

Forex Market Weekly

Focus on US stance regarding China tariffs

- USD/JPY up on solid US/China economic indicators; GBP up on May's proposal
- US stance on China tariffs likely to sway forex
- UK seeking EU agreement on revised Brexit deal; poor visibility ahead of vote

This week's USD/JPY forecast range

4 - 8 Mar: Y110.5 – 112.5/\$ (Y111.9 at end-previous week)

Forex Market View DSFE218
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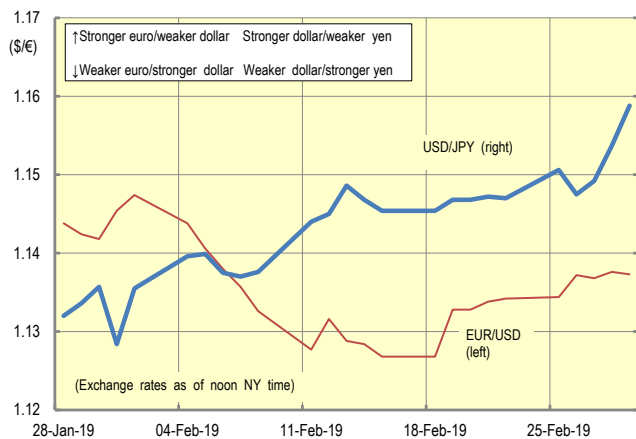


USD/JPY up on solid US/China economic indicators; GBP up on May's proposal

Overview of last week's forex market

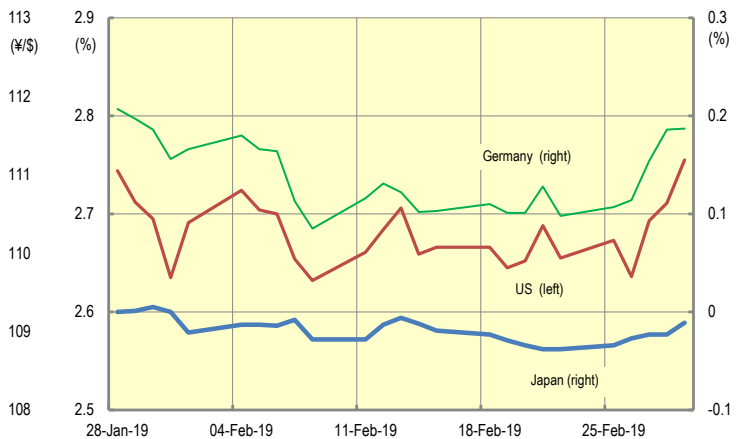
Last week, US President Donald Trump was upbeat about trade negotiations with China. He said the US will delay additional tariffs on Chinese goods, suggested there could be "very big news" over the next week or two if trade talks go well, and added that the two countries are "very, very close" to signing an agreement. As a result, US interest rates, US stocks, and the USD/JPY all moved higher, but the USD/JPY later pulled back. The pair continued moving lower on a decline for US housing starts in December and with the FRB Chairman Jerome Powell citing overseas economies as a risk factor. The USD/JPY fell to 110.35 with tensions between India and Pakistan growing and following reports Trump's former personal lawyer Michael Cohen provided the US House of Representatives with documents backing his claims that Trump broke the law. Meanwhile, the pound rose after UK Prime Minister Theresa May proposed that Parliament should vote on either a no-deal Brexit or a short-term Brexit delay if it cannot pass her revised Brexit plan. At one point, sterling traded as high as USD1.335 after France and Germany expressed a willingness to allow for a Brexit delay provided Britain can explain the basis and objectives for an extension. US interest rates rose, due in part to a rise for British interest rates, resulting in a stronger dollar and a weaker yen. The USD/JPY pulled back after the US and North Korea summit failed to reach any agreement, but then rose to 112.08 on hopes for a US/China trade agreement and on upbeat China economic indicators.

