# Forex Market View

## Is USD/JPY downside resistance really because of dollar strength?

- Dollar strengthening pressures are not that strong
- We see risk of stocks declining and the yen strengthening on US economic slowdown
- China economic slowdown and weakening of the yuan make the yen more likely to appreciate

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

**1 – 30 Nov: Y109.0-114.0/$ (Y112.85/$ as of 31 Oct)**

Forex Market View DSFE191

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## Dollar strengthening pressures are not that strong

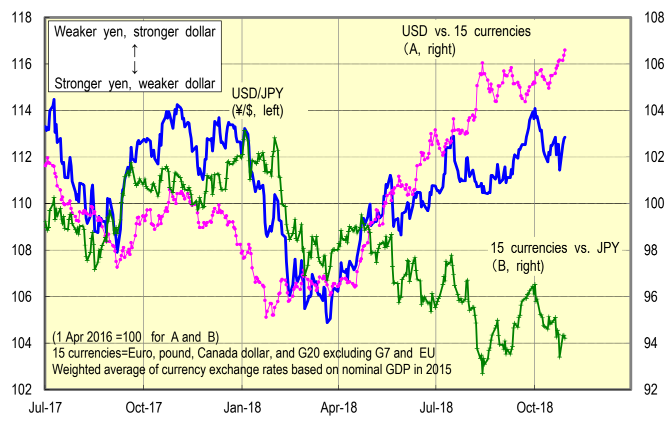
**Dollar, yen, and other currency exchange rates when yen is strengthening in JPY cross market**

The decline in USD/JPY has been small relative to the drop in US share prices, but dollar strength is unlikely the reason why the USD/JPY has not fallen. The USD/JPY has declined less than JPY cross rates since October, but the yen has strengthened in both measures. Since both the yen and dollar tend to strengthen at the same time during risk-off moves, a smaller decline in the USD/JPY than in JPY cross rates is the usual pattern. There have been four major periods of JPY cross rates declining during risk-off moves this year. The first was in Feb-Mar, when the JPY cross vs. the 15 major currencies other than the dollar fell 5.9% and the dollar rose 1.0% against those 15 currencies, resulting in a 5.0% decline in the USD/JPY. Dollar appreciation was curtailed then because the Trump administration was making its first clear steps toward a protectionist trade policy, and that had a weakening impact on the dollar, such that the decline in the USD/JPY was 85% of the decline in the JPY cross rate. The second was in Apr-Jun, when the JPY cross declined 4.2%, and the dollar rose 5.5%, vs. those 15 currencies, resulting in a 1.1% rise in USD/JPY. Expectations of a trade agreement between the US and China were pushing the dollar higher at a faster rate than the yen was appreciating. The third was in Jul-Aug, when the JPY cross declined 5.2%, and the dollar rose 3.2%, vs. those 15 currencies, resulting in a 2.1% decline in USD/JPY. The USD/JPY's decline was 40% of the JPY cross decline. The fourth was in October, when the JPY cross declined 3.2% and the dollar rose 0.9%, resulting in a 2.3% decline in USD/JPY. The USD/JPY's decline was 72% of the JPY cross decline.

**Dollar appreciation is losing momentum because of the strength of the US economy**

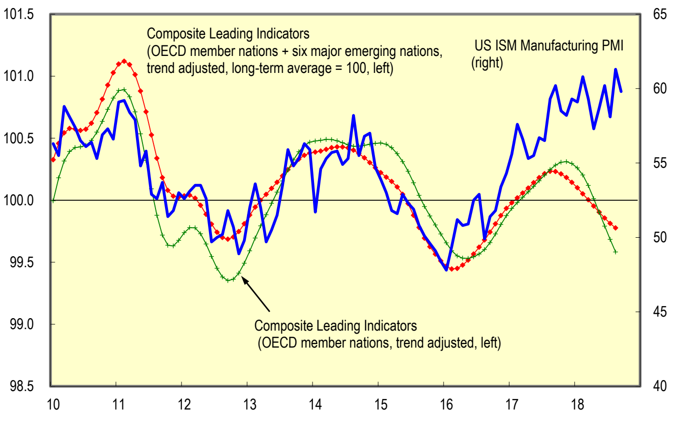
In all four episodes, the USD/JPY decline was smaller than the JPY cross decline, in one episode the USD/JPY rose, and this time the USD/JPY decline was not notably weaker than the JPY cross decline. Rather, compared with Apr-Jun and Jul-Aug, the USD/JPY appeared to follow more closely the JPY cross decline in October, indicating less momentum in dollar appreciation than in yen appreciation.

