

Forex Market Weekly

USD/JPY could fall after FOMC meeting

- Weaker euro, stronger dollar on slowing European economy; signs of yen strength
- Strong dollar/weak yen trend on hopes for better US-China relations unlikely
- USD/JPY could fall after FOMC meeting

Forex Market View DSFE200
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This week's USD/JPY forecast range

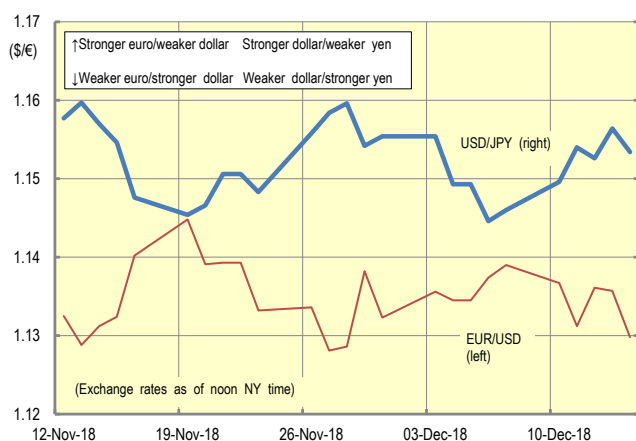
17 - 21 Dec: Y111.8 – 113.8/\$ (Y113.4 at end-previous week)

Weaker euro, stronger dollar on slowing European economy; signs of yen strength

Overview of last week's forex market

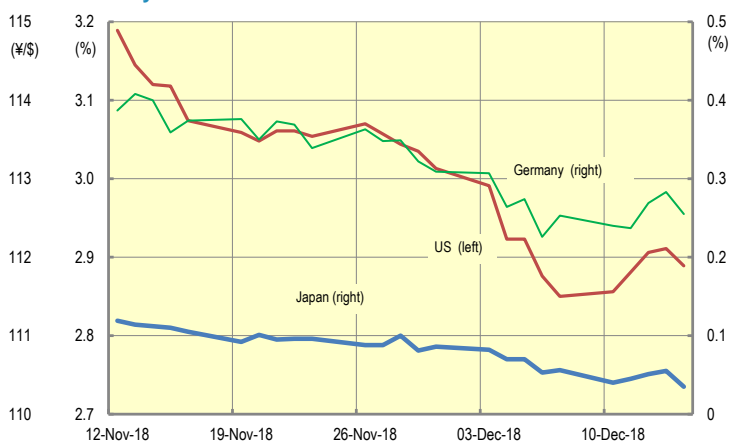
The dollar dropped to JPY112.24 at the start of last week as a weaker-than-expected US jobs report resulted in lower US interest rates and a weaker dollar. The pound fell as British Prime Minister Theresa May cancelled the Parliamentary vote on her Brexit deal scheduled for 11 December due to poor prospects for passage, while the European Commission indicated it had no intention of renegotiating this agreement. The USD/JPY retreated slightly after the US car industry requested during a USTR hearing the addition of a currency clause in trade talks with Japan. However, this pair again turned up on reports China will lower its tariffs on US car imports from 40% to 15%. Chinese authorities are detaining a former Canadian diplomat, while a court in Canada released on bail Huawei CFO Meng Wanzhou. The pound was sold just ahead of Theresa May's no confidence vote, but rebounded after May survived this challenge. The euro bounced back after Italy lowered its 2019 budget deficit target, but weakened after the ECB cut its economic growth forecast and said it would keep reinvesting cash from maturing bonds for a long time after resuming rate hikes. The euro weakened further after December business sentiment, particularly in France, deteriorated. Dollar appreciation continued, but the USD/JPY fell as concerns about economic slowdowns in China and Europe weighed on US equities and the yen rose.

