

Forex Market Weekly

Easing of Brexit concerns could weaken yen

- Soft yen on easing Brexit concerns, hopes for reduced US/China trade friction
- Growing speculation about delayed Brexit, second referendum may lift pound
- Risk of yen appreciation on concerns about slowing Chinese economy

This week's USD/JPY forecast range

21 - 25 Jan: Y108.2 – 110.2/\$ (Y109.8 at end-previous week)

Forex Market View DSFE208
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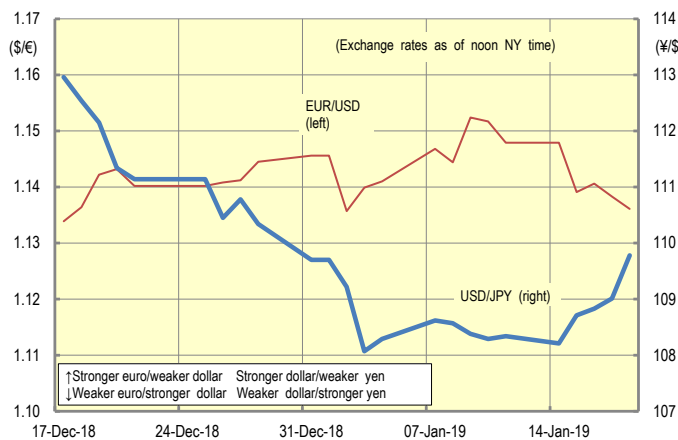


Soft yen on easing Brexit concerns, hopes for reduced US/China trade friction

Overview of last week's forex market

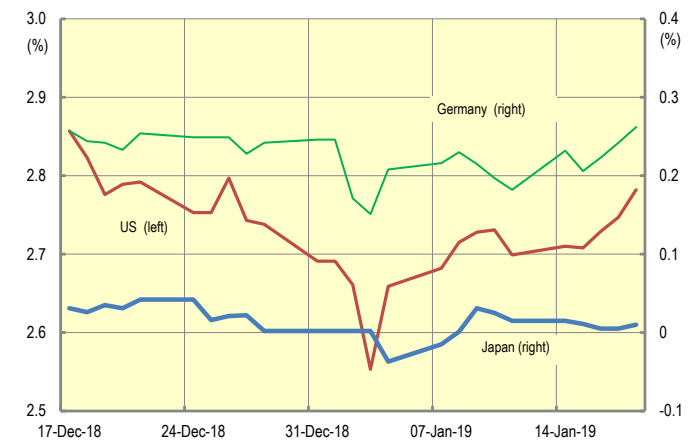
Chinese equities fell and the yen rose as an unexpected decline for China's December imports/exports generated a risk-off mood. As a result, the USD/JPY fell below 108.00. Still, US interest rates rebounded and the USD/JPY turned up. Also, China indicated aggressive fiscal policy steps to support the economy including 2019 tax cuts and a wider range of fee reductions. Chinese equities turned up and the resulting risk-on mood pushed the yen lower. Reports that German Chancellor Angela Merkel is unwilling to renegotiate Brexit with British Prime Minister Theresa May weighed on the pound, with the GBP/USD falling below 1.27 just before the UK Parliament voted on May's Brexit deal. Still, US/Europe equities and US interest rates turned bullish. The euro depreciated, the US dollar strengthened, and the USD/JPY remained solid after ECB President Mario Draghi said that significant monetary stimulus is still needed as the eurozone economy has weakened more than expected. The British Parliament resoundingly rejected May's Brexit plan, but the pound rebounded on expectations for closer bipartisan discussions going forward. Yen depreciation continued with the EU preparing to renegotiate the Brexit deal, with conditions, or agree to postpone the UK's departure from the EU. Theresa May surviving a no-confidence vote also contributed to the weaker yen. US interest rates and equities rose following a report that the US Treasury Secretary proposed rolling back Chinese tariffs (denied by the Treasury Department) with China proposing to increasing imports from the US. The USD/JPY rose back over 109.00.

