira plunged on concerns about the deterioration of US-Turkey relations via a sanctions war. The Russian ruble also weakened substantially, reflecting the US's decision on additional sanctions on Russia. The euro declined versus the dollar as risk-off sentiment intensified. Amid declines by many currencies versus the dollar and/or the yen, the USD/JPY rate declined to Y110.49.

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



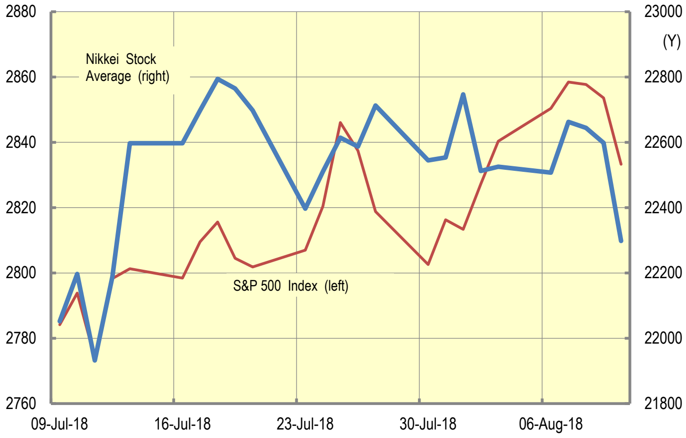
Source: Thomson Reuters; compiled by Daiwa Securities.

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



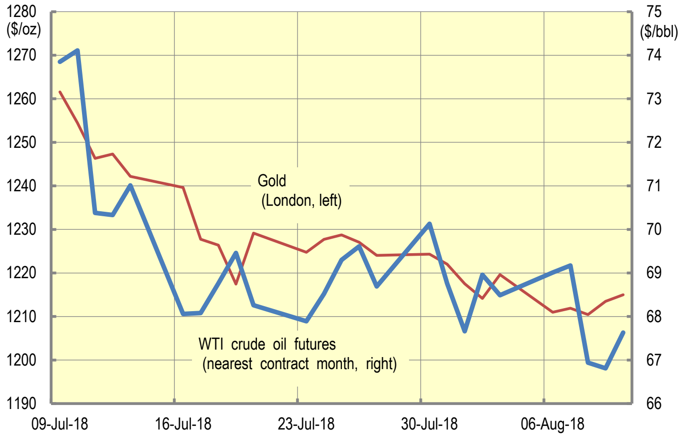
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



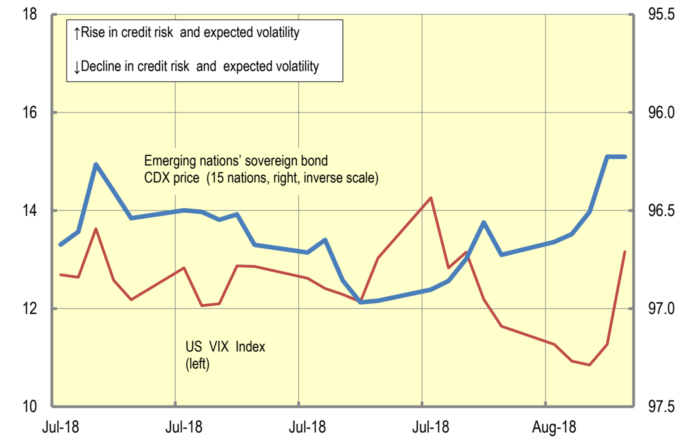
Source: Thomson Reuters; compiled by Daiwa Securities.

Once risk-off sentiment strengthens, yen appreciation should outweigh dollar appreciation

Once risk-off sentiment strengthens, yen appreciation should outweigh dollar appreciation

