

# Forex Market View

## Will yen remain weak on expectations for US-China trade agreement?

- US requires China to verify execution of structural reforms
- China requires US to quickly remove tariffs on Chinese imports
- Tariffs may be lowered in stages in line with verification of China's compliance

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

7 Mar- 5 Apr: Y108.5-112.5/\$ (Y111.65/\$ as of 6 Mar)

Forex Market View DSFE219

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### Risk-on yen depreciation largely supported by expectations for US-China trade agreement

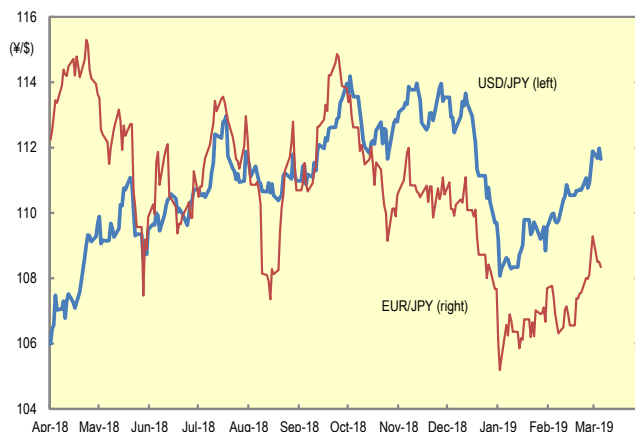
### US requires China to verify execution of structural reforms

This year, the rise in US and German long-term interest rates as well as the widening of their yield differences with Japan have been limited to a low level. Relative to this, the USD/JPY and EUR/JPY rates have risen substantially. This is due to the fact that, as witnessed by the global stock rally, the risk-on market is causing yen depreciation. The comparison of stock prices by nation clearly shows a marked rise in Chinese stocks. The background is the emergence of expectations for a cut in tariffs on Chinese goods due to an agreement on US-China trade, not limited to expectations for the avoidance of higher tariffs. It can be said that risk-on yen depreciation is largely supported by expectations for a new US-China trade agreement.

### US emphasizes ensuring China executes structural reforms

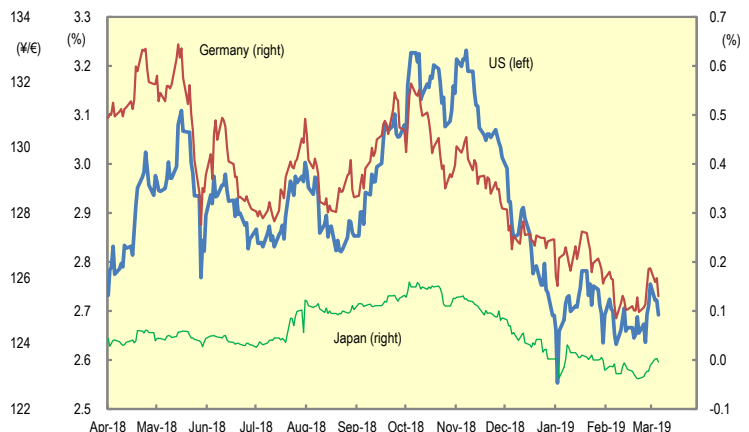
US Trade Representative Robert Lighthizer said that "new rules" are needed as there are still many structural trade issues with China to resolve and it is not enough for China to only commit to expanding imports from the US. Given China's violations against agreements in the past, he said that ensuring China executes structural reforms 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 after both nations sign the agreement.

Chart: USD/JPY and EUR/JPY



Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

### US likely to warn of higher tariffs if China violates any agreement

The USTR announced that the additional duty rate imposed on \$200bn of Chinese imports in September 2018 would “remain at 10% until further notice.” In the annual report on trade policy, which was submitted to the US Congress, the USTR stated that it would “continue to put pressure on China” to correct unfair trade practices. Given the USTR’s stance, we think that the US will continue to verify the execution of structural reforms covering technology transfers, intellectual property rights, subsidies, agriculture, services, and currency. In the process, the US will likely stand ready to raise tariffs if China violates any agreement.