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



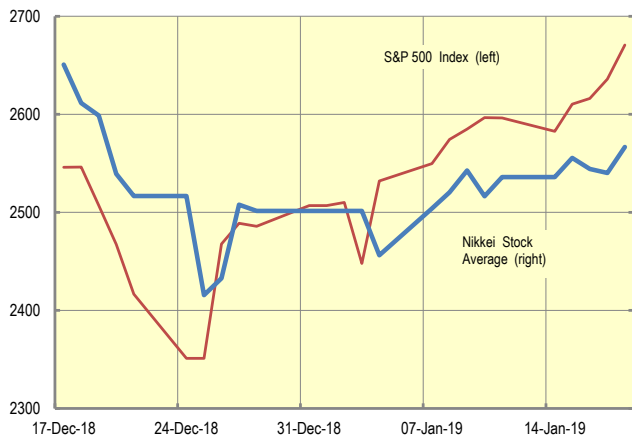
Source: Thomson Reuters; compiled by Daiwa Securities.

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



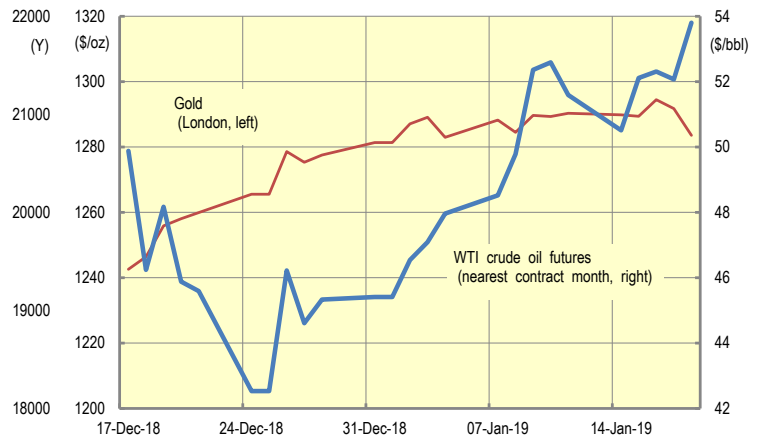
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



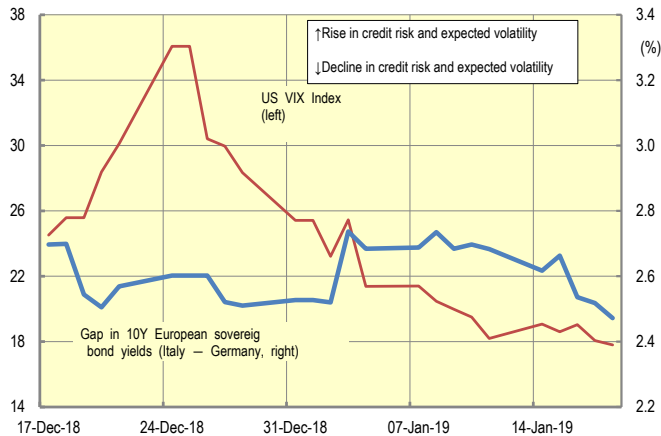
Source: Thomson Reuters; compiled by Daiwa Securities.

