Forex Market View

USD/JPY loses upward momentum on US economic slowdown

- Contribution to US economic growth from net exports declined sharply
- Will employment slow as did business investment in the US?
- USD/JPY to decline on interest rate decline and risk-off moves brought by US economic slowdown

USD/JPY forecast range (latest: noon New York time)

28 Nov– 27 Dec: Y109.3-114.3/$ (Y113.84/$ as of 27 Nov)

Forex Market View DSFE196

FICC Research Dept.

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

Daiwa Securities Co. Ltd.

Contribution to US economic growth from net exports declined sharply

Concerns over economic slowdown explain the decline in USD/JPY

The decline in US stocks and long-term rates in November has been putting downward pressure on the USD/JPY, and we attribute this to concerns over an economic slowdown. Amid recent signs of weakness in US economic indicators and corporate earnings, Fed officials have begun to adopt a more cautious economic outlook. This has led to a weakening of the market's US economic outlook and fading of rate hike expectations. US stocks and long-term rates turned to a declining trend after the US midterm elections, and one possible reason is the concern that the Trump administration will become less able to implement its policies with a split Congress.

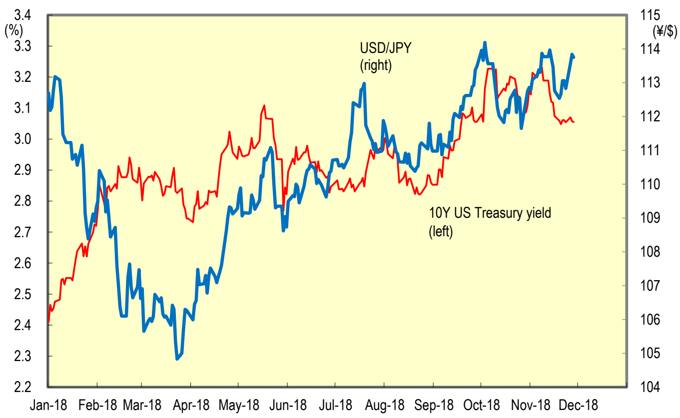
US final demand has slowed considerably

US economic growth is already weakening. The real GDP growth rate (q/q annualized) slowed from its recent high in Apr-Jun 2018 of +4.2% to +3.5% in the following quarter (Jul-Sep). GDP growth is high, but a rise in inventories accounted for +2.07ppt of that growth, such that growth in final demand, which excludes changes in inventory, was only +1.4%. Although partly a pullback from the strong final demand growth number in Apr-Jun of +5.4%, that is the lowest it has been in seven quarters. This slowdown in final demand can be attributed to net exports, business investment, and housing investment.

Contribution to US economic growth from net exports declined sharply

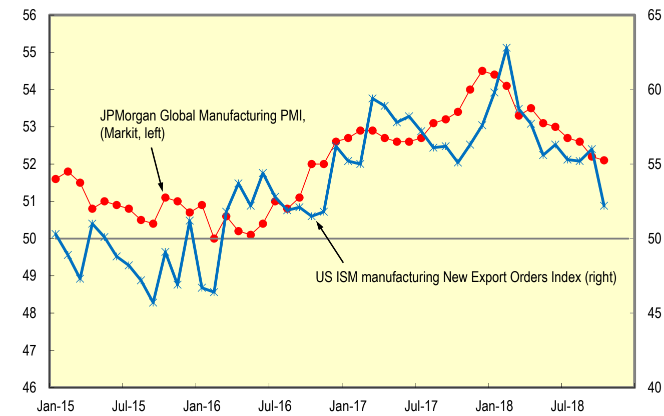
Net exports (exports minus imports) recorded the largest drop in contribution to real GDP growth in the US. Its q/q annualized contribution went from +1.22ppt in Apr-Jun to -1.78ppt in Jul-Sep, a decline of 3.00ppt. Both export declines and import growth have a negative impact on net exports, and exports look likely to continue declining. This can be attributed to the difficult export environment for the US, with global manufacturing PMIs declining in a reflection of slower demand while the dollar's effective exchange rate is in a rising trend. The export orders index for US manufacturers declined significantly in October.

Chart: 10Y US Treasury Yield and USD/JPY



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Global Manufacturing PMI and US Manufacturing New Export Orders Index



Source: Thomson Reuters; compiled by Daiwa Securities.