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



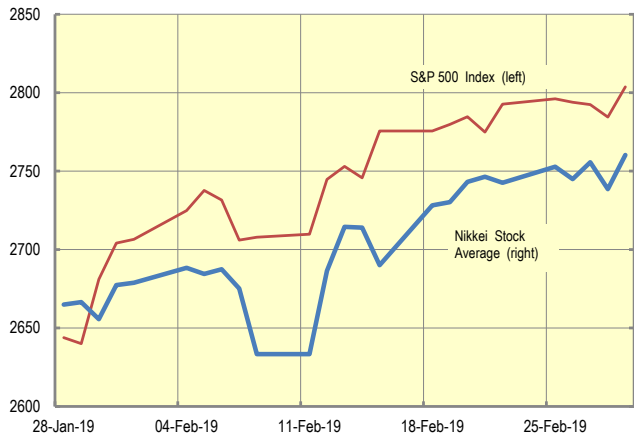
Source: Thomson Reuters; compiled by Daiwa Securities.

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



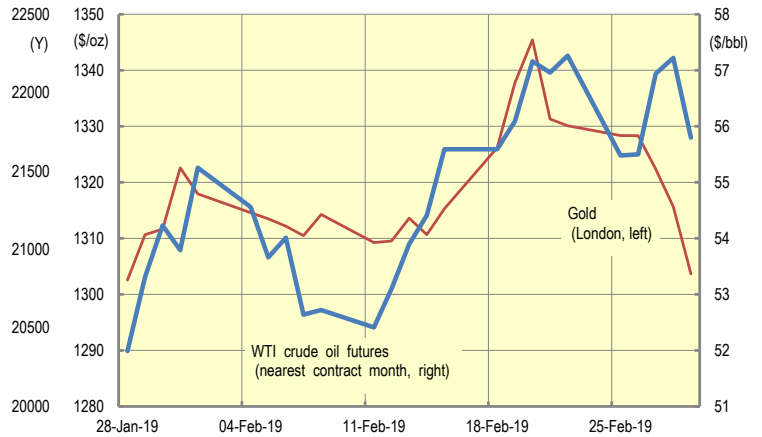
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



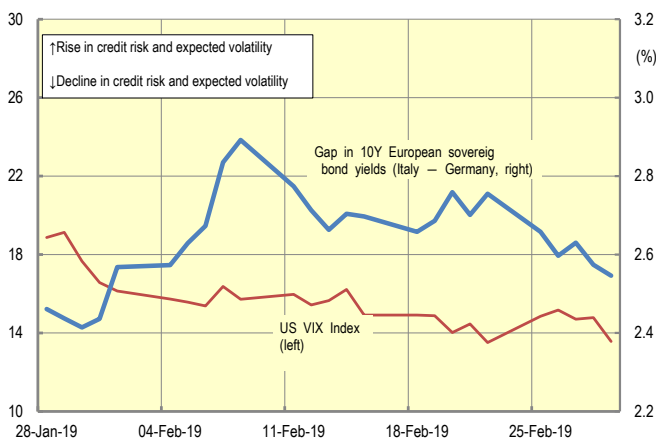
Source: Thomson Reuters; compiled by Daiwa Securities.

Enforcement of any trade agreement key

US stance on Chinese tariffs likely to sway forex

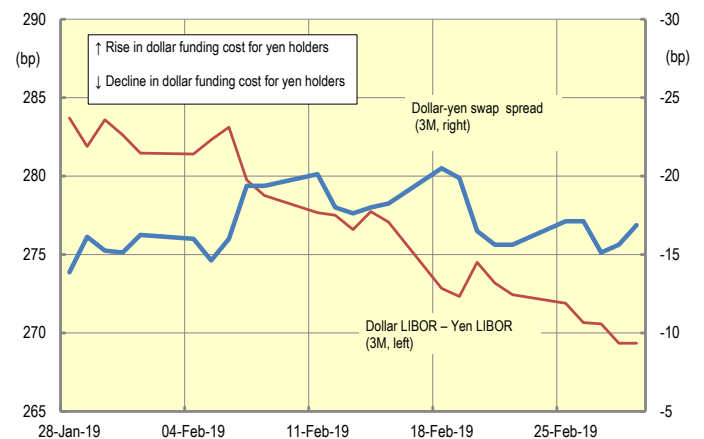
US Trade Representative Robert Lighthizer said that there are still many structural trade issues with China to resolve, adding that ensuring China complies with any deal is very important. Recognizing that all of China's trade practices cannot be changed through one negotiation, Lighthizer said that the US wants monthly meetings for lower-level officials, quarterly meetings for vice ministers, and semiannual meetings at the ministerial level in order to verify compliance with any agreement. He also said that the US will need to maintain the "tariff card" for some time to come. Even if the two sides agree to China importing more US goods and making structural reforms, the US will want to continue verifying the execution of reforms covering technology transfers, intellectual property rights, subsidies, agriculture, services, and currency. The US will likely stand ready to again raise tariffs if China violates any agreement. Meanwhile, there have been reports that the US could remove the bulk of tariffs on Chinese goods if China abides by an eventual agreement. The US stance, particularly whether it will quickly rescind tariffs as China wants once conditions are set, will likely sway forex markets.