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



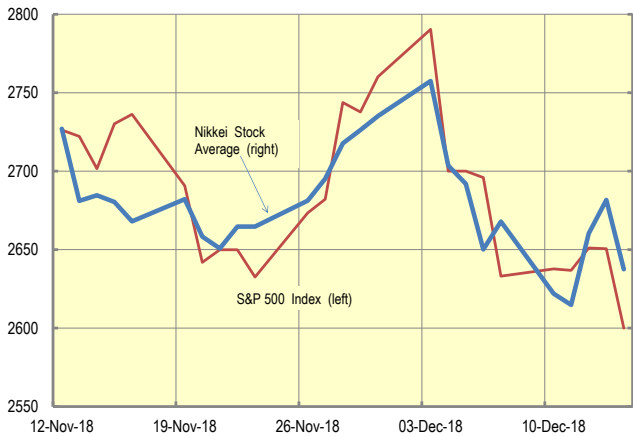
Source: Thomson Reuters; compiled by Daiwa Securities.

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



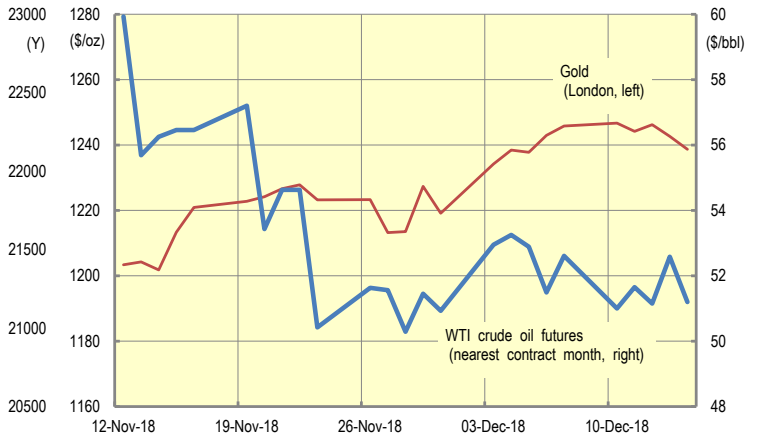
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



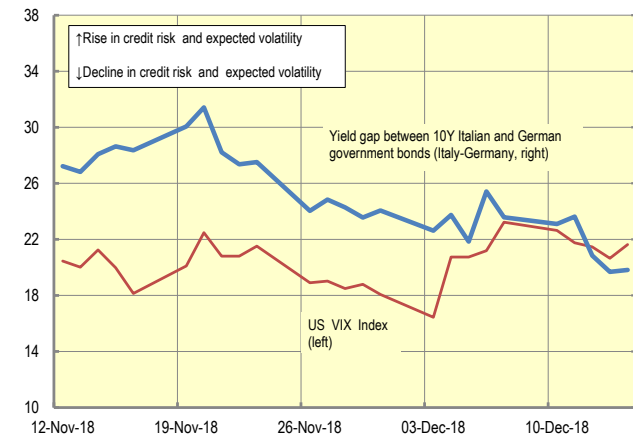
Source: Thomson Reuters; compiled by Daiwa Securities.

State of US-China relations key

Strong dollar/weak yen trend on hopes for better US-China relations unlikely

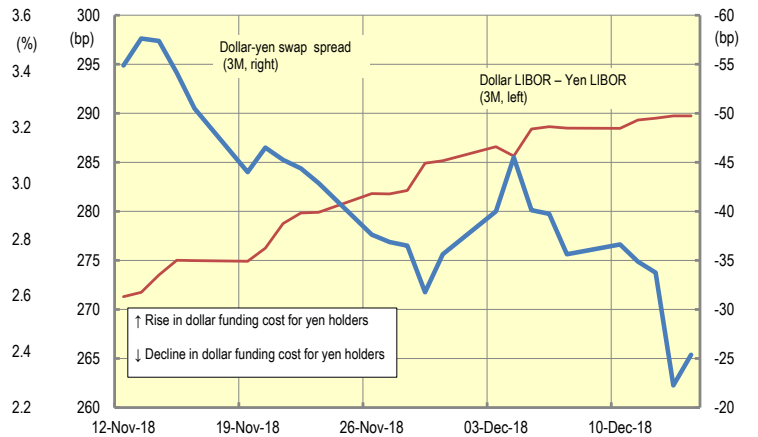
China said it will cut tariffs on US automobile imports from 40% to 15% (level prior to retaliatory hike) and US President Donald Trump said he could intervene in the legal case against Huawei's Meng Wanzhou as part of a trade agreement with China. These developments were viewed as factors heightening expectations for a US/China trade agreement. However, many hold the view that even if China makes concessions and the US stops raising tariffs on Chinese imports, the US will not abolish such tariffs outright. Even if Chinese concessions have a modest positive impact on the US economy, positive effects for the Chinese economy would be almost nonexistent. It will be hard for China to fully satisfy US requests as it does not want to expand concessions that are to its disadvantage. US and Chinese equities have become lackluster, probably due to poor expectations for economic recoveries on mitigation of the trade war. China's detainment of two Canadian citizens could trigger a deterioration in US-China relations. Accordingly, it is hard to imagine a strong dollar / weak yen trend driven by hopes for better US-China relations.

