

Forex Market Weekly

Softer US economic indicators could invite yen appreciation

- USD/JPY topped 111, then fell on poor US retail sales
- Risk-on mood could peak as likely postponement of tariff deadline looks priced in
- USD/JPY uptrend arrested by poor US economic indicators

This week's USD/JPY forecast range

18 - 22 Feb: Y109.2 – 111.2/\$ (Y110.4 at end-previous week)

Forex Market View DSFE215
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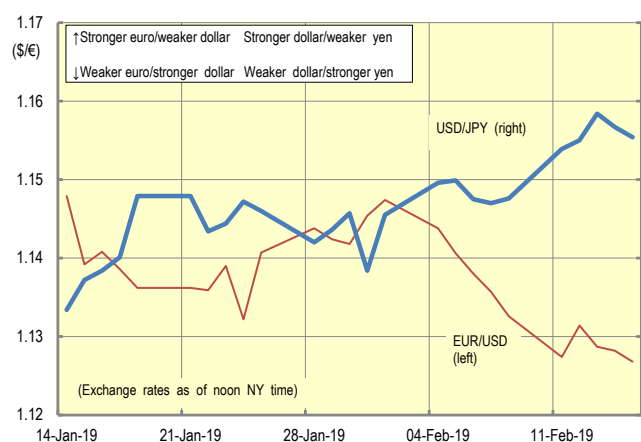


Overview of last week's forex market

USD/JPY topped 111, then fell on poor US retail sales

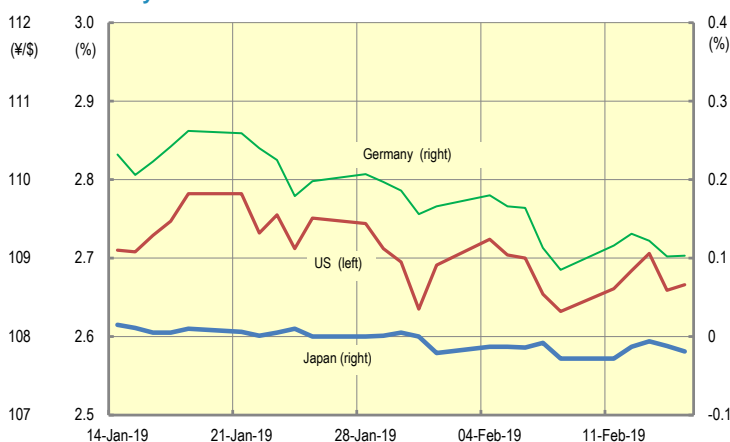
The USD/JPY moved higher as Chinese stocks rose just after the Chinese New Year holiday on hopes that trade talks between China and the US are nearing a breakthrough. The US dollar was boosted by comments from an advisor to US President Donald Trump who suggested the leaders of the US and China could soon meet to hammer out a trade deal. US interest rates and the dollar moved higher after Republicans and Democrats agreed in principle to a spending bill (which included funds for border security). Trump said that the deadline at which time additional tariffs are to be applied to Chinese imports could be pushed back if a trade agreement appears imminent. The resulting risk-on mood pushed up stocks and weighed on the yen. The New Zealand dollar jumped after the Reserve Bank of New Zealand said it expects to keep policy rates at the current levels through 2019. Reports speculating that Trump would sign the budget bill worked out by Republicans and Democrats, thus avoiding another government shutdown, provided a lift to US interest rates, which carried the USD/JPY to 111. The USD/JPY reached a high of 111.13 following reports the US is considering a 60-day extension of the March 1 deadline for higher tariffs on Chinese imports. However, the pair then plunged back below 111 on an unexpectedly sharp drop in December US retail sales. Meanwhile, the British Parliament rejected Prime Minister Theresa May's revised strategy for leaving the EU as Brexit hardliners in the ruling Conservative Party abstained from voting. The heightened concern about a potential "no deal Brexit" pushed the pound lower.

