

# Forex Market Weekly

## Dollar appreciation driven by risk-off

- The USD/JPY rose above 110, while cross-yen rates declined
- Concerns over an economic slowdown rise and central banks become less hawkish
- Concerns over Brexit are a factor constraining yen weakness

### This week's USD/JPY forecast range

**11 - 15 Feb: Y108.8 – 110.8/\$ (Y109.8 at end-previous week)**

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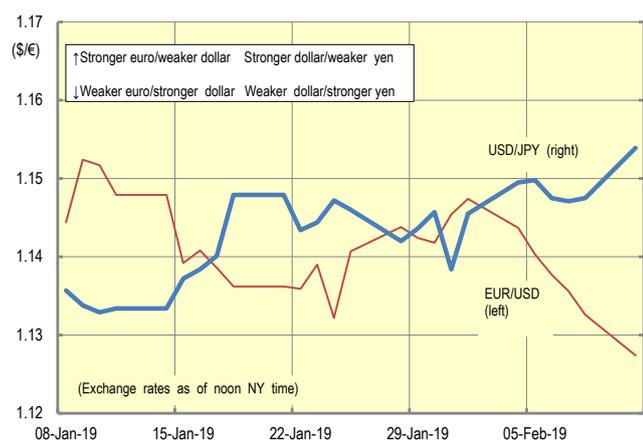
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## Overview of last week's forex market

### The USD/JPY rose above 110, while cross-yen rates declined

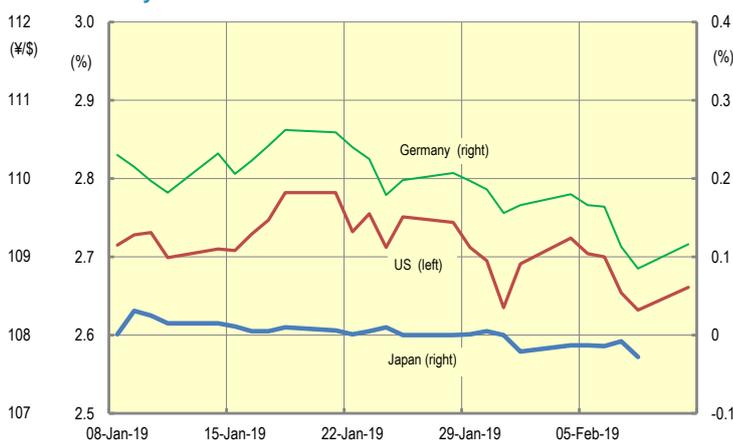
Strong US jobs data and the ISM manufacturing PMI, announced at the end of the week before last, kept US interest rates and the dollar in a rising trend. At the beginning of last week, the trend continued. The USD/JPY rose to 110.16, but then turned to a declining trend in response to the unexpected decline in November US manufacturing orders. The British pound fell on a decline in the UK services sector PMI. Australia's central bank had said in December that its next rate change was more likely to be a rate hike than a rate cut, but at a press conference on February 6, RBA Governor Philip Lowe said the rate outlook was balanced, thus changing to a stance of both a rate hike and a rate cut being possible. This caused the AUD to weaken. US President Trump's state of the union address contained nothing new, and the USD/JPY fell back to the mid-109 level, but with US stocks firm it bounced back to nearly 110. Germany's industrial production index for December declined and the European commission lowered its growth outlook for the euro zone, leading to declines in both German yields and the euro. The pound also fell in response to the BOE lowering its growth forecast. The USD/JPY rose to the mid-110 level on 11 February on expectations of a US-China trade agreement, but cross-yen rates weakened across the board.

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



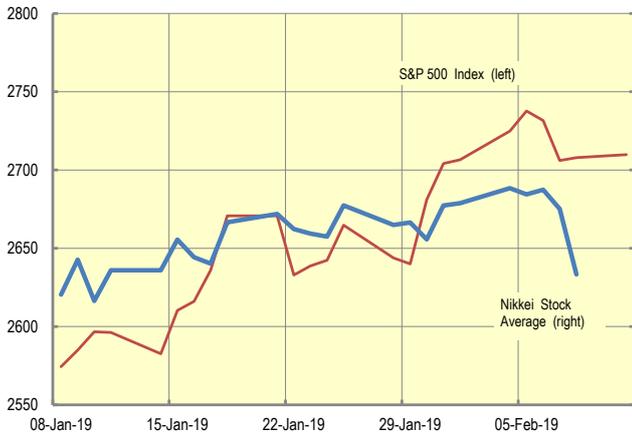
Source: Thomson Reuters; compiled by Daiwa Securities.

