Daiwa Securities

Forex Market Weekly

US financial authorities now see rate hike decisions as more "data dependent"

- USD swayed by comments from US financial authorities
- Risk-on yen weakening probably limited despite US/China trade war "cease fire"
- USD/JPY could easily fall if US rates drop on concerns about slowing US economy

This week's USD/JPY forecast range

3 – 7 Dec: Y112.1 – 114.1/$ (Y113.5 at end-previous week)

Forex Market View DSFE197
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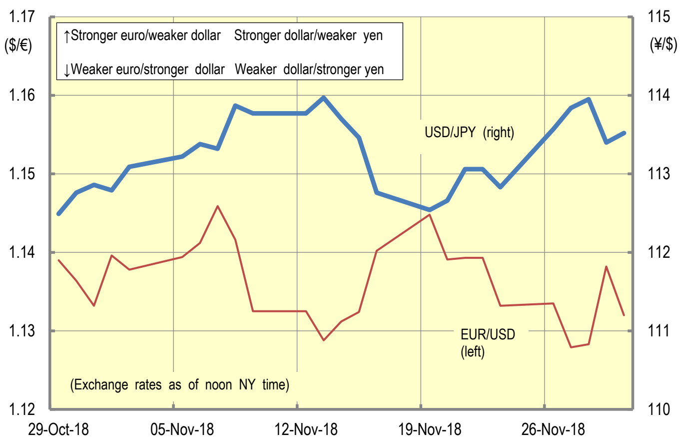
USD swayed by comments from US financial authorities

Overview of last week's forex market

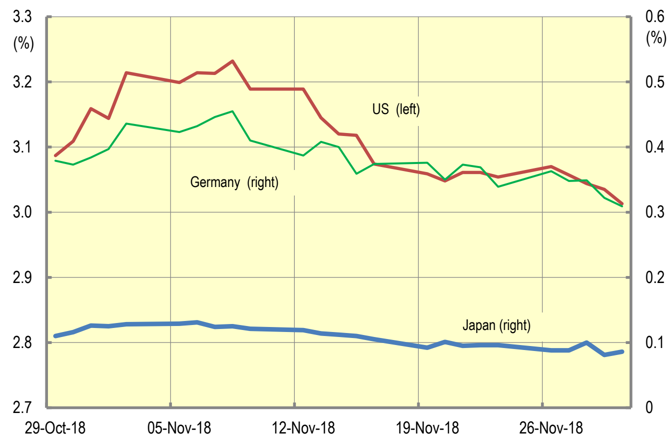
At the start of last week, Japanese equities rose after Osaka was selected to host the World Expo 2025, and the yen declined. The USD/JPY rose on higher US interest rates amid concerns about increased Treasury buying, as well as gains for US equities on expectations for strong Cyber Monday sales. The USD/JPY then declined slightly on reports that US President Donald Trump would most likely follow through with plans to hike tariffs on $200.0bn worth for Chinese goods to 25%. The British pound fell on concerns about whether the UK Parliament can pass the draft EU withdrawal agreement when it votes on 11 December. FRB Vice Chairman Richard Clarida's comment that the Fed should pay even more attention to new economic data as its monetary policy moves closer to a neutral stance was not interpreted as the Fed adopting a more dovish stance. As such, the USD/JPY rose and briefly hit 114 on 29 November. That said, US interest rates declined and the dollar depreciated as FRB Chairman Jerome Powell's comment that the current US policy rate is "just below" the neutral rate was interpreted as suggesting that an end to the current rate hiking stage could be moved forward. The crude oil price, US interest rates, and the USD/JPY rebounded modestly following reports that Russia is open to cutting oil production along with OPEC. The USD/JPY then inched higher on expectations that the US will postpone additional tariffs on Chinese goods as the two sides try to find their way back to the negotiating table.