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



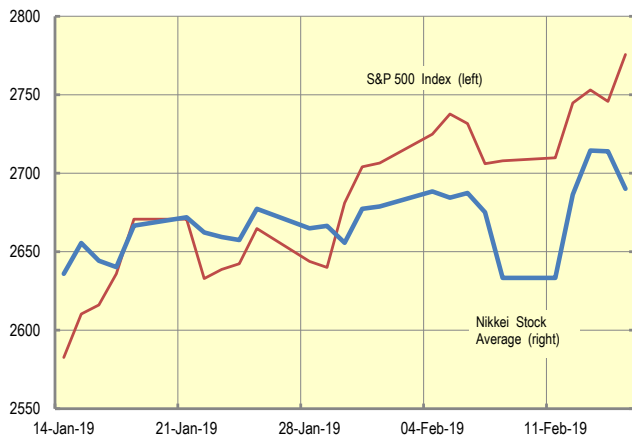
Source: Thomson Reuters; compiled by Daiwa Securities.

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



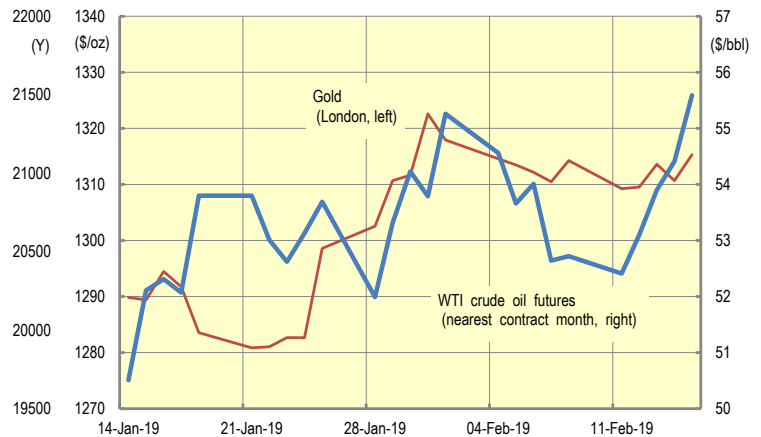
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



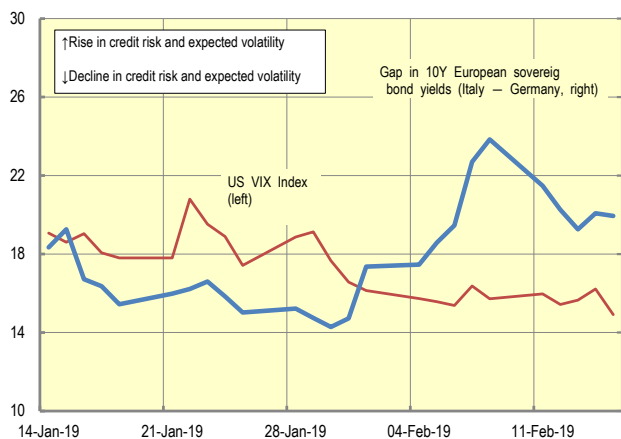
Source: Thomson Reuters; compiled by Daiwa Securities.

Risk of higher US tariffs on Chinese goods remains

Risk-on mood could peak as likely postponement of tariff deadline looks priced in

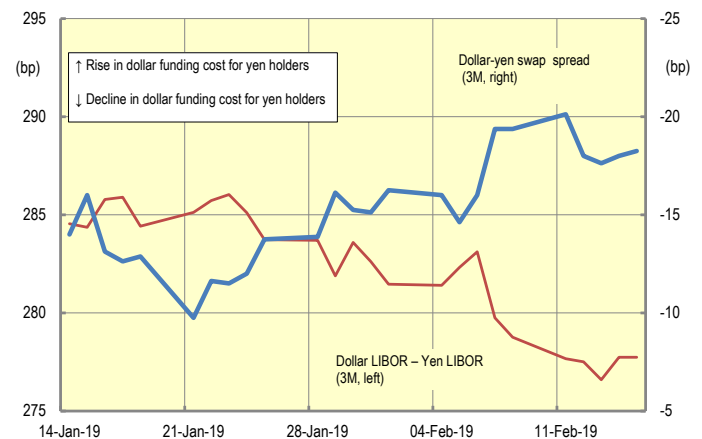
The USD/JPY rose last week as a risk-on mood was generated by (1) expectations the US budget would pass, thus avoiding another government shutdown and (2) comments from the US president that the deadline for higher tariffs on Chinese imports could be pushed back if a trade deal appears close at hand. However, the pair lost upward momentum following reports that the US was indeed considering a 60-day extension of the March 1 deadline for higher tariffs on Chinese imports. The risk-on mood probably played out as we assume the market had already priced in a likely postponement of the tariff deadline. However, we should note that the two sides remain far apart regarding reforms of Chinese trade practices. Many US citizens and members of Congress support the Trump administration's demands that China stop infringing upon intellectual property rights and forcing technology transfers. There also seems to be a considerable number of US companies that support tariffs on Chinese imports. Even if the US can gain some trade concessions from China, there is a very good chance that it will continue to exert pressure on China until implementation of reforms is confirmed. The probability of lower tariffs is small, while the risk of higher tariffs remains. As such, yen depreciation driven by a risk-on mood could peak out.