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



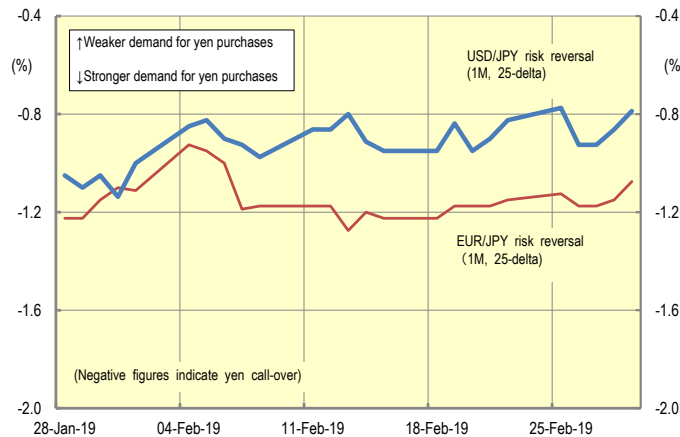
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



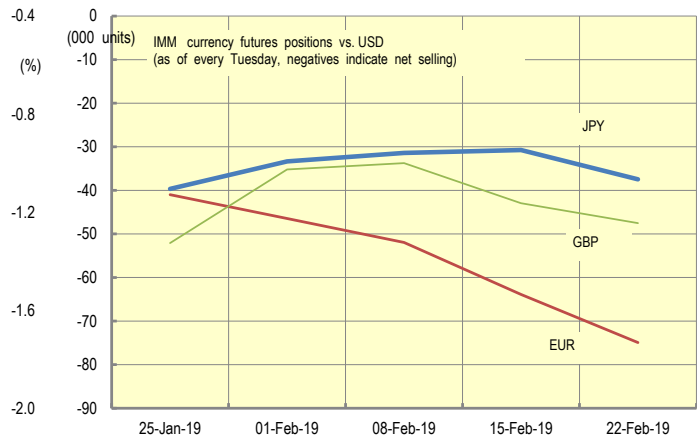
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

UK seeking EU agreement on revised Brexit deal; poor visibility ahead of vote

UK may ask for Brexit delay

The key focus is on whether the UK and EU can agree on legal assurances that safeguard measures against a hard Irish border will not become permanent (binding Britain to the EU customs union). Brexit hardliners in the ruling Conservative Party indicated that they would back a Brexit plan that set a deadline for such safeguard measures, but they could still oppose legal assurances. We expect a risk-on mood if the revised plan passes. Even if the plan is rejected, we expect any risk-off mood to be limited as the UK would then likely ask for a Brexit delay. If Parliament fails to approve the revised Brexit plan by 12 March, it will hold a 13 March vote on whether to accept the no-deal Brexit option. If that option is rejected, it will then hold a 14 March vote on whether to seek a Brexit delay. The EU has indicated that before granting a Brexit extension, the UK would need to present a clear objective and a persuasive reason for postponing Britain's departure from the EU. The UK will probably come up with some reason for a short-term extension lasting up until just before the 23-26 May European Parliamentary election. Yen depreciation on a stronger pound and higher British interest rates is possible if, depending on the particulars, there are increased hopes for avoiding a no-deal Brexit or even scrapping Brexit plans completely.

