

Forex Market Weekly

Rise in USD/JPY on improving US economic data may have peaked

- Dovish Fed stance weakened the dollar, but USD/JPY recovered back above 109 on improving US data
- Risk-on moves look unlikely, even if the US postpones additional tariffs on China
- Doubts remain over the sustainability of US economic data improvement

This week's USD/JPY forecast range

4 - 8 Feb: Y108.2 – 110.2/\$ (Y109.5 at end-previous week)

Forex Market View DSFE211
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.

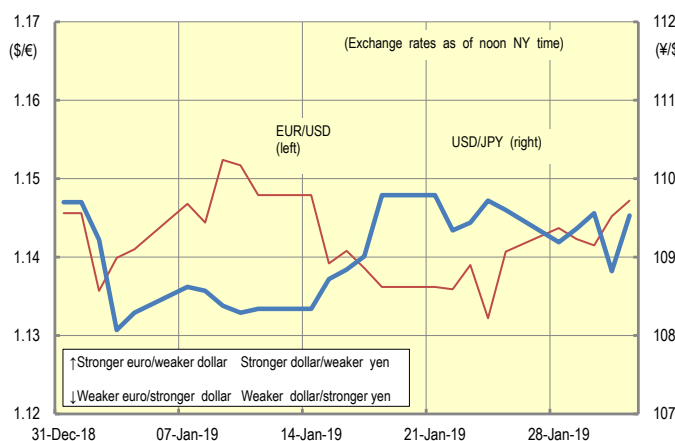


Dovish Fed stance weakened the dollar, but USD/JPY recovered back above 109 on improving US data

Overview of last week's forex market

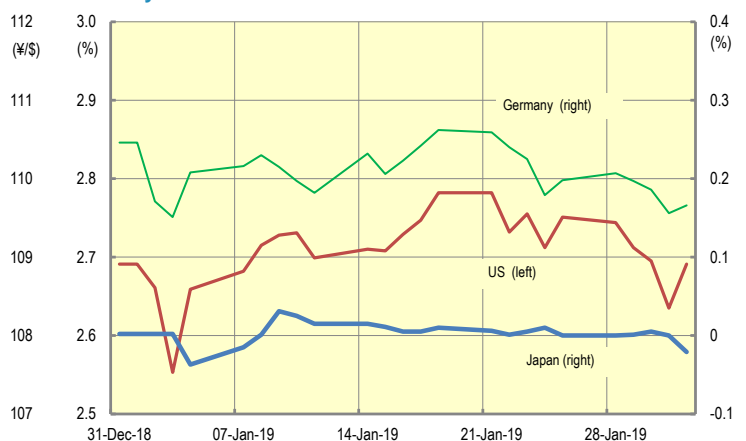
President Trump signed a stopgap budget until February 15 and the US government institutions that were shut down have reopened, but the Democrats and Republicans have yet to agree on funding for border security, and the USD/JPY is peaking. The USD/JPY declined when the US Department of Justice indicted China's Huawei and its CFO on suspicions of stealing trade secrets. With the January US Consumer Sentiment Index dropping to its lowest level since July 2017 and US interest rates declining, the USD/JPY has been trading at the lower 109 level. UK Parliament rejected an amendment extending the deadline for Brexit while passing an amendment demanding an alternative backstop plan, but the EU President refused to renegotiate the deal, and the pound fell. In the US, ADP's private sector payroll data for January showed stronger growth than expected, sending the USD/JPY to as high as 109.74, but the dollar retreated on news that December existing home sales declined more than expected. The FOMC suggested a pause in Fed rate hikes and greater flexibility in its plan for shrinking its balance sheet, pushing US interest rates lower and the USD/JPY down below 109. The USD/JPY then recovered to the mid-109 level on a large increase in US newly constructed home sales for November, strong growth in January employment, and improvement in the ISM manufacturing PMI.

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



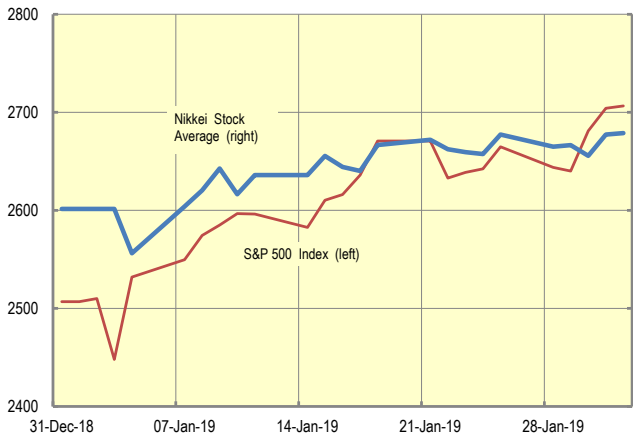
Source: Thomson Reuters; compiled by Daiwa Securities.