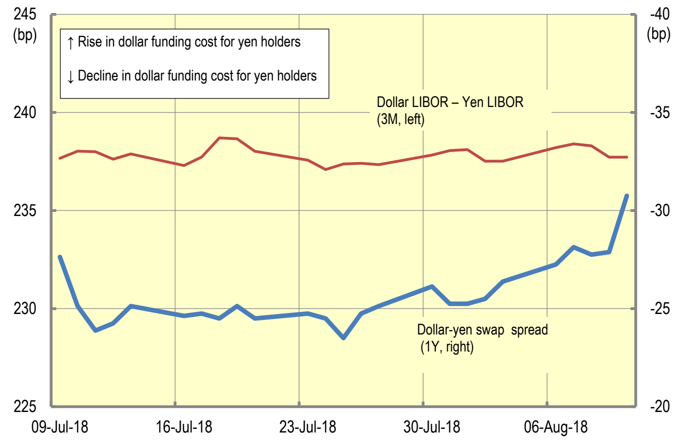
The decline in many currencies (starting with emerging currencies) versus the dollar and/or the yen appears to indicate an increase in risk-off sentiment. One reason would be a larger number of international conflicts. Starting with the US-China trade friction, the US has imposed sanctions on Iran, Russia, and Turkey, while Saudi Arabia partially froze trade with Canada. On top of this, there are signs of the US-North Korea conflict heating up as the US has pointed out that North Korea is not proceeding with the denuclearization process. Moreover, the UK is facing difficulties with Brexit negotiations, raising concerns about a Brexit without a formal agreement. Unless the number of international conflicts decreases, the situation should lead to risk-off driven yen appreciation and/or dollar appreciation. To date, the USD/JPY has risen in some stages dominated by appreciation of the dollar amid a “weak risk-off mode.” However, once we see “strong risk-off sentiment,” a decline in the USD/JPY would be more likely as yen appreciation would outweigh dollar appreciation.

Chart: US VIX Index and Emerging Market CDS



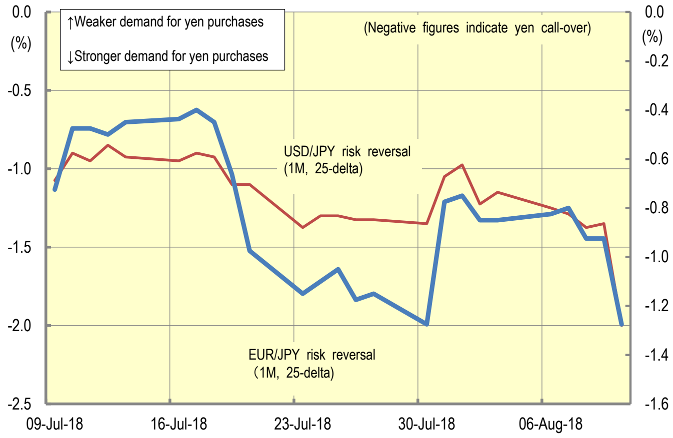
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



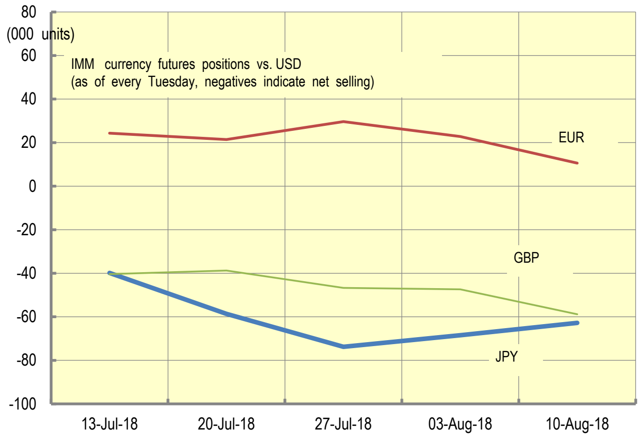
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

July US retail sales may fall short of market consensus, which could lead to a stronger yen

A decline in crude oil prices in anticipation of sluggish demand tends to cause yen appreciation

The US re-imposed sanctions against Iran, which is serving as a factor to raise crude oil prices via concerns about lower oil supplies from Iran. However, this would not constitute strong pressure because (1) moves to change oil suppliers from Iran to other nations would reduce Iran's oil supply, while such a move would increase other nations' oil supply, and (2) oil importing nations are unlikely to decrease supply from Iran before they decide on alternative suppliers. Rather than this, oil prices would likely be affected more by inventory trends. US gasoline inventories already exceed the year-earlier level, and the degree of y/y decline in crude oil and distillate oil inventories has been narrowing. Inventories of petroleum products have been increasing amid a lack of output growth, implying weaker demand. If crude oil prices turn down in anticipation of sluggish demand, yen appreciation would be more likely via lower stock prices and overseas interest rates.