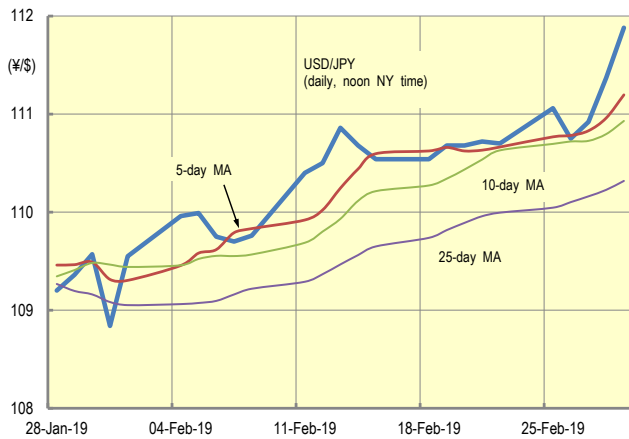
US job growth likely to slow in Feb

The US unemployment rate rose (number of unemployed increased) in January due in part to the government shutdown, while the number of part-time workers increased (employment growth). Trend reversals are expected for February with the unemployment rate declining, but growth in the number of employed people slowing. If February nonfarm payrolls increase by 170,000 workers (market consensus), the three-month (Dec 2018 ~ Feb 2019) average increase would come to 232,000 workers, topping the average growth of 211,000 workers for the second half of 2018. The focus is on whether the market consensus will hold true.

Noteworthy currency: EUR

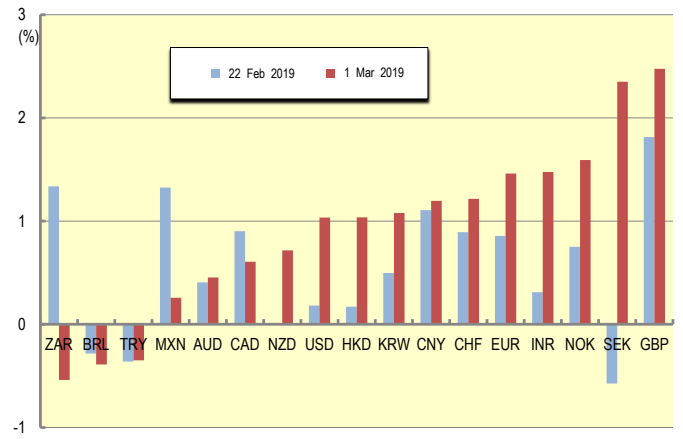
The European Central Bank will likely trim its macroeconomic outlooks when its Governing Council meets on 7 March. Still, the council will probably not become more dovish or urgently rush to end rate hikes. Indeed, we assume it will take a wait-and-see stance. At the same time, the council will likely start serious discussions about a new policy to succeed the current Targeted Longer Term Refinancing Operations (postponement until April possible if discussions at this meeting are not sufficient for making decision). With the start of these discussions, we expect narrower government bond spreads between Italy (which strongly desires new policy replacing TLTRO) and Germany, higher German rates, and a stronger euro.

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

- 5-Mar ● Opening of China's National People's Congress (Beijing)
- RBAMPM
- Jan eurozone retail sales
- 6-Mar Feb US ISM non-manufacturing index
- Dec US new home sale
- Feb US ADP national employment report
- Dec US trade statistics
- 7-Mar ○ MPM at Bank of Canada
- Beige Book (Fed)
- ECB Governing Council meeting (president Draghi's press conference)
- 8-Mar Oct-Dec Japan revised GDP
- Feb China trade statistics
- Feb US jobs data, Jan US housing starts

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

	25 Feb - 1 Mar 2019 (actual)		4 - 8 Mar 2019 (forecasts)	
	Range	End of week	Range	End of week
USD/JPY	110.3-112.1	111.9	110.5-112.5	111.5
EUR/JPY	125.3-127.5	127.2	126.0-128.0	127.1
EUR/USD	1.131-1.142	1.137	1.132-1.147	1.140

Noteworthy currencies and factors

EUR	Euro appreciation is expected, reflecting ECB's stance of keeping current policy and start of discussion on TLTRO
AUD	Stronger AUD is expected as RBA may send messages to eliminate excessive pessimism
JPY	Key is whether US will reach agreement with China by removing most tariffs against China
GBP	Key is whether UK will reach agreement with EU on revised Brexit deal; will UK Parliament approve it or not?

Source: Compiled by Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

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- 1) Duty of good faith.
- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
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[Standard & Poor's]

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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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[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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