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Fed Chairman Jerome Powell has cited signs of a global economic slowdown as a source of concern. He is probably worried because declining exports have amplified the negative contribution of net exports to US economic growth, and if that continues it could have negative impacts on domestic demand. If the US economy slows in response to slower economic growth globally, it should weaken the upward momentum of US interest rates and the dollar relative to other countries' interest rates and currencies. In fact, this trend is already evident in bond yields. Meanwhile, there has been no clear weakening of the dollar because the weakening of European currencies brought by Brexit and other factors have served to strengthen the dollar.

Will employment slow as did business investment in the US?

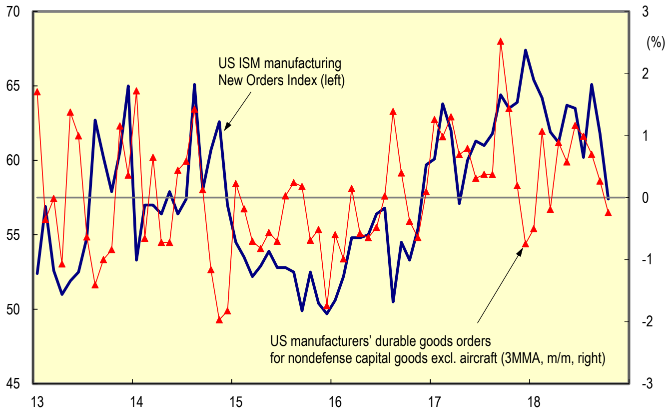
US corporations are becoming less willing to invest

The GDP component that had the next largest decline in its contribution to Jul-Sep US real GDP growth (q/q annualized) behind exports was business investment. The contribution from business investment dropped from +1.15ppt in Apr-Jun to +0.12ppt in Jul-Sep, a decline of 1.03ppt. In its policy statement dated September 26, the FOMC wrote that "household spending and business fixed investment have grown strongly," but it downgraded its assessment of business investment in its policy statement dated November 8, writing that "household spending has continued to grow strongly, while growth of business fixed investment has moderated from its rapid pace earlier in the year." In October, the ISM manufacturing new orders index dropped to its lowest level since April 2017, and this slowdown in business investment appears to be having an impact. The m/m growth in the 3-month moving average of nondefense capital goods excluding aircraft, a leading indicator of business investment, turned negative in October. It appears that US corporations are becoming less willing to invest, as the upward impact on profits from the reduction in corporate taxes wears off and trade friction and the slowdown in overseas economies combine to create concerns over the economy.

Signs that US companies are also becoming less willing to hire

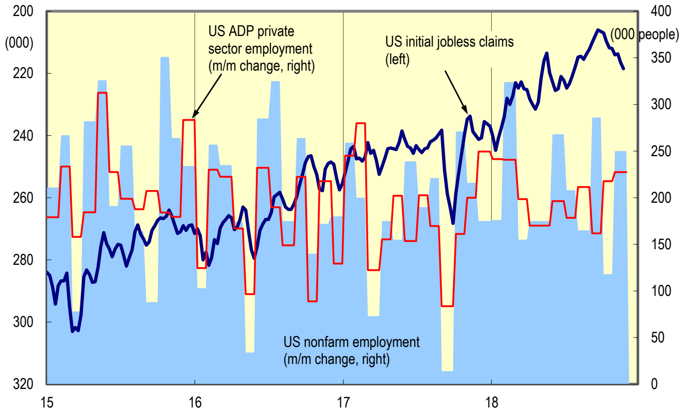
If US companies have begun delaying business investments out of concern over the direction of the economy, they should also become cautious over growth in their payrolls. There are some trends suggesting that companies are becoming less willing to hire. Weekly new unemployment claims had declined to 202,000 by mid-September, but since then have grown to 224,000, the highest since May. Because there was also an increase in the number of unemployment claims from employees who voluntarily quit in order to change jobs, this is not necessarily a sign that employment is weakening. Nevertheless, this together with the fact that the sentiment and employment indices for nonmanufacturers, which account for the bulk of employment, peaked in September and have started worsening makes it likely that this is a sign of the jobs market worsening. Although nonfarm payrolls grew by a strong 250,000 in October, growth in employment is likely to slow moving forward, and if hiring loses momentum, Fed officials will probably adopt a more cautious stance on continued rate hikes. Weaker employment may lead to a decline in US long-term rates and the USD/JPY.

Chart: US Manufacturing New Orders Index and Durable Goods Orders



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: US Initial Jobless Claims and Change in No. of Employees



Source: Thomson Reuters; compiled by Daiwa Securities.

