

Forex Market Weekly

Deteriorating economic indicators and impacts from Fed's dovish turn

- USD/JPY moves on speculation over US-China trade spat
- Worsening of global economic indicators is strengthening the yen
- The Fed's dovish turn may be weakening the dollar

This week's USD/JPY forecast range

28 Jan - 1 Feb: Y108.1 – 110.1/\$ (Y109.5 at end-previous week)

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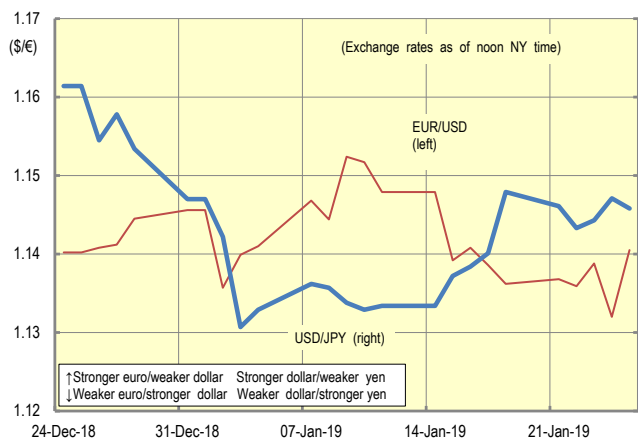


Overview of last week's forex market

USD/JPY moves on speculation over US-China trade spat

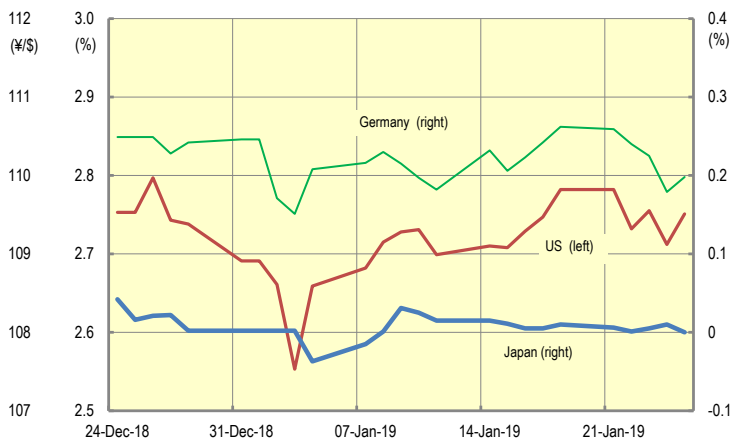
The USD/JPY rose to 109.89 and both US share prices and interest rates increased the Friday before last on expectations the US will lower its tariffs on China, but it retreated slightly on Monday, January 21 after President Trump denied reports that the tariffs would be abolished. US interest rates declined on January 22, when markets opened the week after a US holiday. The USD/JPY dropped to 109.14 on the announcement by the US Department of Justice of plans to request the extradition of Huawei's CFO and on reports that the US rejected a proposal for preliminary trade talks with China. The director of the US National Economic Council (NEC) then denied that the US rejected preliminary trade talks, and the USD/JPY rebounded. When the head of the Council of Economic Advisors (CEA) expressed confidence that the US and China would resolve their trade differences by March, the USD/JPY rose as high as 110.00. As moves to extend the Brexit deadline gained momentum in the UK Parliament, the pound rose above \$1.32. Meanwhile, a worsening of the euro zone PMI combined with a comment by ECB president Mario Draghi that risks to the EU growth outlook "have moved to the downside" pushed the euro down to as low as below \$1.13, although the dollar started to weaken on news that the Fed was considering halting its balance sheet runoff early.

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



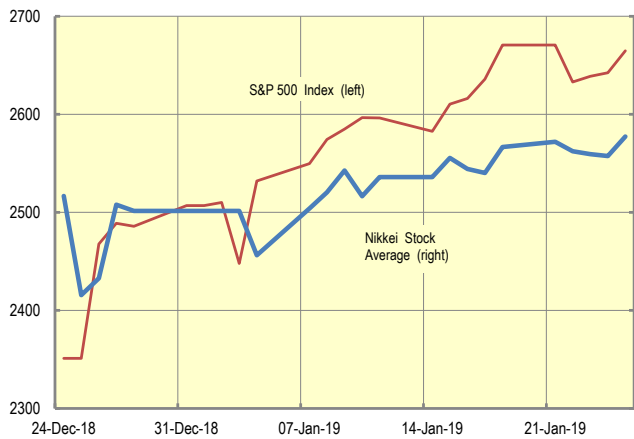
Source: Thomson Reuters; compiled by Daiwa Securities.