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



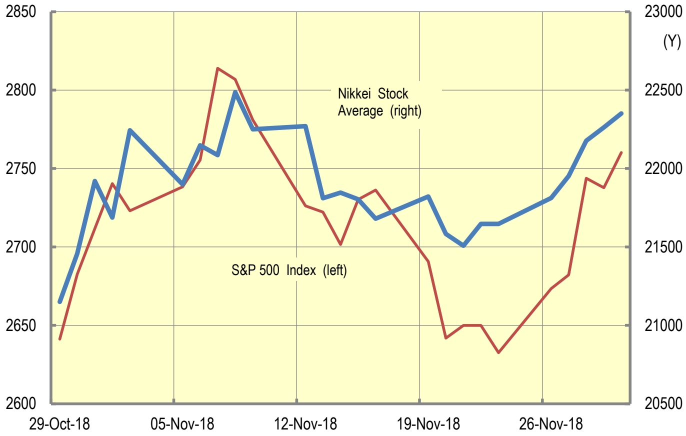
Source: Thomson Reuters; compiled by Daiwa Securities.

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



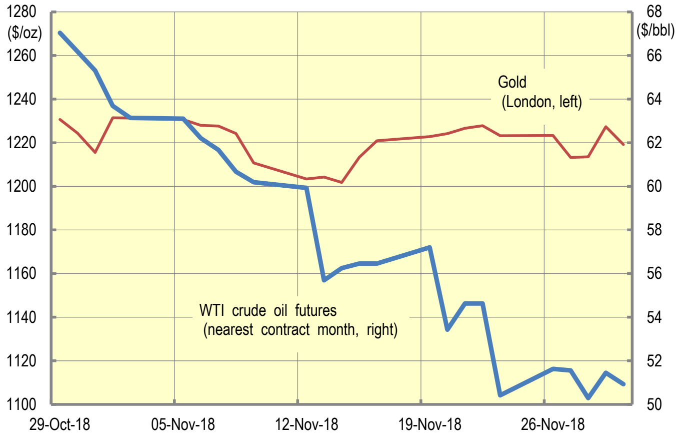
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



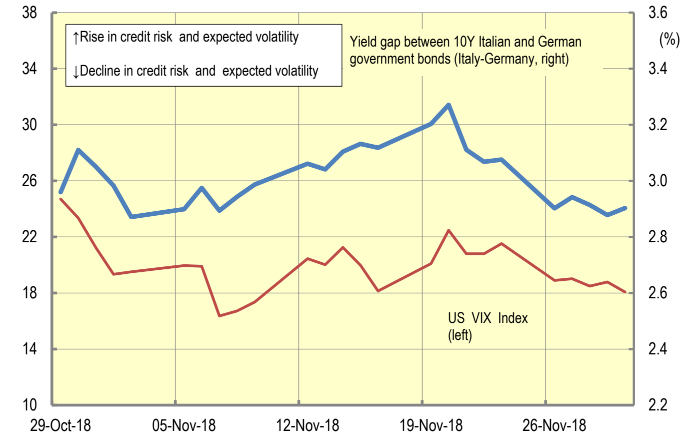
Source: Thomson Reuters; compiled by Daiwa Securities.

Risk-on yen weakening probably limited despite US/China trade war "cease fire"

US postpones additional tariffs on Chinese goods for 90 days

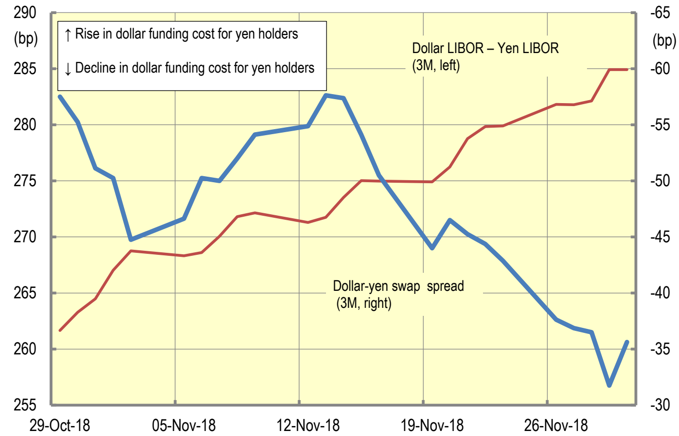
The US has decided to hold off on imposing additional tariffs on Chinese goods for 90 days so that the two sides can negotiate structural changes to China's trade practices. However, there is still the risk of additional tariffs if agreements on such structural changes are not reached within 90 days. Even if postponing additional tariffs improves business sentiment and stems declining demand to some degree, there is still little chance that the economies of the US and China will outperform. There is also the growing risk that the current US administration, which wants to increase domestic production, will introduce automobile tariffs. All told, any risk-on yen depreciation will probably be limited, in our view.