### If China has to succumb to pressure from US, agreement would not be signed

#### China requires US to quickly remove tariffs on Chinese imports

However, if China implements structural reforms, increases imports from the US (agricultural products, chemical products, automobiles), and lowers tariffs on US imports, despite the US maintaining threats of higher tariffs on Chinese imports, China would have to succumb to one-sided pressure from the US. Although China would be able to avoid higher tariffs from the US, other merits would be small for China. The Chinese economy may be negatively affected by the maintenance of the yuan level (prevention of yuan depreciation) and expansion of imports from the US. As it would be hard for China to accept current requests from the US, any concession from the US side would be necessary to reach an agreement.

### China requests quick removal of US tariffs on Chinese goods

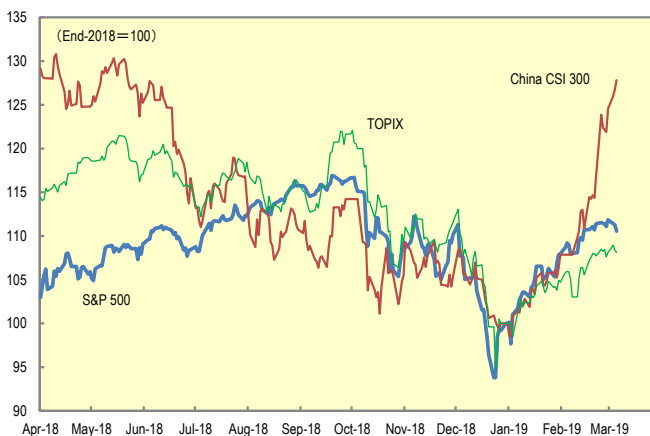
There have been reports that the US could remove the bulk of tariffs on Chinese goods if China abides by an eventual agreement. It appears that China requires “early removal” of tariffs on \$200bn of Chinese goods (around Y22.37tn) to finalize a trade agreement in whatever form. Ahead of next year’s US presidential elections, President Donald Trump would probably want to emphasize his accomplishment via a trade agreement with China. In addition, he would like to support US stock prices due to the accomplishment. If so, will he quickly rescind tariffs with the conditions that China must abide by the agreement?

#### Tariffs may be lowered in stages in line with verification of China’s compliance

### Possibility low that US will immediately rescind tariffs on Chinese goods

The USTR stated that China had without doubt conducted currency manipulation in the past and the weak yuan was offsetting the effect of \$200bn punitive duties on Chinese imports. If so, in the case of an immediate removal of tariffs on Chinese goods due to China’s commitment to the agreement, we would continue to see positive effects from the already depreciated yuan in China. The US may thus think the Chinese economy will benefit more than the US economy. Since the imposition of punitive duties, US imports from China have not decreased in comparison to US exports to China, making the trade deficit wider. Given this, the possibility appears low that the US will immediately rescind tariffs on Chinese goods.

Chart: Stock Price Indices in Japan, US, China



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Yuan vs. Dollar and CNY Index vs. Currency Basket



Source: Thomson Reuters; compiled by Daiwa Securities.

### Tariffs may be lowered in stages in line with verification of China's compliance

It seems that the US is promising lowering tariffs on Chinese goods if it is able to verify China's execution of pledges regarding structural reforms. However, it will take a considerable amount of time before the US confirms China's execution of all structural reforms. China is unlikely to agree with the US stance if the US maintains additional tariffs on Chinese goods until confirmation. If (1) both nations set detailed rules for trade issues and (2) Chinese structural reforms meet a certain level of conditions, they may reach an agreement on a phased cut in tariffs on Chinese goods. If so, China may also lower tariffs on US imports in stages.

