Forex Market Weekly

Risk-off mood if British Parliament rejects Brexit plan

- USD/JPY rise on hopes for US/China trade agreement losing steam
- Yen appreciation on lower oil price possible
- Risk-off mood if British Parliament rejects Brexit plan

This week's USD/JPY forecast range

14 - 18 Jan: Y107.0 – 109.0/$ (Y108.5 at end-previous week)

Forex Market View DSFE206
FICC Research Dept.

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

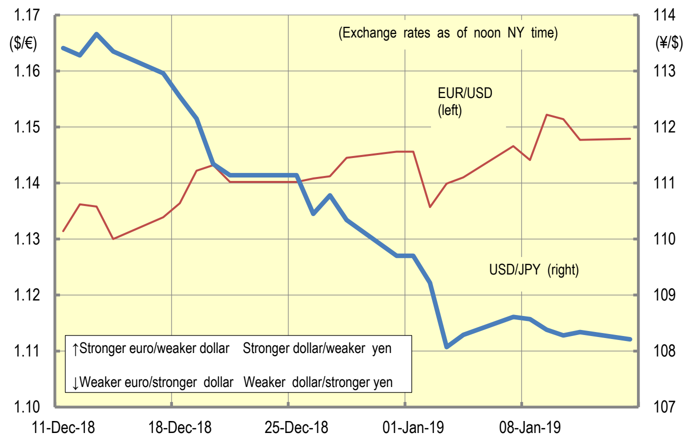
FX Analyst
Mayu Shinooka
(81) 3 5555-8777
mayu.shinooka@daiwa.co.jp
Daiwa Securities Co. Ltd.

Overview of last week's forex market

USD/JPY rise on hopes for US/China trade agreement losing steam

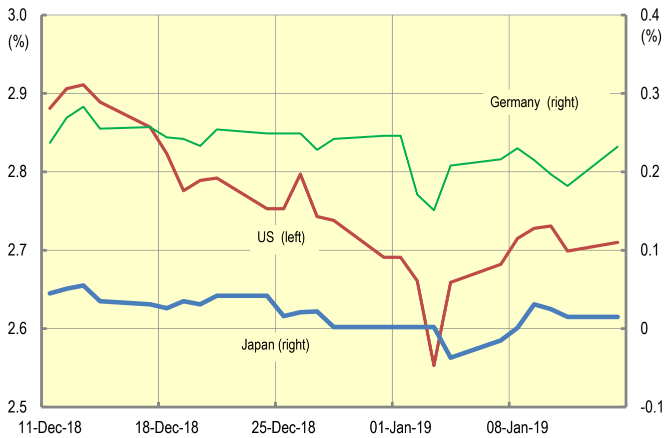
Japanese equities opened last week higher, pulled up by gains for US stocks following a bullish December US jobs report. Still, the USD/JPY was sold and fell to around 108. The pair rebounded on higher US stocks and interest rates after the US Commerce Secretary suggested that trade negotiations with China are close to reaching an agreement the US could accept (resolving structural trade issues and compliance matters remains challenging). The Institute for Supply Management's US non-manufacturing index for December was weaker than expected. However, its new orders index was solid, which limited concerns about a slowing economy and helped push the USD/JPY briefly back over 109. A US trade representative announced that while China promised to purchase large amounts of American goods, the two sides still discussed the need for complete implementation and ongoing verification of any agreement. The dollar declined, likely because this announcement lacked specifics and with some holding the view that more time is needed to resolve structural trade issues. Dovish comments from US monetary authorities also contributed to lower US interest rates and dollar depreciation with the USD/JPY falling as low as 107.77. FRB Chairman Jerome Powell indicated a more cautious stance on rate hikes, but still declared that the Fed's balance sheet will be "substantially smaller" than it is now. US interest rates rose and the USD/JPY climbed back up to around 108.5.

