Daiwa Securities

Forex Market View

Is the upswing in US economic data and the dollar temporary?

- It is difficult to be optimistic that US jobs growth will remain high
- We doubt improvement in US manufacturing sentiment is sustainable
- Watch out for a pullback in the USD/JPY on US economic data underperforming expectations

USD/JPY forecast range (latest: noon New York time)

7 Feb- 6 Mar: Y105.5-110.5/$ (Y109.75/$ as of 6 Feb)

Forex Market View DSFE212

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It is difficult to be optimistic that US jobs growth will remain high

USD/JPY rebounds on strong US economic data

US economic data came in stronger than the market expected, triggering a rebound in both US interest rates and the dollar and pushing the USD/JPY above 110. US economic data that looks outwardly strong also shows glimmers of weakness, however, and doubts remain over whether improvements are sustainable. We think it is premature to expect US interest rates and the USD/JPY to maintain an upward trajectory on optimism over the direction of the US economy.

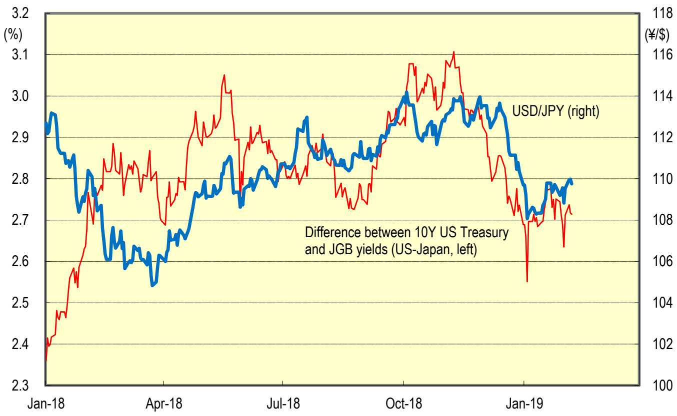
US employment numbers greatly exceed the market forecast

The US nonfarm payroll number for January 2019 grew 304,000 from December, well above the 165,000 increase the market expected and a positive surprise. Although the 312,000 payroll increase initially reported for December 2018 was revised downward by 90,000 to 222,000, the total increase in nonfarm payrolls for 2018 including the annual adjustment was revised upward by 36,000 jobs, and the January 2019 jobs number still exceeded expectations. In addition, January's increase in jobs exceeded the 12-month average increase of 234,000, the six-month average of 232,000, and the 3-month average of 241,000. Workers furloughed by the government shutdown were not counted as unemployed in the business establishment survey because they received back pay, and employment in the government sector increased by 8,000 jobs.

Reasons why hourly wage growth slowed

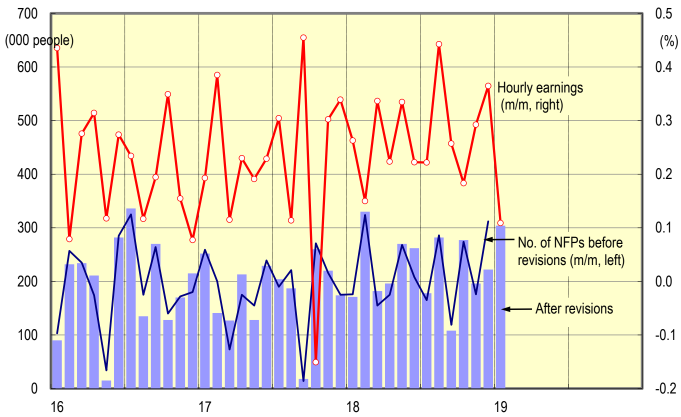
The average hourly wage for private-sector employees, reported in the same business establishment data on US employment, only increased 0.1% m/m, vs. the market forecast of 0.3% growth. There have been months in the past when average hourly wage growth slowed and employment grew, and it is likely that growth in the employment of part-time workers is what caused that to happen this time. It is often the case that in the following month, employment growth slows while average hourly wage growth accelerates as a result of slower employment of part-time workers.

