Forex Market Weekly

UK may need to request Brexit deadline extension

- Risk-on yen deprecation; US demands push yuan higher, dollar lower
- No gains for USD/JPY despite US/China trade talk hopes
- With Brexit agreement out of reach, UK may seek deadline extension

This week's USD/JPY forecast range

<u>25 Feb - 1 Mar: Y109.2 – 111.2/$ (Y110.7 at end-previous week)</u>

Forex Market View DSFE216
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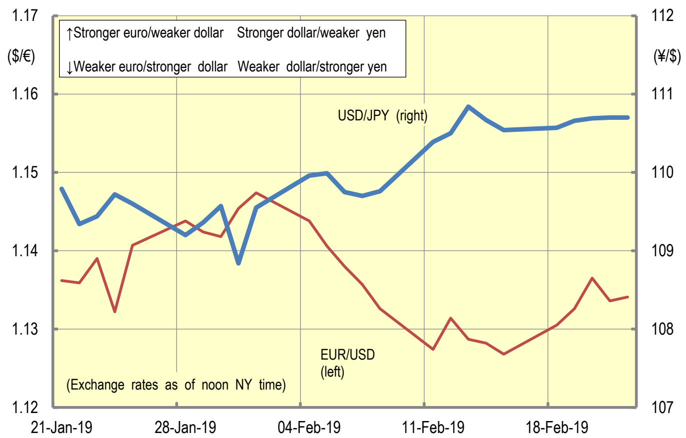
Overview of last week's forex market

Risk-on yen deprecation; US demands push yuan higher, dollar lower

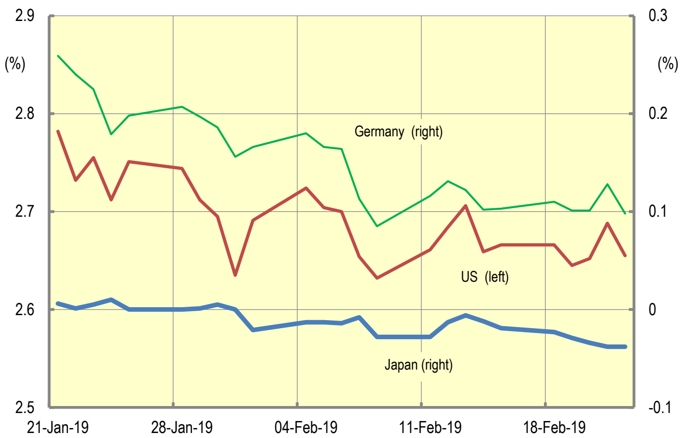
The USD/JPY moved modestly higher with US/China trade talks set to continue and with hopes for a trade agreement lifting Chinese equities. The euro weakened after Peter Praet, chief economist at the European Central Bank, said the ECB could revise its rate guidance if the economic outlook worsens. The yen turned lower after BOJ Governor Haruhiko Kuroda said additional easing would be considered if deemed necessary for realizing the Bank's price stability target. The yuan rose against the dollar, pulling up a host of other currencies, on reports that the US is seeking a promise from China to keep the value of its currency stable as part of any trade agreement. US long-term rates fell and the USD/JPY declined, but later rebounded due to higher share prices on hopes that US and China will hammer out a trade agreement. The pair briefly reached 110.95. The Australian dollar, which had rose on better-than-expected jobs growth, fell sharply after the Chinese port of Dalian blocked imports of Australian coal. US long-term rates rebounded on mixed US economic indicators and with global share prices firming. These rates then turned lower and the USD/JPY pulled back after FRB policymakers suggested they will stop balance sheet reductions within this year.

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.