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



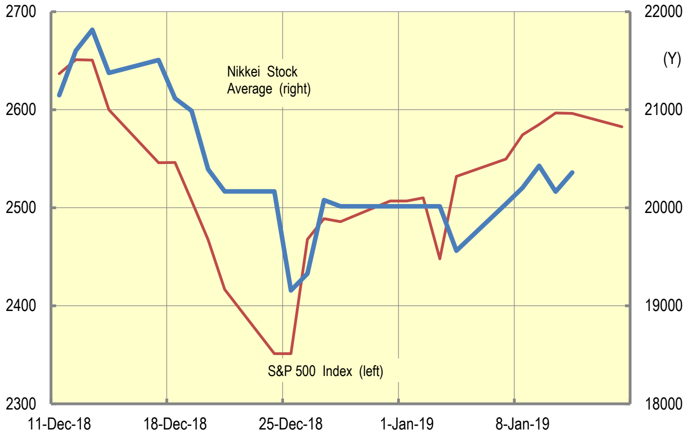
Source: Thomson Reuters; compiled by Daiwa Securities.

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



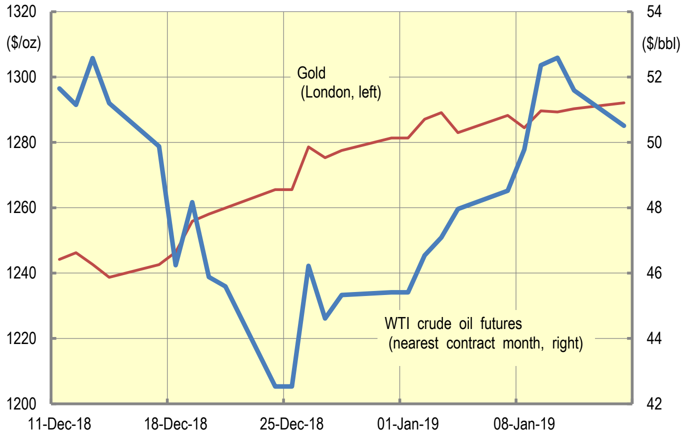
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



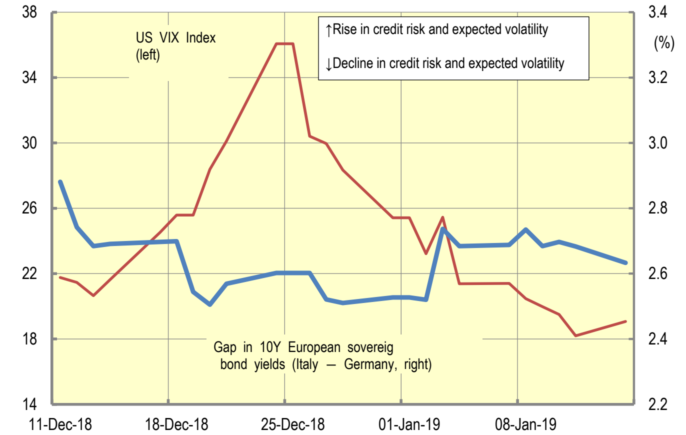
Source: Thomson Reuters; compiled by Daiwa Securities.

Yen appreciation on lower oil price possible

Larger inventories could weigh on oil price

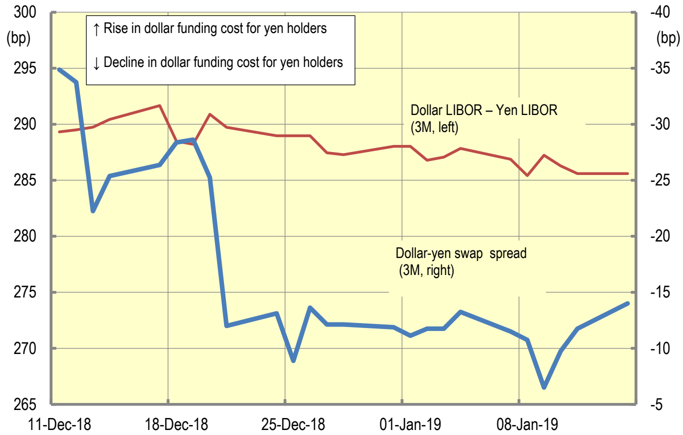
Last week the oil price rose at a time when markets were turning more risk tolerant due to higher US stocks and other factors. One cause for the higher oil price was a slight decline in US crude oil inventories versus the end of the previous week. Still, we do not believe that oil supply/demand conditions are tightening as inventories for gasoline, distillate, and other petroleum products are up sharply. Indeed, crude oil inventories continue growing on-year. There is the strong possibility that demand for petroleum products is declining in the US. If that is the case, inventories of not only petroleum products, but crude oil as well, would increase further. We believe that the resulting downturn for the crude oil price would likely contribute to yen appreciation.