Chart: USD/JPY and Difference Between 10Y US Treasury and JGB Yields



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Change in No. of NFPs and Growth Rate of Hourly Earnings in US



Source: Thomson Reuters; compiled by Daiwa Securities.

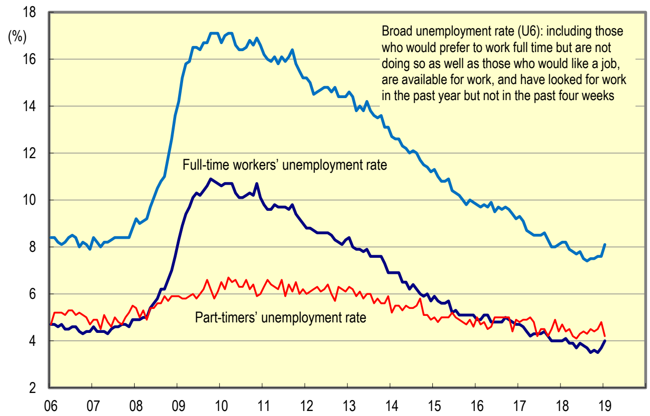
Growth in the involuntarily unemployed and part-time employees

In the US jobs data collected under the household survey, furloughed workers are counted as unemployed even if they are paid their wages. The number of unemployed increased 241,000 in January and the unemployment rate rose to 4.0%, from 3.9% in December. Nevertheless, although the unemployment rate for full-time workers increased from 3.7% to 4.0%, the percentage of part-time workers unemployed fell from 4.8% to 4.2%. Categorized by the reason for unemployment, there was a decline in the number of voluntarily unemployed, either through voluntary separation or from reentering the labor market, and an increase in the number of involuntarily unemployed as a result of layoffs at the company's discretion. This was probably affected by the furloughs brought by the government shutdown. Meanwhile, there was an increase in the number of part-time workers because of downsizing and other economic rationale, and the broader measure of the unemployment rate that counts involuntary part-time workers as unemployed increased to 8.1%, from 7.6% in December. The number of weekly new unemployment claims rose sharply to 253,000 two weeks after the survey was taken, up from 200,000 the previous week and the highest it has been since September 2017.

It is difficult to be optimistic that US jobs growth will remain high

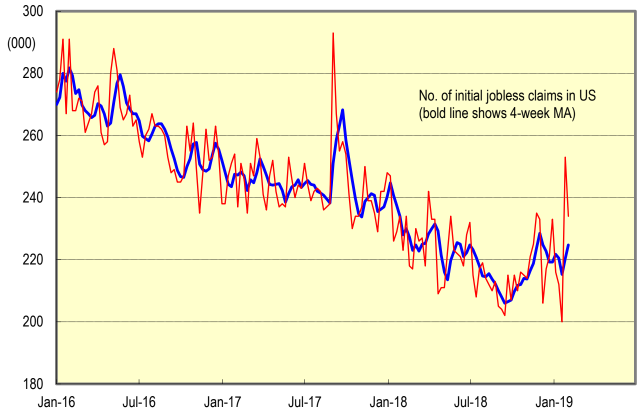
If this growth in the number of involuntary unemployed and involuntary part-time workers can be attributed largely to the government shutdown, unemployment should decline on the government's reopening, but if it mostly reflects the trend at private sector companies, it could be a sign of weakening employment. If the number of part-time workers relative to full-time workers increased to the advantage of employers, it becomes hard to argue that the jobs market is strong in anticipation of future economic growth. Additionally, workers furloughed by the government shutdown are counted as employed in the government sector in the establishment survey, and those furloughed workers that took part-time jobs for economic reasons were also counted as private-sector employees. This double counting may have boosted the nonfarm payrolls number for January. In that case, the ending of furloughs could cause declines in both the number of unemployed and the number of private-sector employees. Being optimistic that employment growth in the US will remain high may bring with it significant risks.