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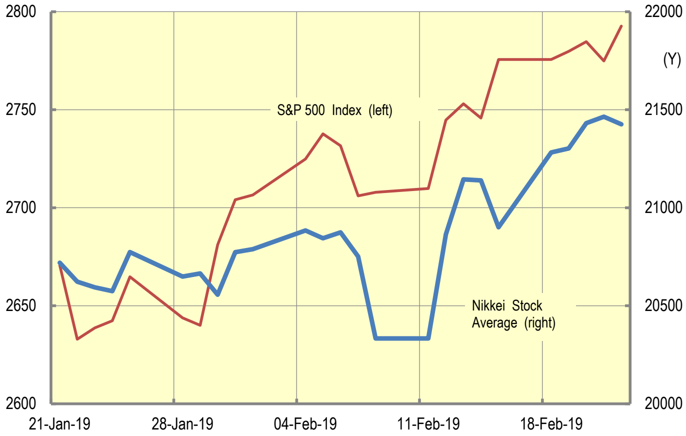
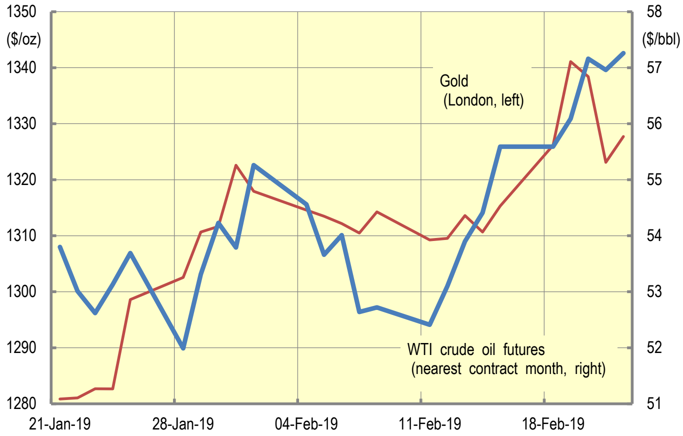
Chart: Stock Market: US S&P 500, Nikkei Stock Average



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



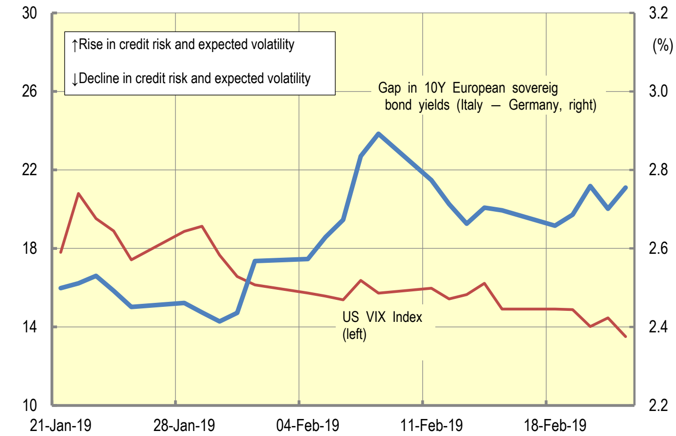
Source: Thomson Reuters; compiled by Daiwa Securities.

No gains for USD/JPY despite US/China trade talk hopes

Sluggish US long-term rates likely contributed to this trend

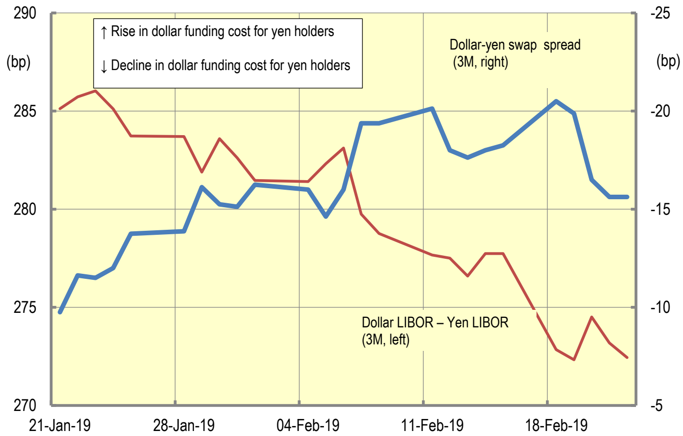
Expectations for a US/China trade agreement have contributed to stock market gains. Indeed, US equity markets recently set new highs for the year. That said, the USD/JPY lacked upward momentum even after reports the US was considering pushing back the deadline for imposing higher tariffs on Chinese imports by 60 days (Feb 14, Japan time), as well as reports that US/China trade negotiators are discussing six memorandums of understanding on the main structural issues and ten short-term measures for reducing China's trade surplus with the US (Feb 21). The lack of an upward trend for US long-term rates probably contributed to this USD/JPY trend. Equity prices are upbeat, supported by lower interest rates. Still, expectations for US/China trade talks are probably not generating a risk-on effect strong enough to lift US rates and the USD/JPY.