**Chart: Exchange Rates of USD, JPY, and Other Currencies**




Source: Thomson Reuters; compiled by Daiwa Securities.

**Chart: OECD Composite Leading Indicators and US ISM Manufacturing PMI**




Source: Thomson Reuters; compiled by Daiwa Securities.

In May, expectations of a US-China trade agreement drove the dollar higher, but rising worries over US-China trade friction appear to have been weakening the dollar recently. Additionally, from May to August the rise in the ISM manufacturing index and expectations of US economic growth strengthened the dollar, whereas in October, US corporate earnings outlooks started reflecting negative impacts from US-China trade friction, and concerns over a US economic slowdown weakened the dollar. The view that the US economy will continue to grow while the global economy, led by the EU and China, remains in a slowing trend has begun to lose proponents, and dollar appreciation rooted in the US economy's relative strength is probably losing momentum.

## We see risk of stocks declining and the yen strengthening on US economic slowdown

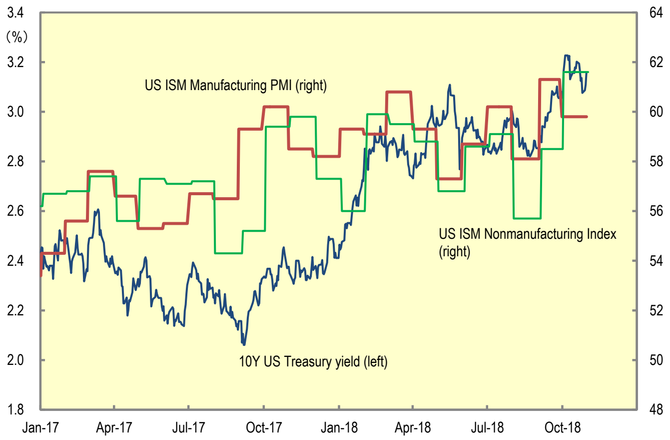
**Sharp decline in US stocks brought by rising interest rates and concerns over an economic slowdown**

In the US, long-term rates rose in January this year on expectations of accelerated economic growth from the Trump tax cuts and on concerns over a rising fiscal deficit, then in February a large increase in the January ISM nonmanufacturing index pushed long-term rates higher and caused a sharp fall in share prices, probably because the rise in long-term yields made share prices look more overvalued. In March, share prices fell sharply again on concerns the US would slap additional tariffs on China, while in Apr-May rising expectations of a US-China trade agreement sparked a rebound in both long-term rates and share prices. After that, with long-term rate increases constrained, share prices continued to climb. With FOMC members prepared to continue hiking rates to above the neutral rate, however, long-term rates continued rising in September, and were boosted further in October on a sharp increase in the September ISM nonmanufacturing index, followed by yet another plunge in share prices. This was probably caused by higher long-term yields making share prices look more overvalued and by emerging signs of a worsening of US corporate earnings outlooks. That share prices have yet to recover since then can probably be attributed to the lack of any signs of compromise in the US-China trade dispute and in fact fears the dispute may become more heated, which are amplifying concerns over a US economic slowdown.

**The possibility of US economic indicators worsening**

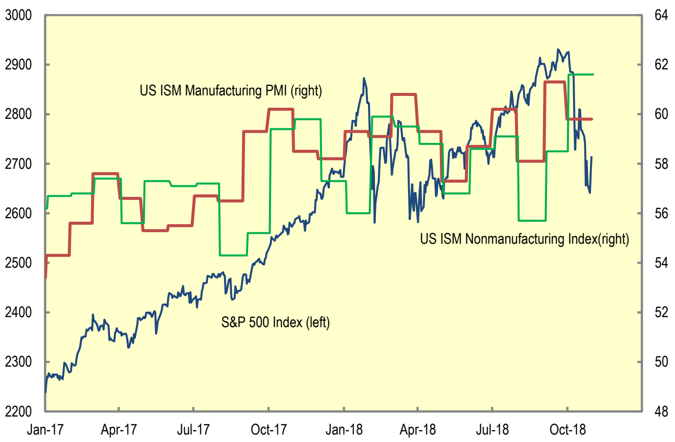
We think the improvement in the September ISM nonmanufacturing index was caused by indications of strong growth in private consumption. Growth in personal income was at its lowest in 15 months, however, while the savings rate dropped to its lowest since 2013. With share prices having fallen and consumer sentiment having worsened, private consumption is poised to weaken in October. The ISM nonmanufacturing index is likely to worsen in October, as is the manufacturing index. The increase in exports and imports on last-minute demand ahead of the US tariffs on China and China's retaliatory tariffs taking effect on September 24 appears to have had a significant impact on the September indices. Exports and imports are likely to decline on a pullback from that increase in October, when the negative impacts from tariffs and associated price hikes may also start to show up. Based on the already-announced regional Fed banks' manufacturing surveys, we think the October ISM manufacturing index is likely to decline by 1-2ppt relative to September.