Chart: US Unemployment Rate (broad, full-time workers, and part-timers)



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: No. of Weekly Initial Jobless Claims in US



Source: Thomson Reuters; compiled by Daiwa Securities.

We doubt improvement in US manufacturing sentiment is sustainable

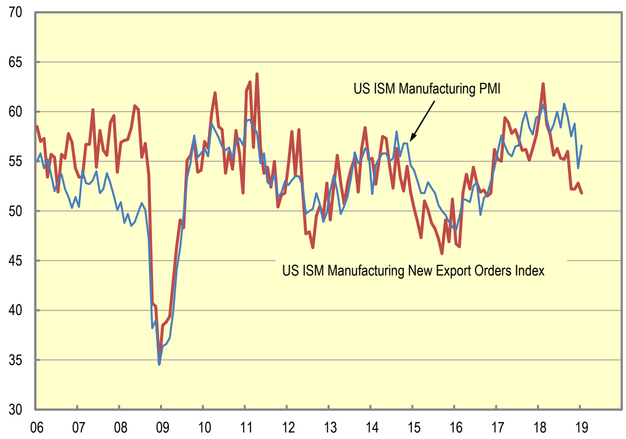
US manufacturing sentiment improves more than expected

Another data release that gave the market a positive surprise in addition to the US jobs data was the January ISM manufacturing PMI, which beat the market forecast of 54.2 by rising to 56.6, from 54.3 in December. This is because out of the PMI's five components, new orders and production rose sharply and inventories rose moderately. The postponement until March of the tariff increase the US had planned for Chinese goods at the start of the year had a positive impact, and we think was one reason for the improvement relative to December. The percentage of companies reporting growth in manufacturer inventories or customer inventories increased and orders outstanding were nearly flat, however, suggesting that demand is not that strong. The proportion of companies reporting an increase in new export orders declined, indicating that the export environment remains difficult on the slowdown in overseas economies and dollar appreciation. This weakness in exports is likely to cause sentiment to worsen.

We doubt improvement in US manufacturing sentiment is sustainable

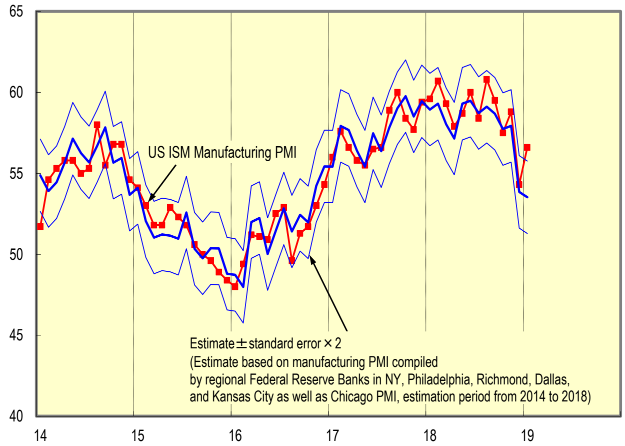
Of the five manufacturing PMIs for January announced by regional Fed banks, four of them showed improvement, and one worsened, relative to December, results that are consistent with improvement in the ISM manufacturing PMI. The Chicago manufacturing PMI worsened considerably, however. Running a regression analysis with these six indices against the actual ISM manufacturing PMI over the past five years shows that actual numbers have nearly always remained within two standard deviation of estimates, but in January the actual PMI was above that range. This suggests that, barring major improvement in the economic environment, the probability of a decline in the February ISM manufacturing PMI is relatively high. Being optimistic over the sustainability of improvements to US manufacturing sentiment probably also brings substantial risks.

Chart: US ISM Manufacturing PMI and New Export Orders Index



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: US ISM Manufacturing PMI (actual and estimate by regression analysis)



Source: Thomson Reuters; compiled by Daiwa Securities.