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



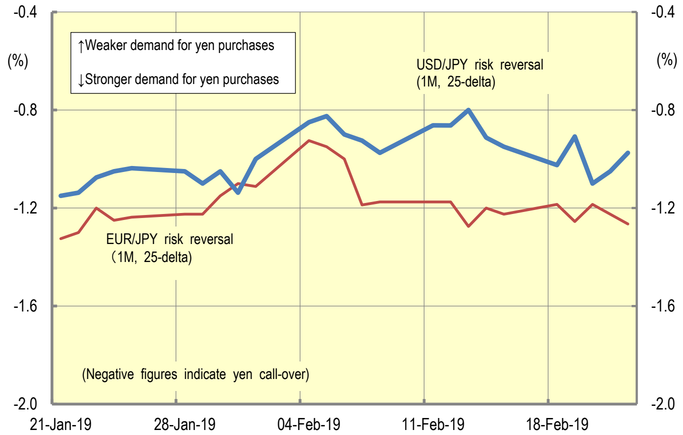
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



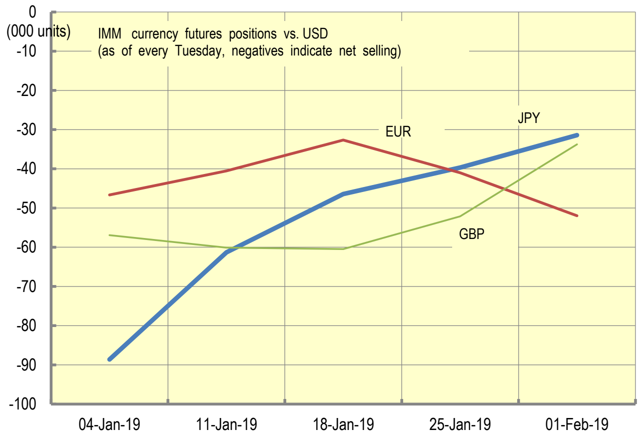
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

With Brexit agreement out of reach, UK may seek deadline extension

Hopes to avoid a no-deal Brexit

The UK has revised the wording of its Brexit Agreement Annex (declaration) in hopes of winning legal assurances from the EU that safeguard measures against a hard Irish border will not become permanent (binding Britain to the EU customs union). However, whether the EU will agree to this request is unclear and, depending on the content, there is still the risk that the UK Parliament could reject a revised agreement if Brexit hardliners oppose the new deal and abstain from voting. Prospects for parliamentary approval of the Brexit plan by 26 February seem poor. Prime Minister Theresa May will probably present a new Brexit plan on 27 February after again informing Parliament of the status of negotiations with the EU. The outlook for a final agreement will become further clouded if Parliament again rejects the prime minister’s Brexit plan as it did on 14 February. The UK is probably leaning towards asking the EU for a Brexit deadline extension in order to avoid a no-deal Brexit.

Risk of yen appreciation on worsening corporate business sentiment in US, China

We await the release of February manufacturing PMI for China. Chinese exports in January grew more than expected on a rush to complete shipments before the Chinese New Year holiday. This means that exports could easily pull back in February, which could potentially hurt corporate business sentiment. As the National Bureau of Statistics reported a slight improvement for PMI in January, there is a high probability that the reading will deteriorate for February. We also await the release of February ISM manufacturing PMI for the US. In January, many of the manufacturing outlook surveys prepared by regional federal reserve banks improved, as did the US ISM manufacturing index. However, in February, some regional federal reserve bank manufacturing outlook surveys deteriorated sharply. Accordingly, there is a strong risk that the ISM manufacturing PMI for February will likewise deteriorate. Any such worsening of corporate business sentiment in China and the US would probably lead to risk-off yen appreciation.