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



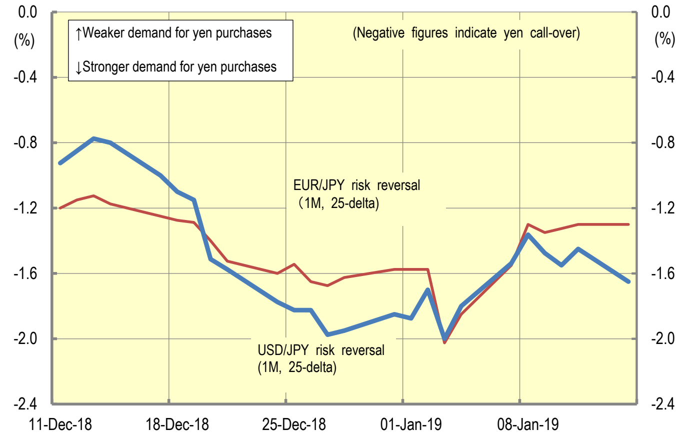
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



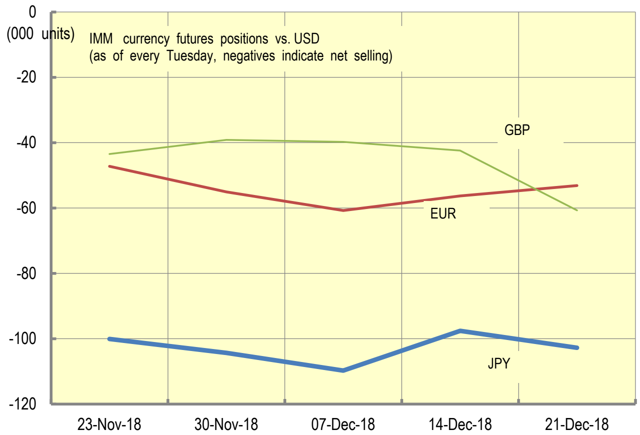
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

Risk-off mood if British Parliament rejects Brexit plan

Risk-off mood if British Parliament rejects Brexit plan

The British Parliament is set to vote on Prime Minister Theresa May’s Brexit deal on 15 January and will most likely reject the deal. Therefore, we cannot rule out the possibility of another vote postponement. However, pushing back the vote is unlikely to improve the prospects for passage. Prime Minister May will be forced to make some very difficult decisions. Rejection of the deal would heighten concerns about a “no-deal Brexit,” which would most likely result in risk-off pound/euro depreciation and yen appreciation. If the deal is voted down, the Parliament would then call on the government to quickly present an alternative proposal. However, the EU indicated that it will not renegotiate the Brexit agreement, so producing an alternative proposal would probably be very challenging. Also, if the deal is rejected, there is a good chance that the opposition Labour Party would submit a vote of non-confidence in May's government. The passage of a no-confidence motion followed by preparations for a general election would further cloud prospects for an orderly withdrawal from the EU. Such a scenario would probably produce a risk-off market. That said, the EU could agree to push back the 29 March deadline for Britain’s departure from the EU. In that case, May could hold a second public referendum on whether Britain should remain an EU member. Such a referendum could result in a majority of votes against leaving the EU. In that case, Britain would retract its request to leave the EU, which would probably dispel all uncertainty. We believe that growing calls for postponing the Brexit deadline could possibly ease the risk-off mood.