Watch out for a pullback in the USD/JPY on US economic data underperforming expectations

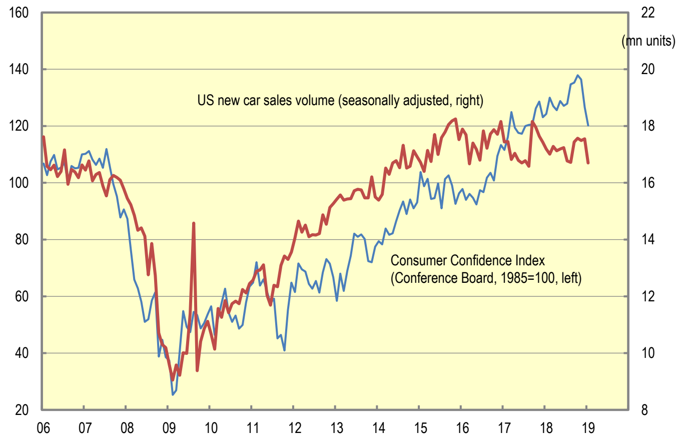
Worsening US consumer sentiment and sharply declining auto sales

Although some US economic indicators show strength, there are others that show weakness. One of those is consumer confidence. The University of Michigan Consumer Sentiment Index dropped to its lowest level in 27 months and the Conference Board Consumer Confidence Index dropped to its lowest level in 19 months. Both the expectations index and current conditions index have turned to declining trends, and consumer sentiment is worsening. Although US share prices rebounded in January after declining in Oct-Dec 2018, there was no improvement in sentiment. This deterioration in consumer sentiment was reflected in US auto sales volume, which totaled a seasonally adjusted annual rate of 16.7 million in January, a sharp decline from 17.55 million in December. With a bottom since 2016 of around 16.7 million vehicles, a further decline in auto sales would likely mean that private consumption has started declining.

Watch out for a pullback in the USD/JPY on US economic data underperforming expectations

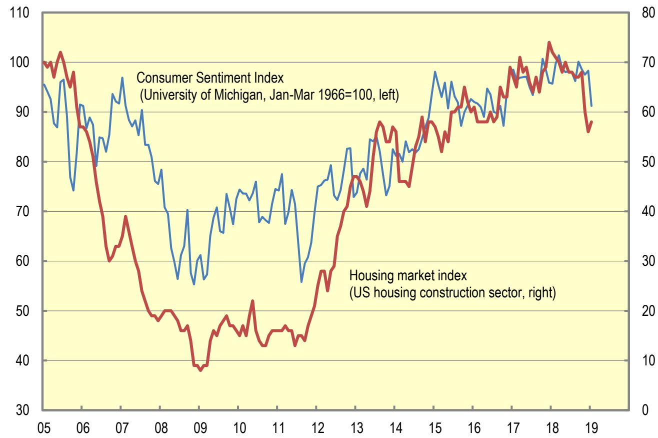
There are thus numerous indicators, mostly consumption-related ones, suggesting the US economy is slowing. If private consumption, the largest component of demand, starts decelerating, it will have a major negative impact on the US economy. Although there are signs of a recovery in demand for home loans in response to the decline in residential mortgage rates, we think a worsening outlook for the economy and household income will dampen housing investment. Watch out for the risk that US economic indicators that were unexpectedly strong in January will be unexpectedly weak from February and spark a pullback in US interest rates and the USD/JPY.

Chart: US Consumer Confidence Index and New Car Sales Volume



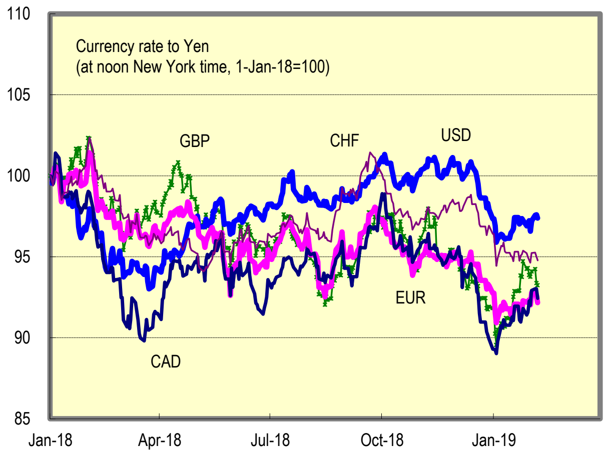
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: US Consumer Sentiment Index and Housing Market Index