**Chart: US ISM Manufacturing PMI, Nonmanufacturing Index, and 10Y US Treasury Yield**




*Source: Thomson Reuters; compiled by Daiwa Securities.*

**Chart: US ISM Manufacturing PMI, Nonmanufacturing Index, Nonmanufacturing PMI and S&P 500 Index**




*Source: Thomson Reuters; compiled by Daiwa Securities.*

**Risk of weaker stocks and stronger yen until US long-term rates head lower**

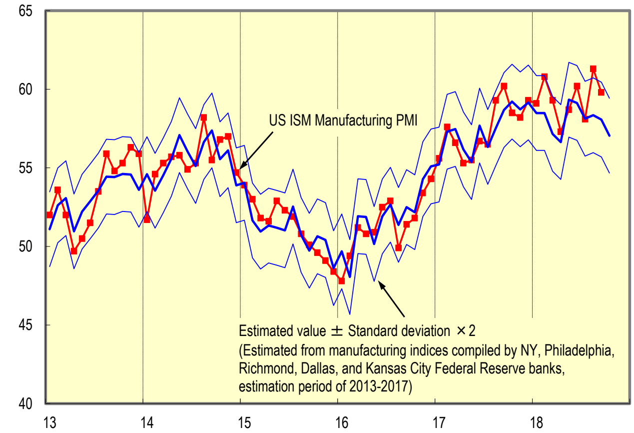
A weakening of both corporate earnings at the micro level and economic indicators at the macro level would raise concerns over an economic slowdown and likely trigger both a decline in share prices and risk-off strengthening of the yen. Long-term rates are also likely to decline when markets turn risk off, but until Fed officials express concern over an economic slowdown and lower their policy rate forecasts, there is unlikely to be any significant lowering of the market's Fed rate hike expectations. That would mean a limited decline in long-term rates and make a share price rebound less likely.

## China's economic slowdown and weakening of the yuan make the yen more likely to appreciate

**China's economic slowdown and weakening of the yuan make the yen more likely**

Because the additional tariffs that the US and China are imposing on the other are on different scales, China should suffer greater direct negative impacts than the US does. The China manufacturing PMI for October announced by the National Bureau of Statistics of China declined to 50.2, its lowest level since July 2016, and both external and internal demand are likely slowing in China. The China manufacturing PMI announced by Caixin/Markit declined to 50.0 in September and is likely to drop below 50 in October on the adverse impacts from tariffs. Because improvement in China's manufacturing PMI tends to strengthen the yuan vs. the dollar and its worsening tends to weaken it, a weakening of the yuan looks likely. A weaker yuan and stronger dollar are sources of concern for the Trump administration and would likely lead to the US taking a harder-line stance on trade with China and demanding a correction of dollar strength. The US-China trade conflict is likely to be a negative for both China (the yuan) and the US (the dollar). With concerns over an economic slowdown in China pushing markets into risk-off mode, worries about the US-China conflict could also have a weakening impact on the dollar, making it likely that the yen will strengthen more than the dollar does.