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



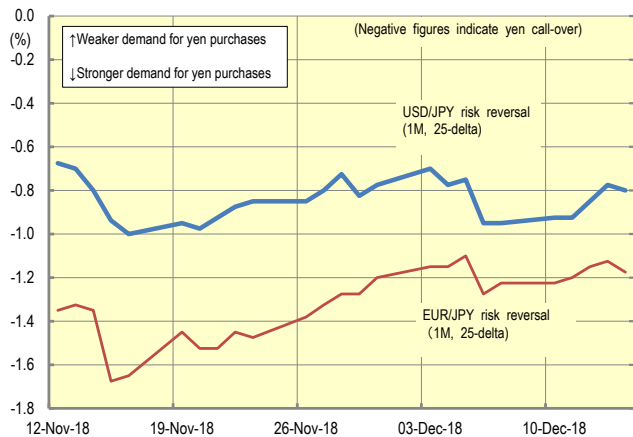
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



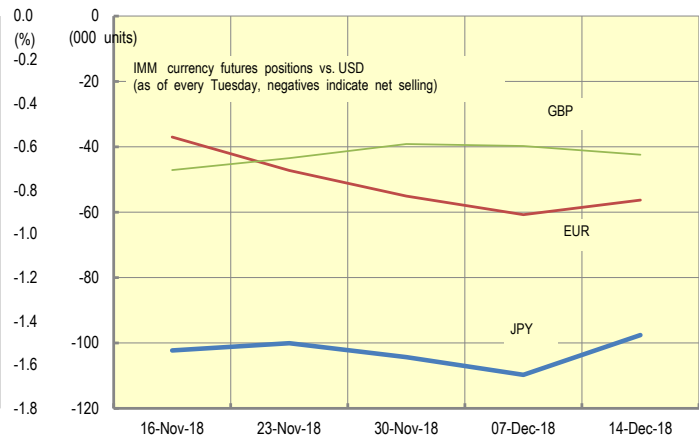
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

Powell's press conference key

USD/JPY could fall after FOMC meeting

The FOMC is expected to raise its FF rate target range to 2.25-2.50% when it next meets on 18-19 December. However, amid concerns about a slowing US economy, another rate hike during the final stages of the current rate-hiking phase could easily make investors risk adverse and lower long-term rates. Indeed, US equities fell after FOMC meetings in June and September of this year. The median 2019 FF rate forecast was 3.125% at the September FOMC meeting, but will likely be lowered to around 2.875% at the December meeting (assuming two hikes in 2019). Such a scenario would probably not surprise the market, but it would still likely pull US rates and the dollar lower. Also, the USD/JPY is likely to fall if FRB Chairman Jerome Powell suggests at his press conference that future rate hikes (or suspension of hikes) are uncertain and dependent on economic trends. (We note that from 30 Jan 2019 Powell plans to hold press conferences after each of the eight FOMC meetings that year).