Noteworthy currency: AUD

The Australian dollar fell sharply last week after (1) one of the nation’s four largest banks predicted two rate cuts this year and (2) the Chinese port of Dalian blocked imports of Australian coal. The view that this coal import ban was in response to increasing diplomatic tensions between China and Australia quickly spread, but Australia’s finance minister refuted this assumption. Reserve Bank of Australia Governor Philip Lowe also tried to ease excessive pessimism. Specifically, he said this ban would not dramatically impact the Australian economy and even suggested the possibility of a rate hike next year if the Bank’s main scenario holds true. However, while these comments arrested the Australian dollar’s slide, they were not enough to dispel all pessimism. Australian dollar upside could be limited for now.

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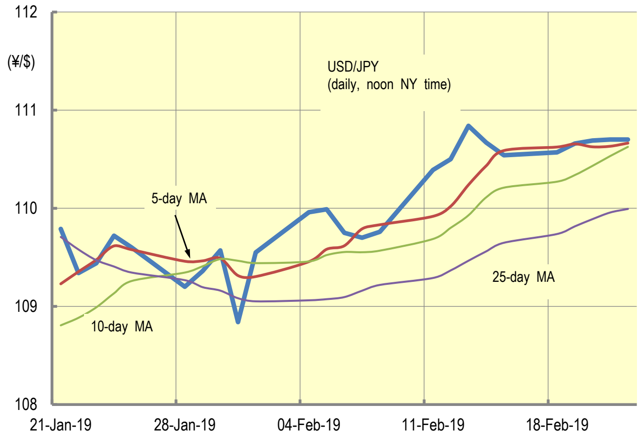
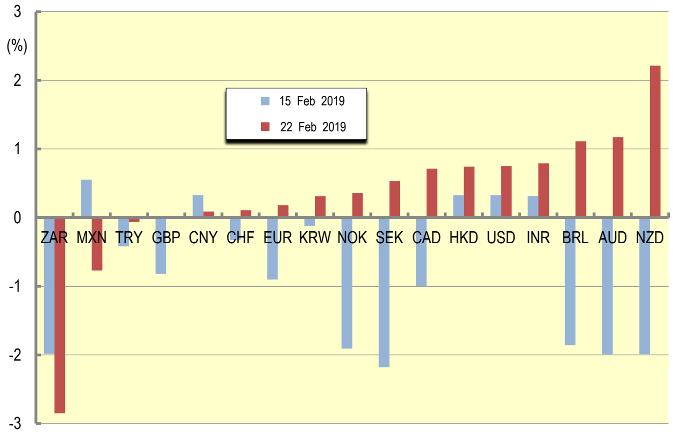
Chart: USD/JPY and Moving Average



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

26-Feb		Dec US housing starts
		Dec US S&P Case-Shiller Home Price Indices
27-Feb		Feb US Consumer Confidence Index (Conference Board)
	○	Congressional testimony by Fed chair Powell (Senate)
		Feb eurozone Economic Sentiment Indicator (ESI)
	●	US-North Korea summit meeting (through 28th, Vietnam)
28-Feb	○	Congressional testimony by Fed chair Powell (House)
		Jan Japan industrial production, shipments., inventories
		Feb China manufacturing PMI (National Bureau of Statistics of China)
		Feb German CPI
		Oct-Dec US GDP (revised)
		Feb US Chicago Purchasing Manager's Index
1-Mar		Feb China manufacturing PMI (Caixin)
		Feb German jobs data
		Feb eurozone CPI, Jan eurozone unemployment rate
		Jan US personal consumption expenditure price index
2-Mar		Feb US ISM manufacturing index
		Feb US University of Michigan's Consumer Sentiment Index (final)

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

	18 - 22 Feb 2019 (actual)		25 Feb - 1 Mar 2019 (forecasts)	
	Range	End of week	Range	End of week
USD/JPY	110.3-111.0	110.7	109.2-111.2	110.2
EUR/JPY	124.6-126.0	125.4	123.8-125.8	124.7
EUR/USD	1.127-1.138	1.133	1.125-1.140	1.132

Noteworthy currencies and factors

AUD	Upside may be limited due to deterioration of Australia-China relations and negative impact on Australian economy
GBP	Key is whether UK will accept backstop plan 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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[Fitch]

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May 2018

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• 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.

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