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



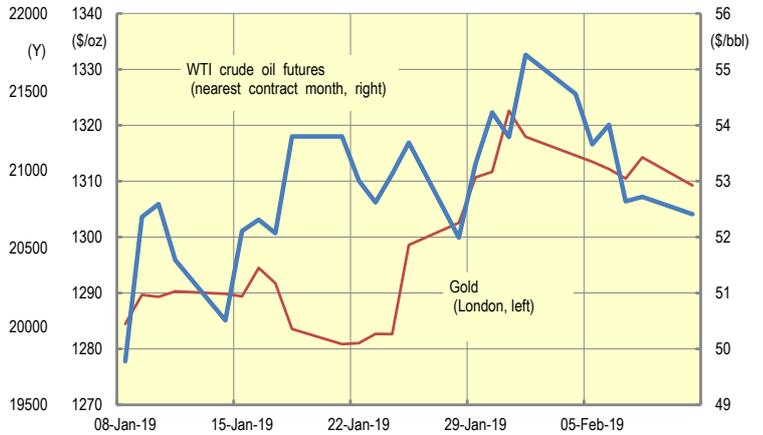
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



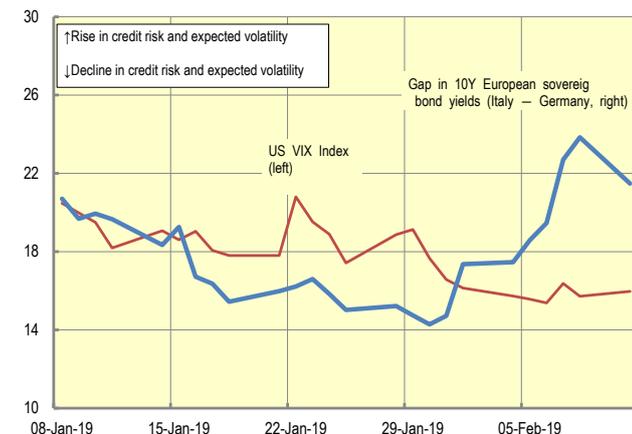
Source: Thomson Reuters; compiled by Daiwa Securities.

**Concerns over an economic slowdown rise and central banks become less hawkish**

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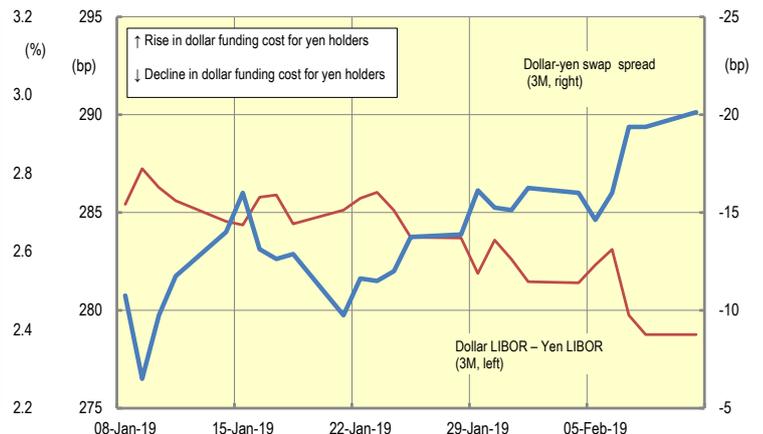
Many currencies, including the euro, Canadian dollar, Aussie dollar and NZ dollar, weakened against both the dollar and the yen because of rising concerns over an economic slowdown and less hawkishness from central banks. Germany's industrial production index for December declined 0.4% m/m, well short of the 0.7% growth expected by the market and a fourth consecutive month of declines (the index only showed growth in three months during 2018: March, May, and August). Italy's industrial production declined 5.5% y/y in December, its largest decline in five years and nine months, Spain's industrial production declined 6.2% y/y, its largest decline in six years, and the Netherlands manufacturing production declined 3.9% m/m, its largest decline in 10 years. The EU's biggest economies are clearly slowing and central bankers in the euro zone are more clearly and forcefully expressing concerns over economic deceleration. German share prices had been strong on declining interest rates and euro depreciation, but they are beginning to retreat on economic slowdown concerns. These conditions are likely to lead to risk-off upward pressures on the yen.