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



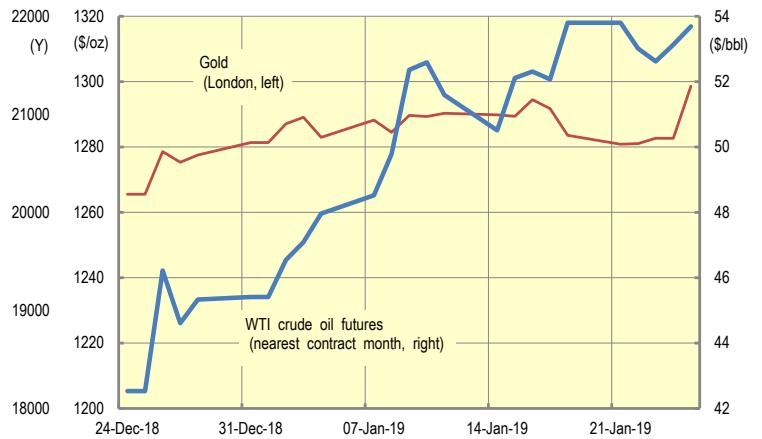
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



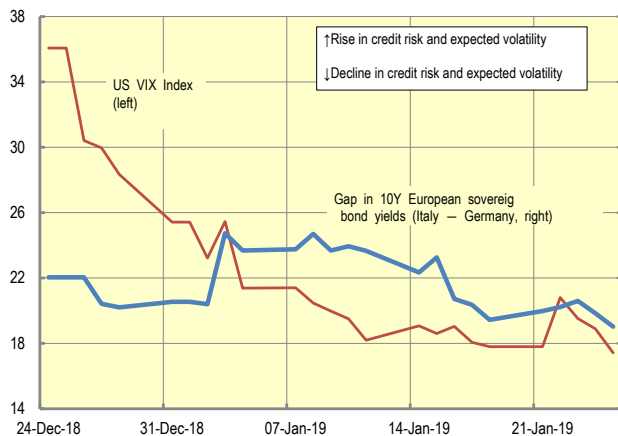
Source: Thomson Reuters; compiled by Daiwa Securities.

Worsening of global economic indicators is strengthening the yen

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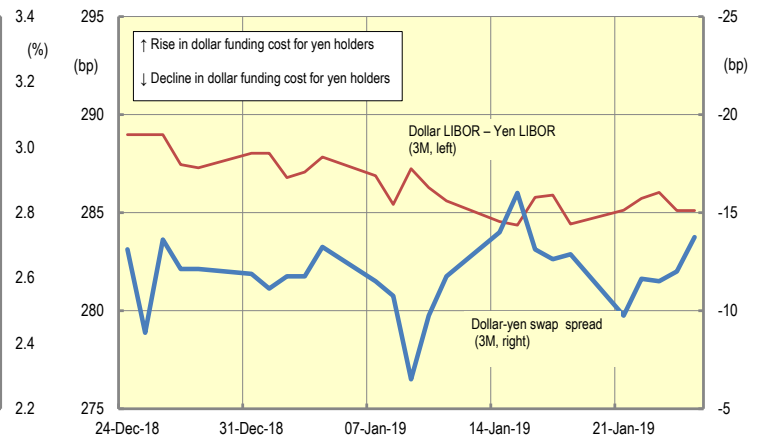
There was a period last week when risk-on moves paused and global share prices, oil prices, and cross-yen rates (except for some currency pairs, including the GBP/JPY) declined, against the backdrop of concern over a global economic slowdown. Japan's January manufacturing PMI declined to 50.0 from 52.6 in December, its lowest since a 49.5 reading in August 2016. Both the new orders and production indices have started declining as sentiment turns to a worsening trend. Germany's manufacturing PMI declined to 49.9 from 51.5 the previous month, its lowest since posting 49.5 in November 2014. In the euro zone, PMIs for both manufacturing and services are worsening, while the composite PMI dropped to 50.7, its lowest since July 2013. A number of key data announcements are due this week, including the Oct-Dec GDP numbers for the US and the euro zone, China's manufacturing PMI for January, US employment data, and the ISM manufacturing PMI. Concerns over an economic slowdown are getting stronger as the economic data underperforms forecasts, and this may strengthen the yen through risk-off moves and declines in interest rates overseas.