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



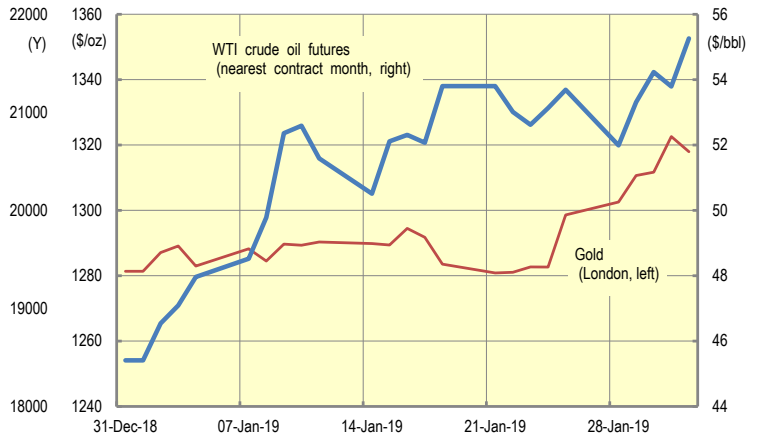
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



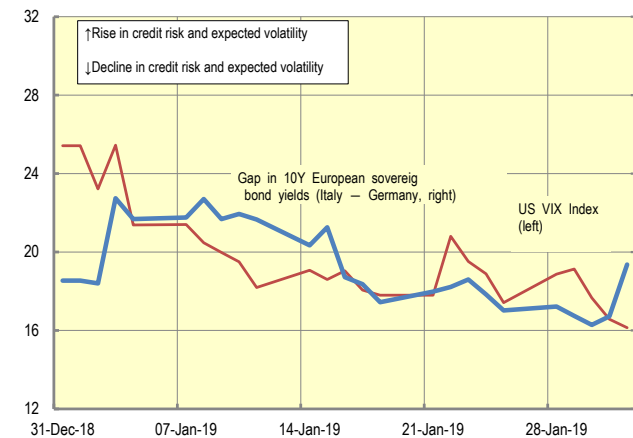
Source: Thomson Reuters; compiled by Daiwa Securities.

Risk-on moves look unlikely, even if the US postpones additional tariffs on China

Risk-on moves look unlikely, even if the US postpones additional tariffs on China

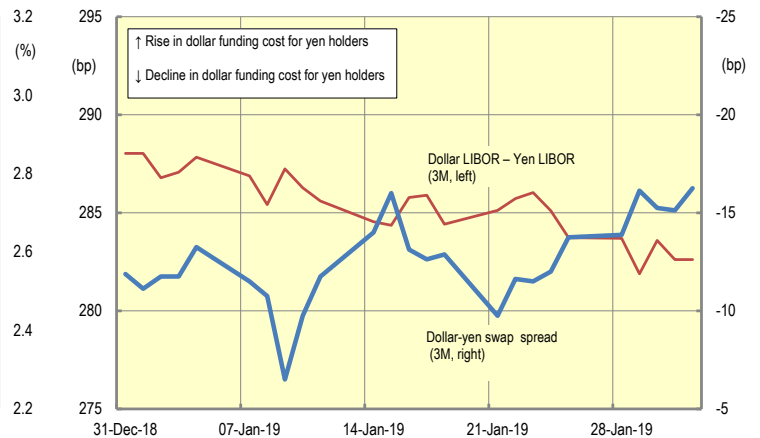
Although the US and China appeared to make some progress in their trade talks, there were no developments that raised expectations of an agreement. The US government said that it will raise tariffs on Chinese goods if satisfactory results cannot be achieved by March 1, but the US president also hinted at an extension. The US Trade Representative said the goal was to reach a detailed, comprehensive, and binding agreement with China. Although a final agreement that addresses structural problems is unlikely, we think the US president's desire to stabilize the economy will likely lead to a partial trade deal and postponement of the additional tariffs. The next working level meeting between the US and China is apparently scheduled for mid-February, but even if the US postpones imposing additional tariffs, unless it also moves toward lowering existing tariffs we think the market is unlikely to turn risk on.