US housing investment was the earliest to start slowing

The contribution to US real GDP growth (q/q annualized) from housing investment is declining, albeit by a slight margin. Housing investment's contribution went from -0.05ppt in Apr-Jun to -0.16ppt in Jul-Sep, a decline of 0.11ppt. Housing investment's contribution to real GDP growth was +0.41ppt in Oct-Dec 2017, but that component of demand has been negative for three consecutive quarters in 2018, and thus it started slowing earlier than exports and business investment. With housing prices high and mortgage rates rising, home sales are declining. Existing home sales in the US increased for the first time in seven months in October, but that increase only amounted to 15% of the decline that occurred from March until September. Single-family home sales and residential building permits also declined in October, and the Housing Market Index (HMI) for November dropped significantly, making it likely that housing investment will continue to weaken. Fed Chairman Jerome Powell has expressed concern over the weakening trend in the housing sector.

USD/JPY to decline on interest rate decline and risk-off moves brought by US economic slowdown

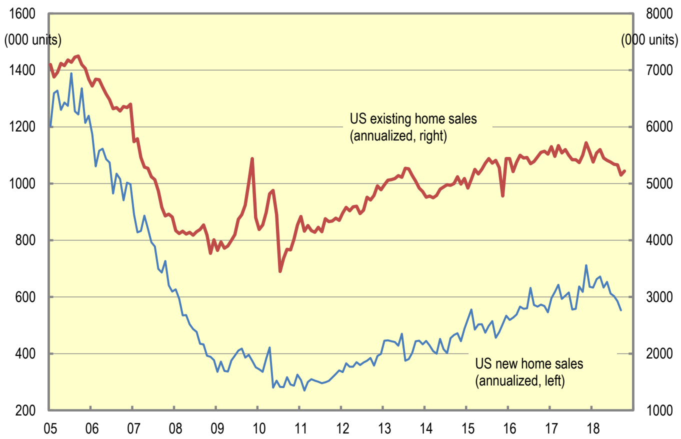
Even robust private consumption provides reason for concern

With so many demand components having started slowing, only private consumption has remained strong. Its contribution to real GDP growth (q/q annualized) posted a recent high in Jul-Sep at +2.69ppt, up from +2.57ppt in Apr-Jun. A big reason for this was probably growth in the wealth effect, as US stock market indices posted new highs from September to early October. Share prices turned to a declining trend after that, however, and relative to their levels at end-September, as of November 27 the Dow Jones industrial average was down 6.5%, the S&P 500 was down 8.0%, and the NASDAQ composite index was down 12.0%. Reflecting this weakening of share prices, the University of Michigan Consumer Sentiment Index, after posting in September its highest reading since March this year, declined for two consecutive months in October and November. Additionally, if employment weakens from November, that will also have a negative impact on consumption expenditures. Although net sales over the Thanksgiving holidays in November increased in y/y terms, the number of retail store visits was lower than the year-ago figure. US private consumption is also showing cause for concern and bears close watching.

USD/JPY to decline on interest rate decline and risk-off moves brought by US economic

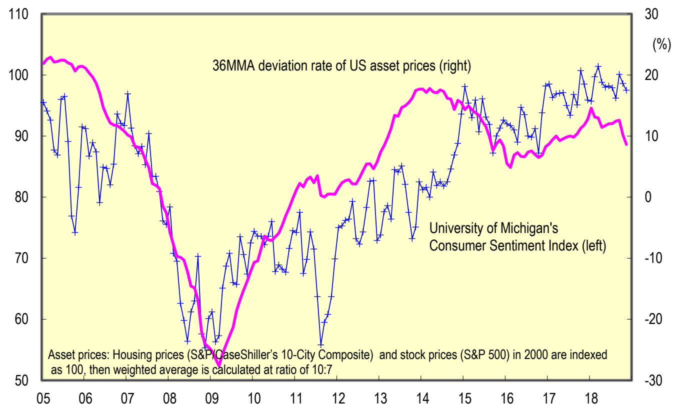
The US economic expansion that began after bottoming in June 2009 has lasted for 113 months as of November 2018, and if it lasts until June 2019 it will equal the length of the longest expansion ever, 120 months from March 1991 until March 2001. In August 2000, seven months prior to the economy's peak during that expansion in March 2001, the S&P 500 peaked, and 13 months prior in February 2000, the NASDAQ composite index peaked. If share prices lead the economy by seven months and the S&P 500 peaked in September 2018, the US economy should peak in April 2019. It may be best to expect the USD/JPY to lose its upward momentum on interest rate declines and risk-off moves prompted by a US economic slowdown.