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



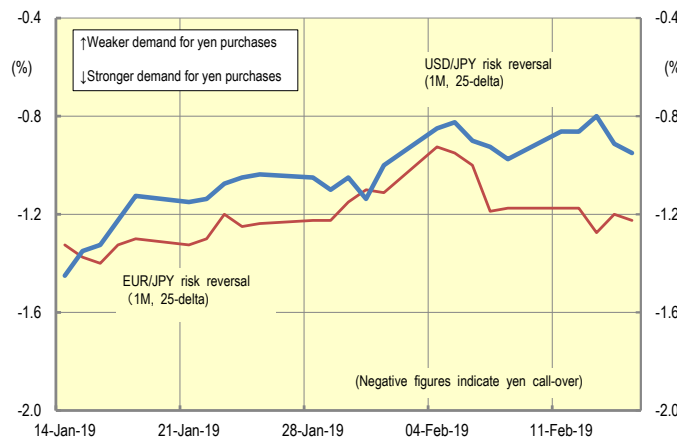
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



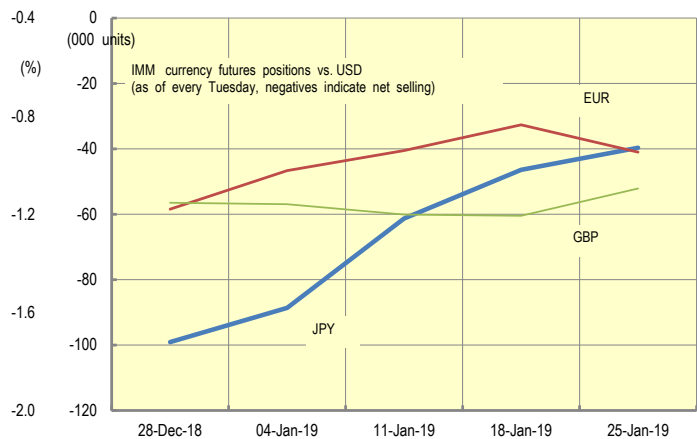
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

No risk-on mood if Chinese export growth short-lived

USD/JPY uptrend arrested by poor US economic indicators

January Chinese exports (USD-denominated) grew 9.1% y/y, significantly better than the market consensus for a 3.2% decline. We can assume export demand strengthened, but there is also a good chance that growth in January was largely because many Chinese companies wanted to complete shipments before the Chinese New Year holiday (4-10 February). We note that the Chinese New Year in 2018 was from 15 to 21 February and February exports that year surged 43.6% y/y. If seasonal factors played a big role, exports this year could easily pull back in February from this strong showing in January. Incidentally, export orders rebounded even though the January Caixin/Markit Manufacturing PMI fell sharply on declines for production and new orders. Data for February could shed some light on whether this export growth was a one-off, but probably will not support a risk-on investment mood based on a more optimistic view of the global economy.

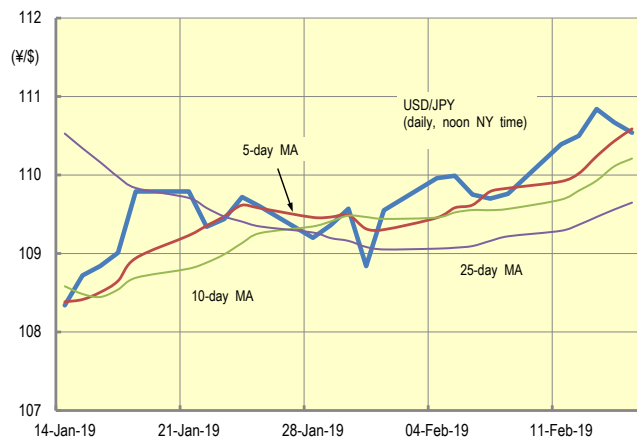
USD/JPY uptrend arrested by poor US economic indicators