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



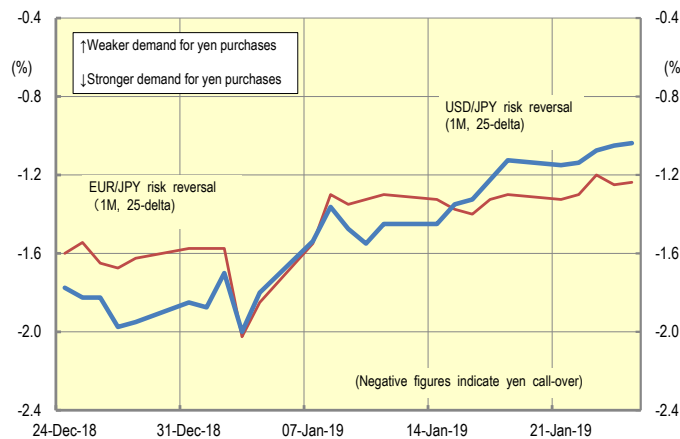
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



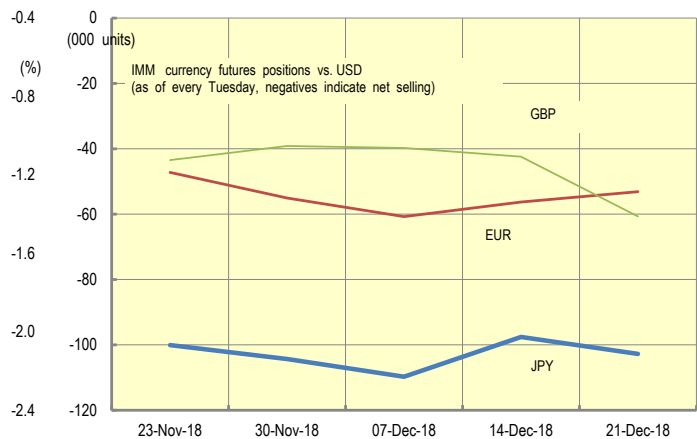
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

The Fed's dovish turn may be weakening the dollar

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At the upcoming FOMC meeting, officials will probably exhibit caution on continued rate hikes, citing downside risks to the US economy from a global economic slowdown and other factors. Although this is what the market expects, it would probably have a negative impact on US interest rates and the dollar. If the Fed indicates that it may prematurely end the runoff of its balance sheet from reducing reinvestments, the weakening impact on the dollar will probably be unmistakable.

Pound strengthens on speculation that the Brexit deadline will be delayed

The UK Parliament will debate and vote on an alternate Brexit proposal on January 29. There is growing momentum within Parliament to avoid a no-deal Brexit by extending the date by which the UK must leave the EU, and both Germany and France look set to agree to such an extension. The EU is questioning the purpose and length of the Brexit extension, however, while also ruling out any renegotiation of the backstop plan for avoiding a hard border in Ireland. If the results of the vote in Parliament increase the likelihood of Prime Minister May proposing a Brexit extension to the EU, the pound will likely strengthen.