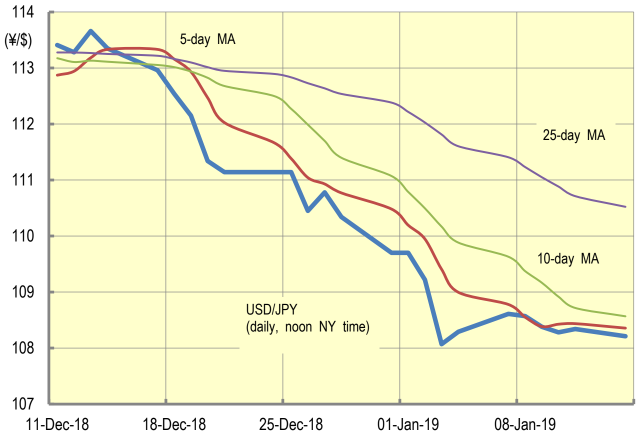
Dec US retail sales could sway USD/JPY

According to some major credit card companies, US online and at-store sales between 1 November and 24 December 2018 (key year-end shopping period) grew on-year at the strongest pace in six years. However, some department stores reported that sales weakened around mid-December and remained tepid up through Christmas week (23-29 Dec). December US consumer sentiment data showed that expectations are now much less upbeat. There is a good chance that personal consumption slowed from mid-December when US equity markets started falling at a faster pace. US retail sales data is due out on 16 January (could be postponed by government shutdown) and our focus is on where the reading lands relative to the market consensus (+0.2% m/m). These results will probably sway the USD/JPY to some degree.

Noteworthy currency: AUD

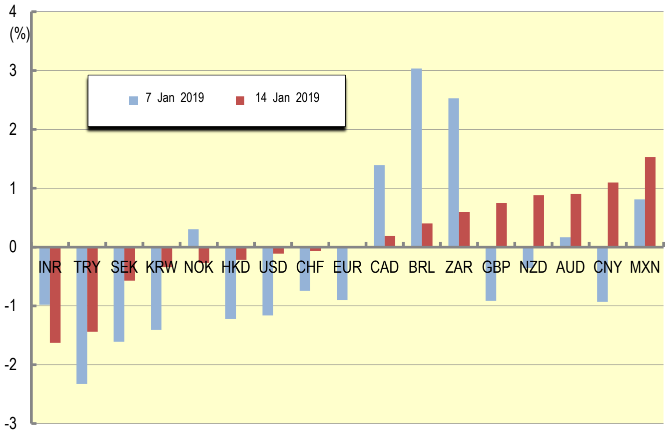
The Australian dollar had continued rising on expectations for a slower US rate hike pace and progress for US/China trade negotiations. However, weaker-than-expected Chinese trade statistics released at the beginning of the week apparently tempered this upward momentum. If the yuan drops against the US dollar on heightened concerns about a slowing Chinese economy, the Australian dollar would also likely work lower. Downward pressure on the Australian dollar will likely increase this week as we anticipate a risk-off mood if the British Parliament rejects the Brexit plan.

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

15-Jan		German GDP in 2018
		Nov eurozone trade balance
		Jan NY Fed's Empire State Manufacturing Index
	●	UK Parliament to vote on Brexit Withdrawal Agreement
16-Jan		Dec Europe new car sales
		Dec US retail sales*
17-Jan	○	Beige Book (Fed)
	○	MPM at South African central bank
		Dec US housing starts*
18-Jan		Dec US industrial production, capacity utilization rate
19-Jan		Jan 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.
**Indicates possibility that announcement may be postponed in the case of US government shutdowns.*

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

	7 - 11 Jan 2019 (actual)		14 - 18 Jan 2019 (forecasts)	
	Range	Weekend	Range	Weekend
USD/JPY	107.7-109.1	108.5	107.0-109.0	108.0
EUR/JPY	123.4-125.1	124.5	122.0-125.5	123.7
EUR/USD	1.139-1.157	1.147	1.135-1.155	1.145

Noteworthy currencies and factors

AUD	AUD may weaken due to risk-off sentiment on concerns about slowdown in China and possible rejection of Brexit Withdrawal Agreement
GBP	If UK Parliament rejects Brexit Withdrawal Agreement, pound would weaken due to concerns about no deal Brexit
CNY	US may request China to induce yuan appreciation; slowing economy creating pressure to weaken yuan

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.

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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.

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[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

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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.

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[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)

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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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The Financial Futures Association of Japan
Japan Investment Advisers Association
Type II Financial Instruments Firms Association