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



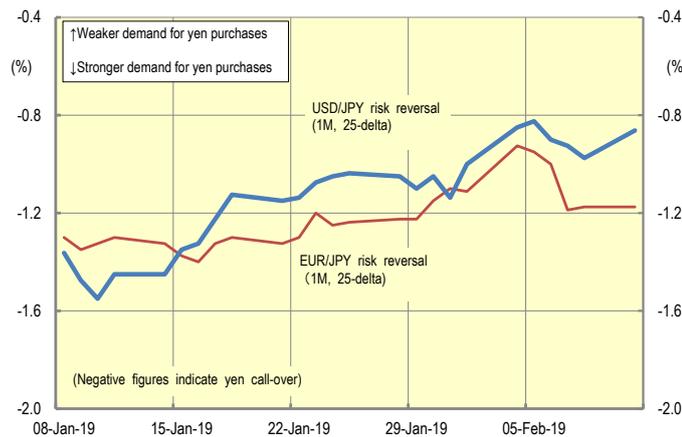
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



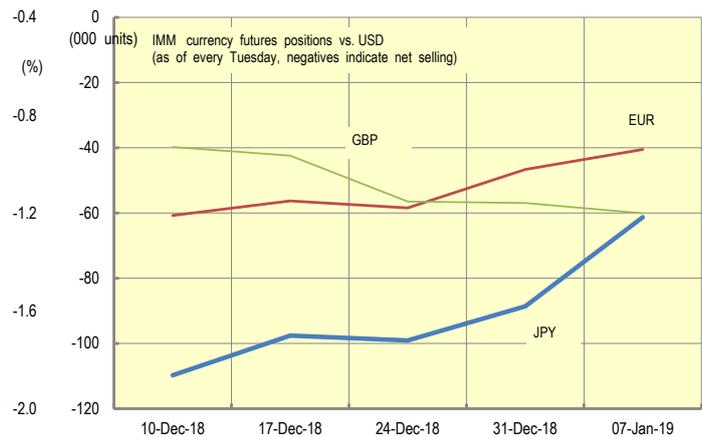
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

**USD/JPY has been stronger than the declines in US interest rates and share prices would suggest**

### Concerns over Brexit are a factor constraining yen weakness

US interest rates rose in response to US jobs data and the ISM manufacturing index, then retreated nearly back to prior levels. This can probably be attributed to concerns over an economic slowdown that are spreading globally, and US stocks also retreated somewhat after a long run of increases. Nevertheless, the USD/JPY has been strong given the decline in US interest rates and share prices, and is now above 110, higher than the upper-108 level it was tracking prior to US interest rates rising. Risk-off moves tends to strengthen both the yen and the dollar, and this time dollar buying predominated, but the yen is likely to strengthen against the dollar if US interest rates remain in a declining trend. Keys to the USD/JPY's direction are whether there is progress in this week's US-China trade talks and whether US economic data beats market expectations.