Chart: US VIX Index and Gap Between Italian and German Long-term Yields



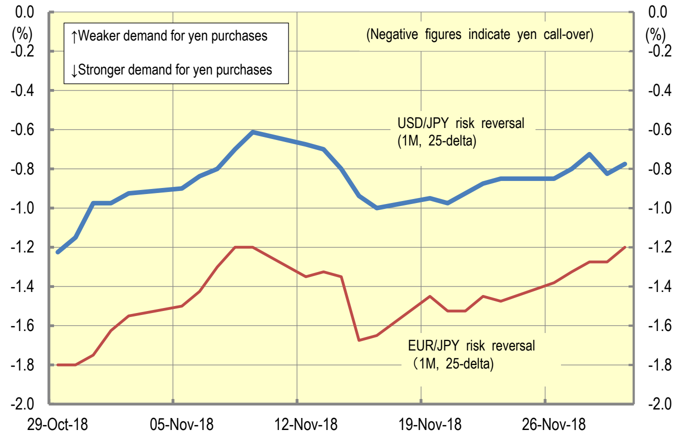
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



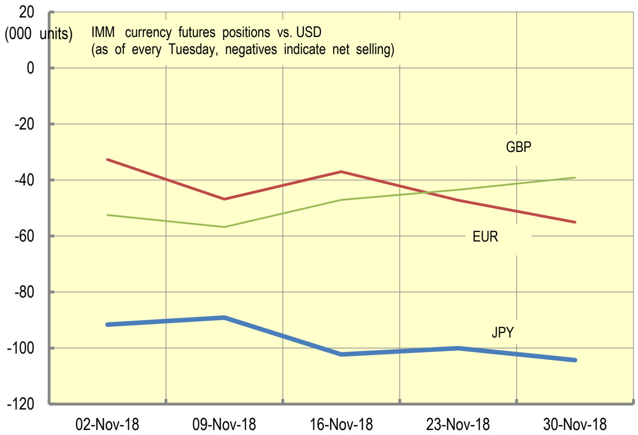
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

USD/JPY could easily fall if US rates drop on concerns about slowing US economy

Focus on US economic indicators

US interest rates and the dollar fell after FRB Vice Chairman Clarida said on 16 November that the Fed's policy interest rate is moving closer to the level deemed as "neutral" and, as such, rate hikes must now be more data dependent. The dollar weakened as expectations for rate hikes in 2019 eased as the view that an end to the current rate hike program was close at hand after Fed Chairman Powell said on 28 November that the policy rate is now "just below" neutral. On 3 October, Powell indicated that the Fed could keep raising rates until reaching a level "past neutral." However, recently he has not made such comments, which suggests he is now paying closer attention to signs of a slowing economy. The decline in US interest rates in reaction to the comments from financial authorities on 16 and 28 November lifted US equities, while risk-on yen weakness underpinned the USD/JPY. However, during periods when US interest rates decline due to concerns about a slowing US economy, stocks do not rise and the USD/JPY can easily fall. Several important US economic indicators are due out this week. The market expects m/m declines (contractions) for the November ISM manufacturing and non-manufacturing reports, as well as non-farm payrolls. However, there is probably a good chance that the USD/JPY will continue declining if these indicators come in lower than the market forecasts.

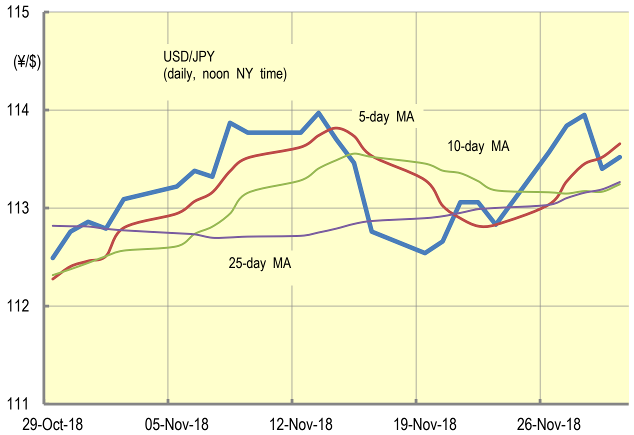
Expect yen appreciation on sustained cheap oil, even if OPEC trims production