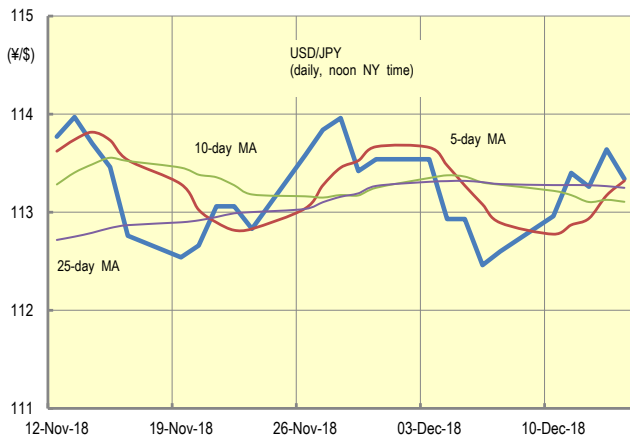
Pound likely weak on poor Brexit visibility

UK Prime Minister Theresa May postponed a Parliamentary vote on her Brexit deal due to poor prospects for passage, but the EU has maintained its stance against renegotiating the agreement. If Parliament rejects the deal when it votes sometime before 21 January 2019, the risk of a no-deal Brexit would remain. In order to avoid a no-deal Brexit, the EU would probably need to approve a postponement of the 29 March 2019 date for Britain's scheduled departure from the EU. That would raise the possibility of a second national referendum on whether Britain should stay or leave the EU. For now, a bearish tone for the pound seems likely amid such uncertainty. When US rates are stable, the USD/JPY can rise on a stronger dollar due to a weaker pound and weaker euro. If a risk-off mood intensifies and US rates fall, yen strength would probably predominate dollar strength.

Noteworthy currency: SEK

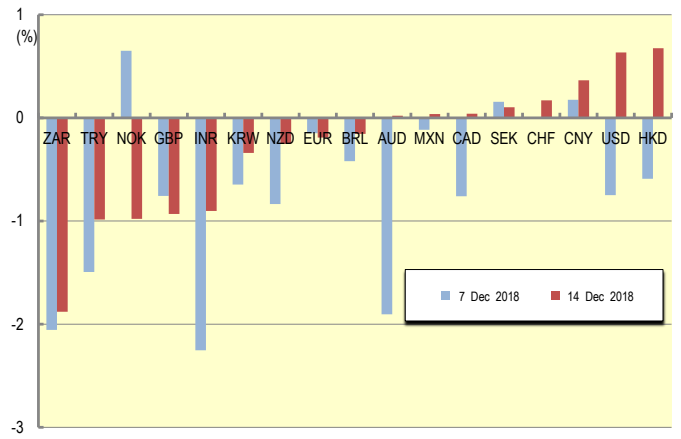
Sweden's central bank will decide whether to hike rates at its December 20 Executive Board meeting or wait until the February 2019 meeting. The central bank would be inclined to immediately raise rates if its scenario plays out as expected, but recent indicators, particularly inflation and consumption, have been weak. However, a rate hike decision will depend on whether board members conclude that these indicators have deviated from their scenario. While the stronger likelihood is that the Board will wait until the February meeting to take any action, a December rate hike is still a real possibility. A rate hike in December would probably push up the krona as expectations for a hike at that time have dropped off significantly.

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

- 17-Dec Dec NY Fed's Empire State Manufacturing Index
- 18-Dec Dec German IFO business climate index
- Nov US housing starts
- 19-Dec Nov Japan Trade statistics
- Jul-Sep US current balance
- 20-Dec Nov US existing home sales
- FOMC statement (Chair Powell's press conference)
- BOJ MPM (BOJ governor Kuroda's press conference)
- Monetary policy meeting at Sweden's central bank
- BOE MPC meeting, minutes
- Dec Philadelphia Fed's Business Outlook Survey Index
- 21-Dec Nov US personal income, consumption expenditures, durable goods orders
- 22-Dec Dec US University of Michigan's Consumer Sentiment Index (final)

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

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

	10 - 14 Dec 2018 (actual)		17 - 21 Dec 2018 (forecasts)	
	Range	Weekend	Range	Weekend
USD/JPY	112.2-113.7	113.4	111.8-113.8	112.5
EUR/JPY	127.9-129.3	128.2	126.5-129.0	127.1
EUR/USD	1.126-1.145	1.131	1.123-1.143	1.130

Noteworthy currencies and factors

SEK	Amid strong speculations on postponed rate hike, implementation of rate hike would lead to currency appreciation
USD	If US rate hike causes risk-off yield decline, dollar may weaken
GBP	Due to lingering uncertainty about Brexit, pound would weaken
EUR	If EU approves Italy's revised draft budget, euro likely to strengthen

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.).
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- 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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- 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.

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