**Chart: Regression Analysis of US ISM Manufacturing PMI**

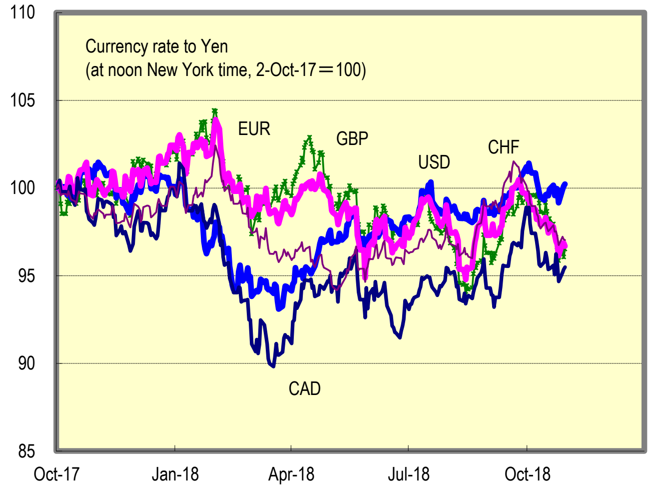



*Source: Fed, Thomson Reuters; compiled by Daiwa Securities.*

**Chart: China's Manufacturing PMI and USD/CNY**

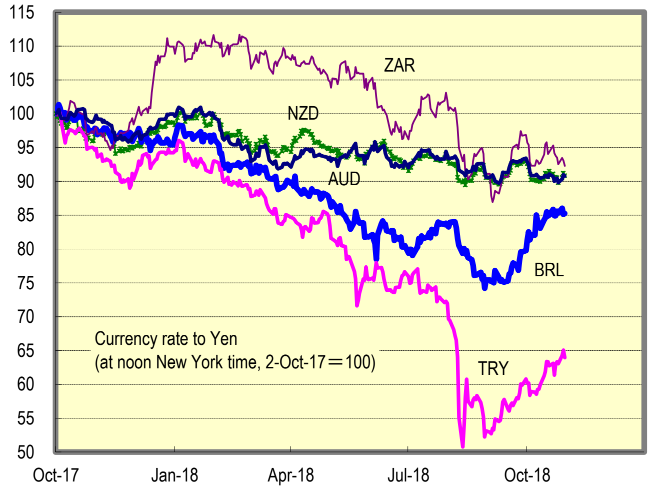

*Source: Thomson Reuters; compiled by Daiwa Securities.*

### 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 29 Jun 2018 | 28 Sep 2018 | Forecast Oct-Dec 2018 | Jan-Mar 2019 | Apr-Jun 2019 | Jul-Sep 2019 | Oct-Dec 2019 |
|---|---|---|---|---|---|---|---|
| USD-JPY | 110.7 | 113.7 | 110.0 | 108.0 | 110.0 | 108.0 | 107.0 |
| | | | 108-115 | 105-113 | 105-113 | 105-113 | 104-112 |
| EUR-JPY | 129.3 | 131.9 | 127.5 | 123.0 | 127.5 | 124.5 | 122.0 |
| | | | 123-133 | 121-132 | 121-132 | 121-132 | 119-130 |
| AUD-JPY | 81.9 | 82.1 | 78.0 | 74.5 | 78.0 | 75.5 | 74.0 |
| | | | 76-83 | 73-82 | 73-82 | 73-82 | 71-80 |
| CAD-JPY | 84.3 | 88.0 | 84.5 | 82.0 | 84.5 | 82.5 | 81.0 |
| | | | 82-90 | 79-88 | 79-88 | 79-88 | 78-87 |
| NZD-JPY | 74.9 | 75.2 | 71.5 | 68.0 | 71.5 | 69.0 | 67.5 |
| | | | 69-76 | 66-75 | 66-75 | 66-75 | 65-74 |
| TRY-JPY | 24.1 | 18.8 | 18.5 | 17.0 | 18.5 | 17.5 | 16.7 |
| | | | 16-21 | 15-21 | 15-21 | 15-21 | 14-20 |
| ZAR-JPY | 8.1 | 8.0 | 7.4 | 7.0 | 7.5 | 7.2 | 7.0 |
| | | | 7.1-8.1 | 6.7-7.9 | 6.7-7.9 | 6.7-7.9 | 6.5-7.7 |
| BRL-JPY | 28.6 | 28.1 | 27.5 | 25.7 | 27.5 | 26.4 | 25.5 |
| | | | 25-30 | 24-30 | 24-30 | 24-30 | 23-29 |
| KRW-JPY | 9.9 | 10.2 | 9.6 | 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 | 15.7 | 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.
4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

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**■ Credit Rating Agencies**

**[Standard & Poor's]**

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**[Moody's]**

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**[Fitch]**

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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 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.

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Japan Investment Advisers Association
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