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



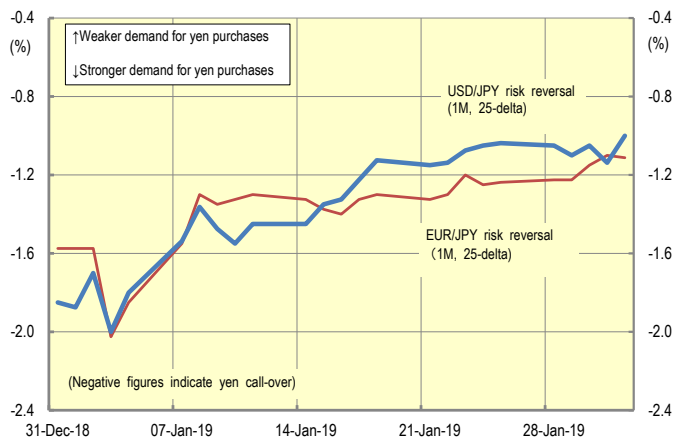
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



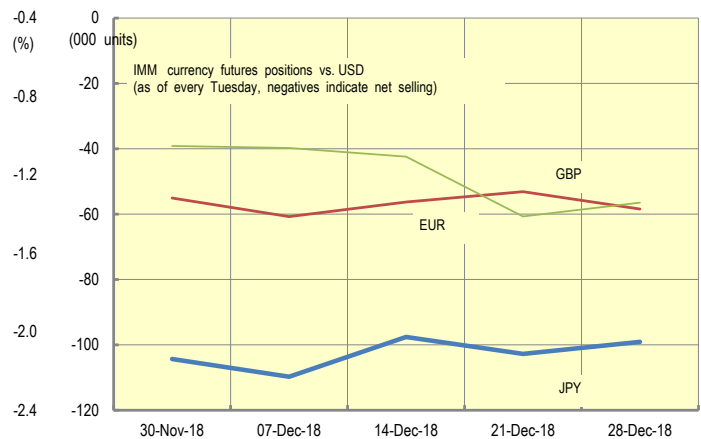
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

Doubts remain over the sustainability of US economic data improvement

Doubts remain over the sustainability of US economic data improvement

The dovish impression left by the Fed at the January FOMC meeting sparked a decline in US interest rates and weakening of the dollar. The decline in US rates pushed share prices higher, but the dollar depreciation caused by declining interest rates outweighed the risk-on yen depreciation, and the USD/JPY declined, although it later rose on improvement in the US economic data. Doubts remain over the sustainability of US economic data improvement, however. Based on the weakness of growth in employee hourly wages, we think the job growth was likely fueled by the temporary hiring of contingent workers. The unemployment rate rose 0.3ppt for full-time workers and declined 0.6ppt for part-time workers. Improvement in the US ISM manufacturing PMI can probably largely be attributed to the positive impact relative to December of the US decision to postpone the additional tariffs on China planned for January, but the economic landscape has hardly improved, given the weakening of new export orders and sluggish growth in orders outstanding. US auto sales declined rapidly m/m to their lowest level in 17 months, creating concerns over private consumption.

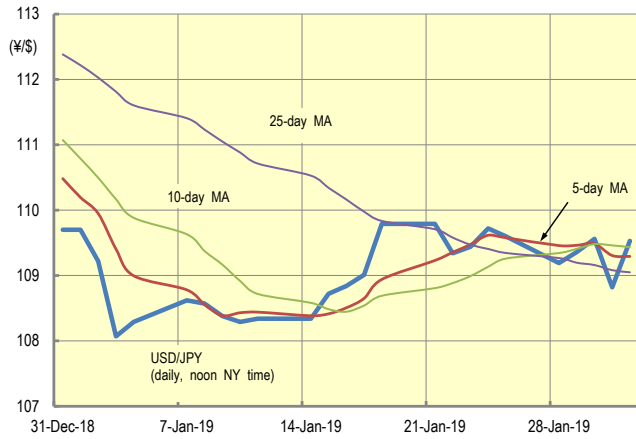
Worries over a no-deal Brexit may be rising

On January 29, the UK Parliament passed an amendment demanding a backstop alternative. The UK Prime Minister supported the amendment and indicated plans to ask the EU to renegotiate their Brexit deal. Ireland's prime minister rejected the idea of replacing the backstop with "alternative arrangements," however. The EU refused to renegotiate on the basis of there not being enough time to work out an alternative but said that it would promptly engage in negotiations if the UK desired a close relationship with the EU after leaving it. This effectively makes the UK remaining in the EU customs union a prerequisite to renegotiation. If the UK does not rethink its plans to exit the customs union and also does not make an effort to extend the deadline for Brexit, it will likely renew concerns over a no-deal Brexit and trigger risk-off market moves.