Even though non-OPEC member Russia is leaning towards cutting crude oil production along with OPEC, it is not in favor of a large production cut. Meanwhile, the US is against the use of production cuts to push up the oil price. Of note, despite gathering evidence of Saudi Arabia's role in the murder of journalist Jamal Khashoggi, the US has indicated a tolerant stance as it does not want to harm relations with the kingdom. Saudi Arabia, which in the past indicated a desire to cut production, has said that cooperation from other oil-producing countries is necessary and it will not carry out such cuts independently. Even if OPEC agrees to cut production when it meets on 6 December, we anticipate only modest output cuts. Continued yen appreciation on a decline in global interest rates due to concerns about cheap oil on excessive oil supply seems likely.

Noteworthy currency: AUD

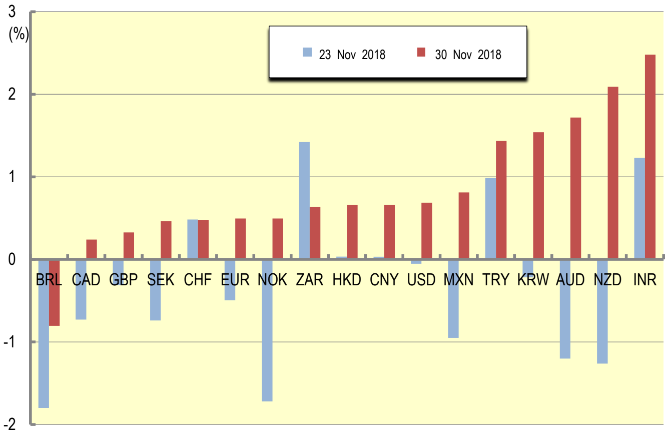
Gains for the Australia dollar after the US decided to hold off on imposing additional tariffs on Chinese goods were probably due to temporary risk-on buying. Indeed, we see potential for a risk-off mood to resurface if China's November PMI, due out on 3 December, comes in below the 50.0 level separating expansion from contraction. Of note, the reading for October was 50.1. We need to watch for a possible drop in the Australian dollar as the Reserve Bank of Australia appears set to thoroughly adopt a dovish stance when its meets on 4 December in order to quash the suddenly growing expectations for a rate hike.

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

3-Dec		Nov China manufacturing PMI (Caixin/Markit)
4-Dec		Nov US ISM manufacturing index
		Nov US new car sales
	○	RBA MPM
5-Dec		Jul-Sep Australian GDP
		Oct eurozone retail sales
		Nov US ADP national employment report
6-Dec		Nov US ISM non-manufacturing index
	○	Fed chair Powell's congressional testimony on economic projections
	○	Beige Book（Fed）
		Oct German manufacturing orders
		Oct US trade statistics
		OPEC Meeting (Vienna)
7-Dec		Nov US jobs report
	●	Election of German ruling party CDU's leader
8-Dec		Dec US University of Michigan's Consumer Sentiment Index (preliminary)

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

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

	26 - 30 Nov 2018 (actual)		3 - 7 Dec 2018 (forecasts)	
	Range	Weekend	Range	Weekend
USD/JPY	112.8-114.1	113.5	112.1-114.1	113.1
EUR/JPY	127.9-129.3	128.5	127.1-129.6	128.4
EUR/USD	1.126-1.141	1.132	1.125-1.145	1.135

Noteworthy currencies and factors

AUD	Deterioration in China PMI may cause risk-off currency depreciation
GBP	Court of Justice of the European Union to judge whether UK is able to reject draft EU withdrawal agreement
EUR	Whether US administration will show intention to raise tariff on imported cars from Europe
Currencies in oil-producing nations	If slight output cuts are decided at OPEC meeting, cheaper crude oil prices would cause currency depreciation

Source; Compiled by Daiwa Securities.

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[Standard & Poor's]

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[Moody's]

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[Fitch]

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May 2018

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• 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.

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