The dollar weakened on an unexpected sharp decline for December US retail sales. Retail sales that month were probably impacted more by the US stock market slump from 4 to 24 December than by the partial government shutdown (22 Dec to 25 Jan). The subsequent US stock market rally was a positive for personal consumption, but January consumer sentiment was worse than in December. With US car sales also falling sharply, there is a good chance that consumption has remained poor. US new unemployment insurance claims have clearly increased. Indeed, the number of such claims has held above 230,000 in the fourth and fifth weeks of January and the first week of February. The February US jobs report due out next week will probably clearly point to slowing job growth. The USD/JPY had risen during the first half of February on upbeat US economic indicators, but the risk of a decline on weaker economic indicators is growing.

Noteworthy currency: EUR

Some important economic indicators are due out in Europe this week. February PMIs for each European country are scheduled for 21 February. The German manufacturing PMI, seen as the most important indicator, is projected to land at 49.9 (vs. final reading of 49.7 for January), remaining below the 50 dividing line between expanding and contracting production activity. We note that February German services sector PMI is forecast at 52.9 versus 53.0 for January. The German ZEW indicator of economic sentiment, due out on the 19th, is expected to stop declining, but the German Ifo business climate index, due out on the 22nd, is forecast to have deteriorated. Any improvement for European indicators, which have been pointing to a prolonged economic deceleration, would probably cause the euro to reverse course and strengthen, while confirmation that conditions continue worsening would probably spur on euro depreciation.

Chart: USD/JPY and Moving Average



Source: Thomson Reuters; compiled by Daiwa Securities.

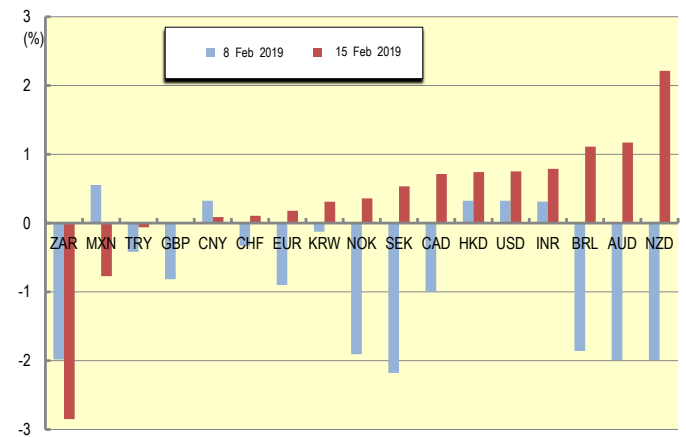
Chart: Weekly Schedule for Major Economic Indicators/events

- 19-Feb ○ Minutes of RBAMP (5 Feb)
 Feb German ZEW Indicator of Economic Sentiment
- 20-Feb Jan Japan trade statistics
- 21-Feb ○ Minutes of FOMC meeting (29-30 Jan)
 Jan Australia jobs data
 Feb eurozone PMI (Markit)
 Dec US durable goods orders
 Feb Philadelphia Fed's Business Outlook Survey Index
- 22-Feb Jan US existing home sales
 Jan China 70 cities housing prices
 Feb German IFO business climate index

Source; Compiled by Daiwa Securities.

Notes: Dates based on JST. ○ indicates monetary policy-related events.

Chart: Weekly Currency Performance (vs. yen)



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

	11 - 15 Feb 2019 (actual)		18 - 22 Feb 2019 (forecasts)	
	Range	End of week	Range	End of week
USD/JPY	109.6-111.2	110.4	109.2-111.2	110.2
EUR/JPY	124.1-125.6	124.7	123.3-125.3	124.3
EUR/USD	1.123-1.135	1.129	1.121-1.136	1.128

Noteworthy currencies and factors

EUR	Key is whether business sentiment will improve or continue to worsen
GBP	Key is whether UK will accept backstop that would not require renegotiations

Source; Compiled by Daiwa Securities.

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[Standard & Poor's]

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[Moody's]

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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]

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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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Chief of Kanto Local Finance Bureau (Kin-sho) No.108

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