Noteworthy currency: AUD

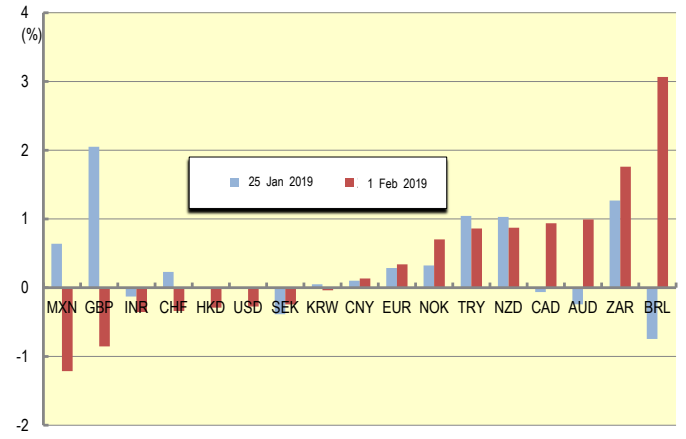
The key question for the Reserve Bank of Australia's policy meeting scheduled for February 5 is whether the central bank changes its policy stance in response to significant deterioration in the external environment, marked by US-China trade friction and concerns over a global economic slowdown. The market's rate expectations have reversed, from expecting rate hikes to expecting rate cuts. With the ECB and Fed changing to more cautious policy stances, if the Reserve Bank of Australia becomes significantly more dovish, such as by changing its policy stance from its next move being a rate hike to both a rate hike and rate cut being possible, the AUD will weaken. If it goes no further than signaling caution by noting an increase in uncertainties affecting the economy, however, the FX market is unlikely to react much.

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

- 5-Feb Chinese New Year (holiday from 4th to 10th)
Nov US manufacturing orders
- MPM at RBA
Dec eurozone retail sales
- State of the Union address by US President
- 6-Feb Jan US ISM non-manufacturing index
Dec German manufacturing sector orders
Nov US trade statistics
- 7-Feb ○ BOE MPC meeting, minutes, *Inflation Report*
- 8-Feb Dec German trade statistics, industrial production
President Trump's former lawyer's congressional testimony

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

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

	28 Jan - 1 Feb 2019 (actual)		4 - 8 Feb 2019 (forecasts)	
	Range	Weekend	Range	Weekend
USD/JPY	108.4-109.8	109.5	108.2-110.2	109.2
EUR/JPY	124.3-125.8	125.4	123.5-126.0	124.8
EUR/USD	1.138-1.152	1.145	1.133-1.153	1.143

Noteworthy currencies and factors

AUD	RBA's policy stance warrants attention; major dovish turn would weaken AUD
CNY	If China suspends moves to induce yuan to strengthen, US may react against further depreciation of yuan
GBP	Mounting concerns about no deal Brexit may lead to weaker pound

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.

■ The Significance of Registration

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.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of March 7th, 2017, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

[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.moody.com/pages/default_ja.aspx))

Assumptions, Significance and Limitations of Credit Ratings

Credit ratings are Moody's Investors Service ("MIS") current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. MIS defines credit risk as the risk that an entity may not meet its contractual, financial obligations as they come due and any estimated financial loss in the event of default. Credit ratings do not address any other risk, including but not limited to: liquidity risk, market value risk, or price volatility. Credit ratings do not constitute investment or financial advice, and credit ratings are not recommendations to purchase, sell, or hold particular securities. No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such rating or other opinion or information, is given or made by MIS in any form or manner whatsoever.

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.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of April 16th, 2018, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Moody's Japan K.K. (https://www.moody.com/pages/default_ja.aspx)

[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)

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 "Outline of Rating Policies" in the section of "Regulatory Affairs" on the website of Fitch Ratings Japan Limited (<https://www.fitchratings.co.jp/web/>)

Assumptions, Significance and Limitations of Credit Ratings

Ratings assigned by Fitch are opinions based on established criteria and methodologies. Ratings are not facts, and therefore cannot be described as being "accurate" or "inaccurate". Credit ratings do not directly address any risk other than credit risk. Credit ratings do not comment on the adequacy of market price or market liquidity for rated instruments. Ratings are relative measures of risk; as a result, the assignment of ratings in the same category to entities and obligations may not fully reflect small differences in the degrees of risk. Credit ratings, as opinions on relative ranking of vulnerability to default, do not imply or convey a specific statistical probability of default.

In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The assignment of a rating to any issuer or any security should not be viewed as a guarantee of the accuracy, completeness, or timeliness of the information relied on in connection with the rating or the results obtained from the use of such information. If any such information should turn out to contain misrepresentations or to be otherwise misleading, the rating associated with that information may not be appropriate. Despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

For the details of assumption, purpose and restriction of credit ratings, please refer to "Definitions of ratings and other forms of opinion" on the website of Fitch Rating Japan Limited.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of May 13th, 2016, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Fitch Rating Japan Limited (<https://www.fitchratings.co.jp/web/>)

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

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 materials presented along with this cover letter, 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.

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.

Corporate Name: Daiwa Securities Co. Ltd.

Financial instruments firm: chief of Kanto Local Finance Bureau
(Kin-sho) No.108

Memberships: Japan Securities Dealers Association

The Financial Futures Association of Japan

Japan Investment Advisers Association

Type II Financial Instruments Firms Association