Chart: US Existing and New Home Sales



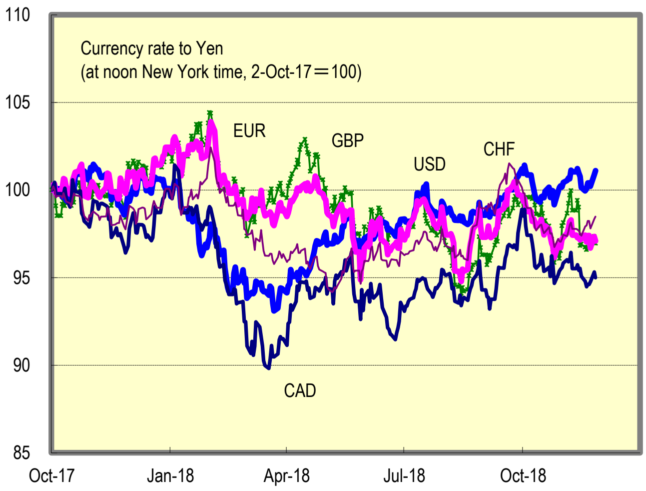
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Change in US Asset Prices and Consumer Sentiment Index



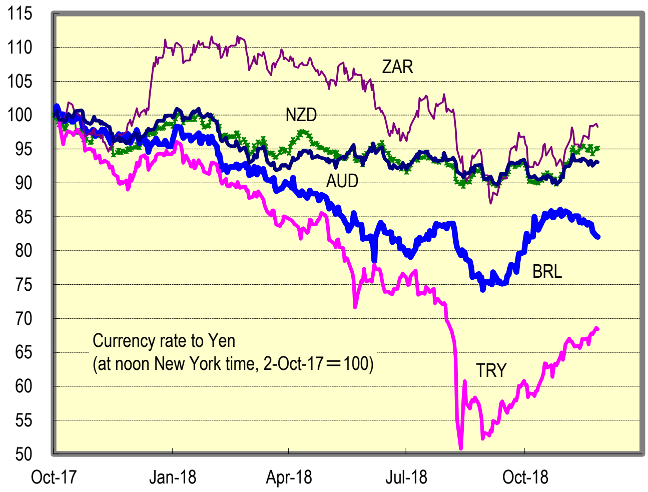
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Major Currencies/JPY FX Index



Source: Fed, Thomson Reuters; compiled by Daiwa Securities.

Chart: EM Currencies/JPY FX Index



Source: Fed, Thomson Reuters; compiled by Daiwa Securities.

Chart: Currency Exchange Rate Forecasts

	Actual		Forecast				
	29 Jun 2018	28 Sep 2018	Oct-Dec 2018	Jan-Mar 2019	Apr-Jun 2019	Jul-Sep 2019	Oct-Dec 2019
USD-JPY	110.7	113.7	111.0	108.0	110.0	108.0	107.0
			109-115	105-113	105-113	105-113	104-112
EUR-JPY	129.3	131.9	126.5	122.0	126.5	123.5	121.0
			124-133	120-131	120-131	120-131	118-129
AUD-JPY	81.9	82.1	79.0	74.5	78.0	75.5	74.0
			76-83	73-82	73-82	73-82	71-80
CAD-JPY	84.3	88.0	83.5	80.0	83.0	80.5	79.5
			82-90	78-87	78-87	78-87	77-86
NZD-JPY	74.9	75.2	73.5	69.0	72.5	70.0	68.5
			71-78	67-76	67-76	67-76	66-75
TRY-JPY	24.1	18.8	19.5	17.7	19.3	18.3	17.6
			17-22	16-22	16-22	16-22	15-21
ZAR-JPY	8.1	8.0	7.7	7.2	7.6	7.3	7.1
			7.2-8.2	6.8-8.0	6.8-8.0	6.8-8.0	6.6-7.8
BRL-JPY	28.6	28.1	28.5	26.4	28.2	27.0	26.1
			26-31	25-31	25-31	25-31	24-30
KRW-JPY	9.9	10.2	9.8	9.3	9.6	9.4	9.2
(100 KRW)			9.3-10.3	9.0-10.0	9.0-10.0	9.0-10.0	8.9-9.9
CNY-JPY	16.7	16.5	15.9	15.2	15.9	15.4	15.1
			15.4-16.7	15.0-16.5	15.0-16.5	15.0-16.5	14.6-16.1

Source: BIS, Fed, Thomson Reuters; compiled by Daiwa Securities.
Notes: 1) Actual shows market rates at noon NY time.
2) Forecast upper row; as of quarter end, lower row; range during quarter.

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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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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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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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May 2018

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.

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