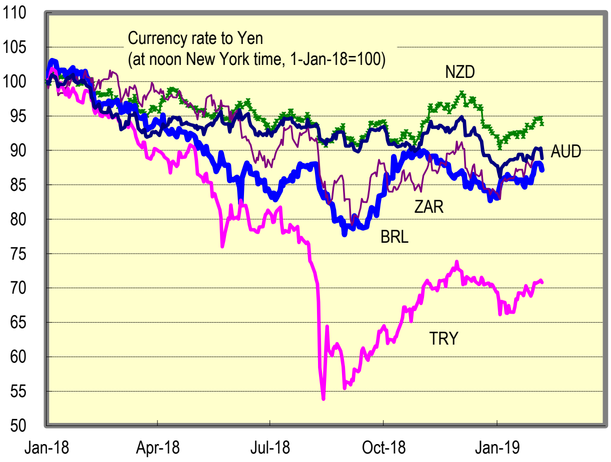
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Major Currencies/JPY FX Index



Source: Fed, Thomson Reuters; compiled by Daiwa Securities.

Chart: EM Currencies/JPY FX Index



Source: Fed, Thomson Reuters; compiled by Daiwa Securities.

Chart: Currency Exchange Rate Forecasts

	Actual		Forecast				
	28 Sep 2018	31 Dec 2018	Jan-Mar 2019	Apr-Jun 2019	Jul-Sep 2019	Oct-Dec 2019	Jan-Mar 2020
USD-JPY	113.7	110.3	108.0	110.0	107.0	105.0	105.0
			104-112	104-112	104-112	101-110	101-110
EUR-JPY	131.9	126.3	122.0	126.5	122.0	119.0	119.0
			118-128	118-130	118-130	115-127	115-127
AUD-JPY	82.1	77.7	75.5	79.5	76.0	73.5	73.5
			73-81	73-82	73-82	70-79	70-79
CAD-JPY	88.0	81.0	79.5	82.0	79.5	77.5	77.5
			77-85	76-85	76-85	74-83	74-83
NZD-JPY	75.2	74.0	71.5	75.0	72.0	69.5	69.5
			69-77	69-78	69-78	66-75	66-75
TRY-JPY	18.8	20.9	19.3	20.8	19.5	18.5	18.5
			17-22	17-22	17-22	16-21	16-21
ZAR-JPY	8.0	7.7	7.5	7.9	7.5	7.2	7.2
			7.0-8.1	7.0-8.3	7.0-8.3	6.7-8.0	6.7-8.0
BRL-JPY	28.1	28.5	27.8	29.8	28.2	27.0	27.0
			26-31	26-31	26-31	25-30	25-30
KRW-JPY	10.2	9.9	9.4	9.8	9.4	9.1	9.1
(100 KRW)			9.1-10.0	9.1-10.1	9.1-10.1	8.8-9.8	8.8-9.8
CNY-JPY	16.5	16.1	15.4	16.2	15.5	15.0	15.0
			15.0-16.3	15.0-16.5	15.0-16.5	14.5-16.0	14.5-16.0

Source: BIS, Fed, Thomson Reuters; compiled by Daiwa Securities.
Notes: 1) Actual shows market rates at noon NY time.
2) Forecast upper row; as of quarter end, lower row; range during quarter.

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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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).

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

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The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

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[Fitch]

The Name of the Credit Rating Agencies group, etc

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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.

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The Financial Futures Association of Japan
Japan Investment Advisers Association
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