Consensus building remains challenging

Growing speculation about delayed Brexit, second referendum may lift pound

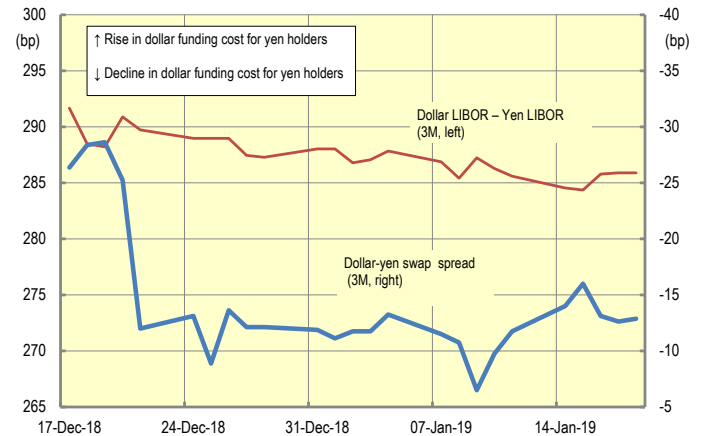
On 21 January, British Prime Minister May will submit to the British Parliament a motion pertaining to the next measures to be taken following rejection of her Brexit deal, which will be followed by alternative proposals submitted by members of Parliament. On 29 January, Parliament is scheduled to discuss and vote on all alternative proposals. Based on the degree of support for each, the British government will compile the alternative proposals and discuss how to best rework the Brexit agreement with the EU. If Britain can obtain EU approval for a reworked Brexit proposal, the British Parliament would hold another vote. The market expects (1) the British government to switch its stance from leaving to remaining in the EU customs union, (2) the EU to accept a revised Brexit proposal, and (3) the British Parliament to pass the new deal. That said, while the opposition Labour Party supports Britain remaining in the EU customs union, the Secretary General of the ruling Conservative Party has declared that the country will leave the EU customs union. May also promised Brexit hardliners that she would not agree to remain in the union. There is the strong likelihood that the British government will not switch to a soft-Brexit proposal that includes the nation remaining in the EU customs union. There is also a proposal for setting a deadline with legal guarantees for an Irish border backstop (safety measure). Even if a majority of members of Parliament support this proposal, it could still be rejected by the EU. With the 29 March Brexit deadline steadily approaching and consensus building remaining as daunting as ever, both the ruling and opposition parties are becoming more open to postponing the date for Britain's departure from the EU. The British Parliament is likely to pass a Brexit deadline postponement proposal and the EU should agree to a later date. The pound is likely to appreciate if there is growing speculation about postponing Brexit with diminished concerns about a no-deal Brexit. That said, upside for the pound is probably limited as pushing back the Brexit deal would not make consensus building any easier. Recent opinion polls show that a majority of British people now want to remain in the EU. If May were to change her position and allow for a second referendum, expectations for abandoning Brexit would grow and the pound would probably appreciate.

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



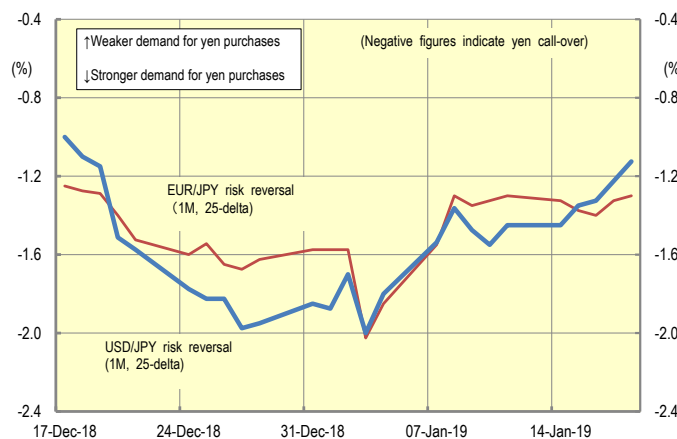
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



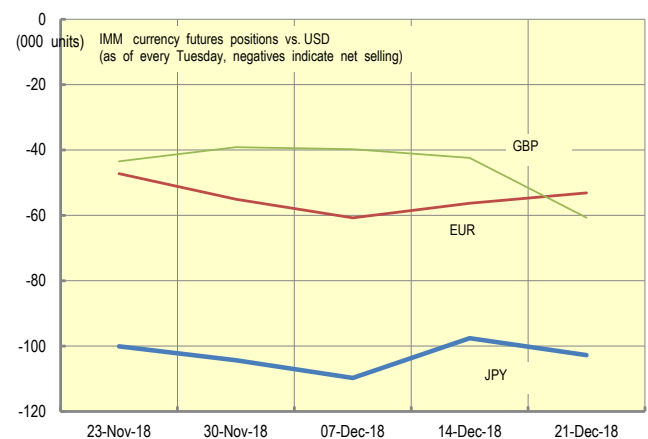
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

Chinese economic indicators out this week key after recent weakness

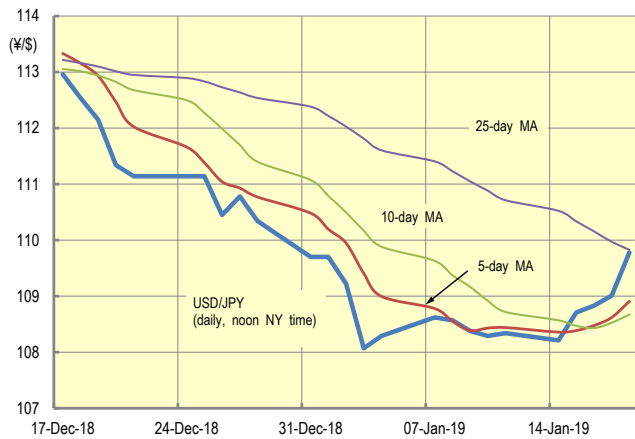
Risk of yen appreciation on concerns about slowing Chinese economy