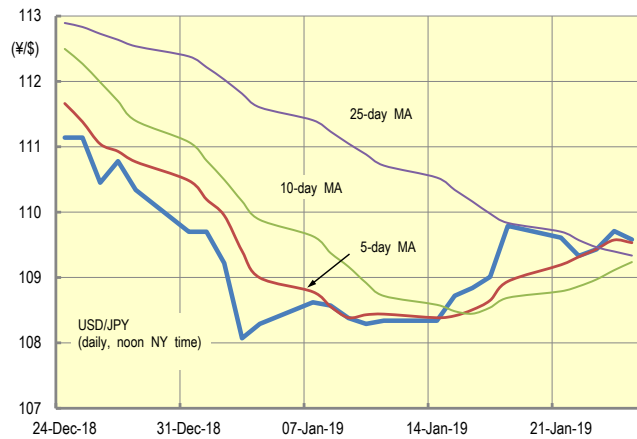
Risk-on effects from a US-China trade agreement may be limited

In the US-China trade talks, although China may agree to increase imports from the US and guide the yuan higher, it will probably be difficult for the two sides to find agreement on intellectual property rights and technology transfers. If the US extends the grace period for imposing additional tariffs but takes the position that it will keep the pressure on China by leaving open the risk of imposing additional tariffs, any risk-on yen weakening would probably be minor.

Noteworthy currency: CNY

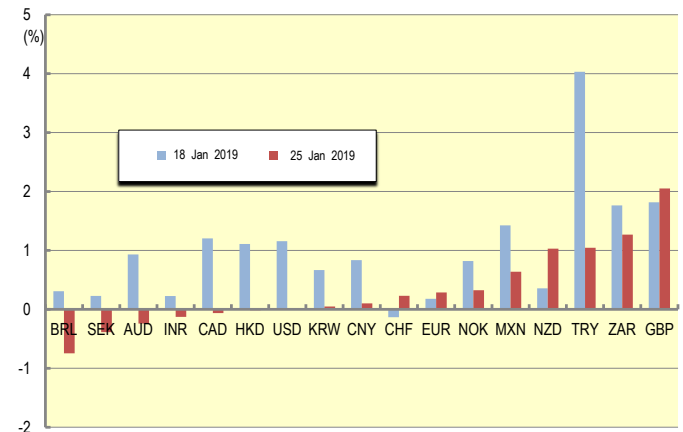
US Treasury officials have said that exchange rates will also become a topic of discussion at the US-China trade talks, but Chinese officials already appear to be deferring to the US and leading the yuan higher. The yuan is not only about 3.1% stronger vs. the dollar than it was at end-November, it is about 2.0% stronger vs. a basket of currencies. If sentiment continues worsening in China, however, it should become more difficult for China to guide the yuan higher.

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

- 29-Jan Nov US S&P Case-Shiller Home Price Indices
- UK Parliament to deliberate and vote on Brexit alternative proposal
- 30-Jan Jan Consumer Confidence Index (Conference Board)
- Jan Economic Sentiment Indicator (ESI)
- Jan German CPI
- Jan US ADP national employment report
- Oct-Dec US GDP*
- US-China trade talks (until 31st, Washington DC)
- 31-Jan ○ FOMC statement (Fed chair Powell's press conference)
- Summary of Opinions at BOJ MPM on 22-23 Jan
- Dec Japan industrial production, shipments, inventories
- Jan China manufacturing PMI (National Bureau of Statistics of China)
- Jan German jobs report
- Oct-Dec eurozone GDP, Dec unemployment rate
- Dec US personal income/expenditures, Oct-Dec US employment cost index
- Jan US Chicago Purchasing Manager's Index
- 1-Feb Jan China manufacturing PMI (Caixin)
- Jan eurzone CPI
- Jan US jobs report
- 2-Feb Jan US ISM manufacturing index

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.

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

	21 - 25 Jan 2019 (actual)		28 Jan - 1 Feb 2019 (forecasts)	
	Range	Weekend	Range	Weekend
USD/JPY	109.1-110.0	109.5	108.1-110.1	109.0
EUR/JPY	123.7-125.4	124.9	123.2-125.7	124.3
EUR/USD	1.128-1.142	1.141	1.130-1.150	1.140

Noteworthy currencies and factors

CNY	Whether China will continuously induce yuan to strengthen in consideration of US
USD	Dollar would weaken if Fed implies suspension of balance sheet reduction
GBP	If speculations on Brexit delay mount, this would cause pound appreciation
JPY	Deterioration in economic indicators in US and China would lead to risk-off yen appreciation

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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