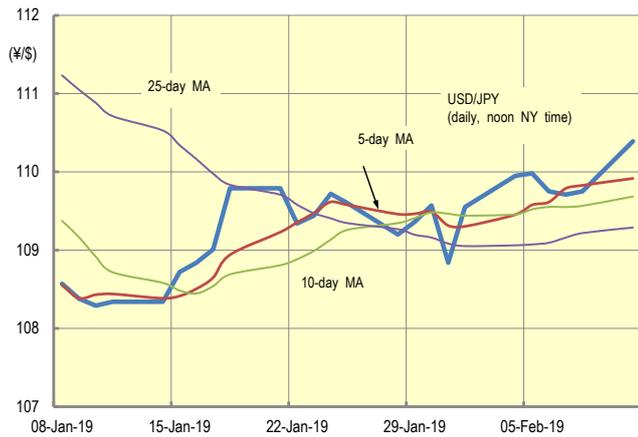
**Concerns over Brexit are a factor constraining yen weakness**

The risk-on yen depreciation triggered by reports that the US president wants an early meeting with China's President proved to be temporary, and the subsequent turn to dollar strengthening and the pullback in cross-yen rates can probably be attributed to concerns over a global economic slowdown and Brexit. UK Prime minister Theresa May explained the status of Brexit negotiations to Parliament on February 12, and it appears likely that there has been no progress in talks to revise the proposed Brexit deal. There were also some reports that the Prime Minister was preparing to resign. The UK may have reached a point where it must choose between voting again to approve the Brexit plan already agreed to with the EU (without passage a no-deal Brexit would draw closer) or extending the Brexit deadline in order to hold another referendum on whether the UK should leave the EU.

**Noteworthy currency: NZD**

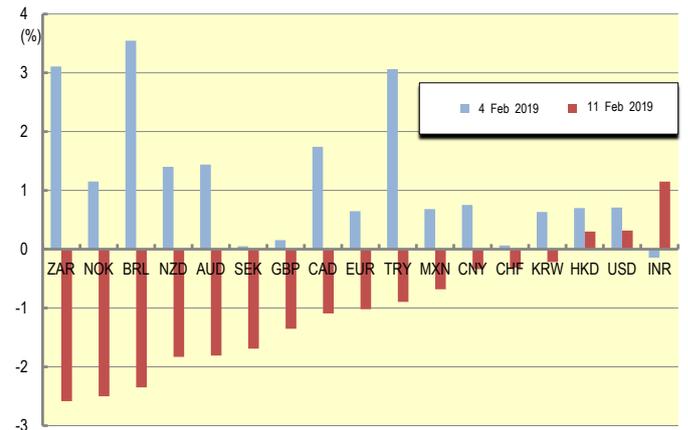
New Zealand's central bank holds a policy meeting on February 13. Last week, the Reserve Bank of Australia (RBA) lowered its growth and inflation forecasts and shifted to a more cautious stance, causing Australian interest rate futures to price in a rate cut this year and sending the AUD sharply lower. The Reserve Bank of New Zealand's stance was that its next rate move could be in either direction, a more dovish stance than that taken by the RBA, but Australia's shift caused the market to price in New Zealand rate cuts and weakened the NZD. Although we expect it to signal a cautious stance at its policy meeting, this is already priced in to an extent and the NZD's decline may be limited.

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

- 11-Feb ● Eurozone finance ministers meeting (Brussels)
- 12-Feb ● EU finance ministers meeting (Brussels)
- 13-Feb ○ MPM at New Zealand's central bank  
Dec eurozone industrial production  
**Jan US CPI**
- 14-Feb Oct-Dec Japan GDP  
**Jan China trade statistics**  
Oct-Dec German GDP  
**Dec US retail sales**
- 15-Feb Jan China CPI, PPI  
Jan Europe new car sales  
Dec eurozone trade balance  
**Feb NY Fed's Empire State Manufacturing Index**  
Jan US industrial production, capacity utilization rate
- 16-Feb **Feb 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/international events.

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

	4 - 8 Feb 2019 (actual)		11 - 15 Feb 2019 (forecasts)	
	Range	Weekend	Range	Weekend
USD/JPY	109.4-110.2	109.7	108.8-110.8	109.8
EUR/JPY	124.1-126.0	124.2	123.0-125.5	124.3
EUR/USD	1.131-1.147	1.132	1.122-1.142	1.132

Noteworthy currencies and factors

NZD	NZD would weaken slightly as market has largely factored in central bank's cautious stance
SEK	MPM expected to be uneventful; even if central bank shows cautious stance, reactions would be limited
GBP	Pound may weaken due to mounting concerns about no deal Brexit

Source; Compiled by Daiwa Securities.

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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)

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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.

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