Expectations for economic stimulus measures from the Chinese government and progress for US/China trade talks are limiting risk-off sentiment and concerns about China's slowing economy. Still, economic indicators are causing market swings. China's December import/export data was much weaker than the market consensus. Indicators due out this week include December industrial production, retail sales, and Oct-Dec GDP. We can probably anticipate risk-off yen appreciation if these indicators are likewise weaker than the market expects.

Noteworthy currency: EUR

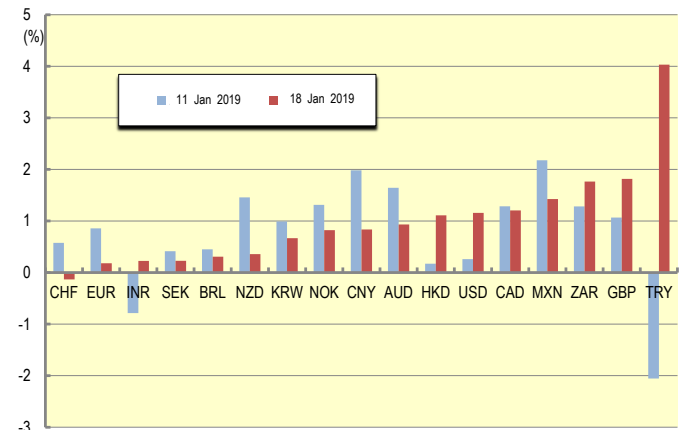
The ECB will hold its next monetary policy meeting on 24 January. While recognizing the potential for European economies to continue softening more than expected, we expect the Governing Council to set a tone suggesting that additional rate hikes are still possible. If the start of discussions on long-term refinancing operations (LTRO) is clarified, the euro could appreciate, reflecting a decline in Italian rates and a rise in German rates. However, we expect a mostly calm result from the meeting as there is little likelihood of any changes to its forward guidance or any important suggestions. Indeed, January eurozone PMI and German ifo Business Climate Index are more likely to impact the euro than this meeting.

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

- 21-Jan **Oct-Dec China GDP**
Dec China industrial production, retail sales
- Eurozone finance ministers meeting (Brussels)
- **UK Prime Minister May submits motion on next measures**
- 22-Jan Jan German ZEW Indicator of Economic Sentiment
Davos Meeting (until 25th, Switzerland)
- 23-Jan Dec US existing home sales
Dec Japan trade statistics
- **BOJ MPM /Outlook Report (governor press conference)**
- 24-Jan Jan eurozone PMI (Markit)
- **ECB Governing Council meeting (President Draghi's press conference)**
- 25-Jan Jan German IFO business climate index
Dec US durable goods orders*
- 26-Jan Dec US new home sales*

Source: Compiled by Daiwa Securities.

Notes: Dates based on JST. ○ indicates monetary policy-related and ● indicates political/international events.

*Indicates possibility that announcement may be postponed if US government remains shut down.

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

	14 - 18 Jan 2019 (actual)		21 - 25 Jan 2019 (forecasts)	
	Range	Weekend	Range	Weekend
USD/JPY	107.9-109.4	109.3	108.2-110.2	109.1
EUR/JPY	123.3-124.9	124.6	123.4-125.9	124.5
EUR/USD	1.136-1.150	1.139	1.131-1.151	1.141

Noteworthy currencies and factors

EUR	Economic indicators, having risk of further deterioration, would have greater impact than ECB monetary policy meeting
GBP	If speculations on Brexit postponement mount, this would lead to pound appreciation
AUD	Likely affected by tug-of-war between expectations for US-China trade talks and weaker Chinese economic indicators
CNY	Likely affected by tug-of-war between expectations for US-China trade talks and weaker Chinese economic indicators

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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- 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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