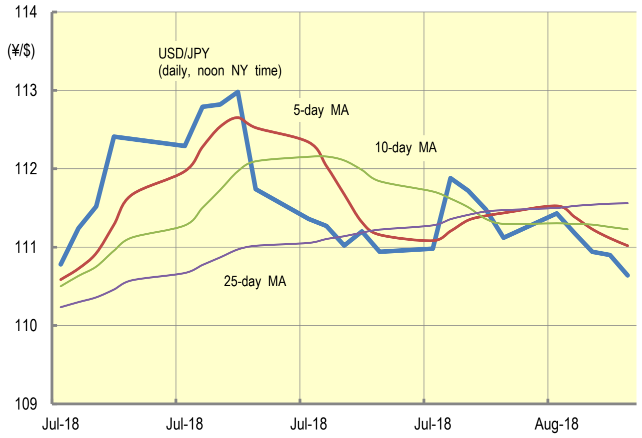
July US retail sales may fall short of market consensus, which could lead to a stronger yen

The m/m average growth of US retail sales during March-June was high at 0.7%, indicating favorable private consumption on tax-cut effects. This trend has supported risk-on moves and the rise in the USD/JPY. However, US consumer sentiment reached a peak in March, and June core retail sales (excluding automobiles, gasoline, construction materials, and food services) remained flat. In July, auto sales (volume basis) fell remarkably, alongside a slight decline in gasoline prices. Even if July core retail sales (to be announced on 15 August) meet the market consensus at the same growth as the +0.4% logged in June, overall retail sales are highly likely to fall short of the market consensus of +0.3%. If the growth is low and roughly flat m/m, the figure could cause concern about a US economic slowdown and risk-off yen appreciation.

Noteworthy currency: TRY

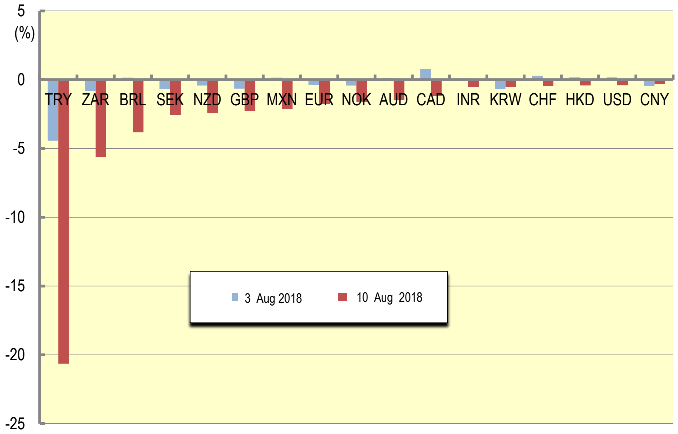
Last week, the Turkish lira plunged due to deterioration in US-Turkey relations. Despite a number of negative factors, Turkey has few available measures to protect its currency, making it difficult to put the brakes on lira depreciation at the beginning of this week as well. Finance Minister Berat Albayrak announced that the nation would formulate/implement an action plan to alleviate concerns, but the details are unclear. As the nation has only a small amount of foreign reserves, it is unable to support the lira via buying intervention. Moreover, the central bank is reluctant to intervene in the currency market. Even after the currency plunge, President Recep Tayyip Erdogan recommended that the public buy the lira and sell the dollar/gold. As he is refusing a rate hike—the only remaining realistic measure to protect the currency—it looks difficult for the lira to stage a recovery, despite implementation of an action plan, unless the president accepts a tightening stance.

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

14-Aug	Jul China retail sales, industrial production
	Apr-Jun German GDP
	Apr-Jun eurozone GDP (revised)
	Aug German ZEW Indicator of Economic Sentiment
	Jul US Import/Export Price Index
15-Aug	Jul China 70 cities housing prices
	Jul US retail sales
	Aug NY Fed's Empire State Manufacturing Index
	Apr-Jun US labor productivity/unit labor cost
	Jul US industrial production, capacity utilization rate
16-Aug	Jul Japan trade statistics
	Jul UK retail sales
	Jul US housing starts
	Aug Philadelphia Fed's Business Outlook Survey Index

Source; Compiled by Daiwa Securities.
Notes: Dates based on JST.

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

	6 - 10 Aug 2018 2018 (actual)		13 - 17 Aug 2018 (forecasts)	
	Range	Weekend	Range	Weekend
USD/JPY	110.5-111.6	110.9	109.5-111.5	110.0
EUR/JPY	126.0-129.5	126.5	124.0-127.5	125.0
EUR/USD	1.138-1.163	1.141	1.130-1.150	1.135

Noteworthy currencies and factors

TRY	Formulated measures failed to eliminate concerns; lira would remain weak
EUR	On weak note due to concerns about exposure to Turkey at European banks
GBP	Tough negotiations with EU would weigh on pound; having negative impact on euro
CNY	Fluctuation range would expand reflecting PBOC's stance of ensuring ample liquidity of CNY

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 ("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.moodys.com/pages/default_ja.aspx)

Assumptions, Significance and Limitations of Credit Ratings

Credit ratings are Moody's Investors Service'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 April 16th, 2018, 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.moodys.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/)

May 2018

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