### Reactionary moves against expectations for quick tariff removal may weaken pressure on yen depreciation

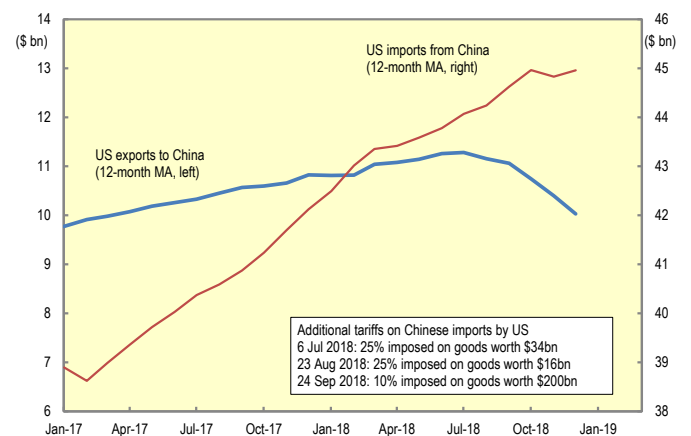
So far, expectations for a US-China trade agreement have caused risk-on yen depreciation. Amid media reports that a trade deal may be signed at the US-China summit meeting around 27 March, expectations for a quick removal of US tariffs on Chinese goods may rein in yen appreciation until the details of the agreement are clarified. However, the US is likely to be cautious about cutting tariffs on Chinese items. For example, if they agree with starting to consider phased tariff cuts at the semiannual meetings at the ministerial level alongside verification of China honoring its pledge, this would create reactionary moves against expectations for quick tariff removal, which may weaken pressure on risk-on yen depreciation.

Chart: US Trade in Goods by Country and Area

	Trade balance		Exports		Imports	
	CY18	Y/y	CY18	Y/y	CY18	Y/y
Worldwide total	-878.7	-83.0	1664.1	117.8	2542.8	200.8
Canada	-19.8	-2.7	298.7	16.5	318.5	19.2
Mexico	-81.5	-10.6	265.0	21.7	346.5	32.3
Eurozone	-151.5	-19.1	233.1	22.5	384.6	41.6
Other European nations	-50.9	-9.7	137.2	15.1	188.1	24.9
China	-419.2	-43.6	120.3	-9.6	539.5	34.0
Japan	-67.6	1.2	75.0	7.4	142.6	6.1
Other Pacific-rim nations	-23.8	-0.7	217.3	16.1	241.1	16.8
South/Central America	41.5	7.3	163.8	13.6	122.3	6.3
OPEC	-21.2	-8.4	59.0	-0.3	80.2	8.1
Africa	-9.9	1.5	26.0	3.9	35.8	2.4
Others	-93.7	3.6	85.3	14.3	179.0	10.7

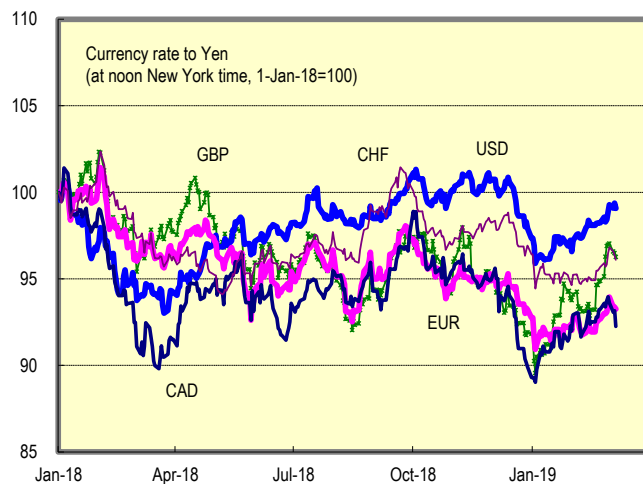
Source: US Department of Commerce; compiled by Daiwa Securities.

Chart: US Imports and Exports vs. China



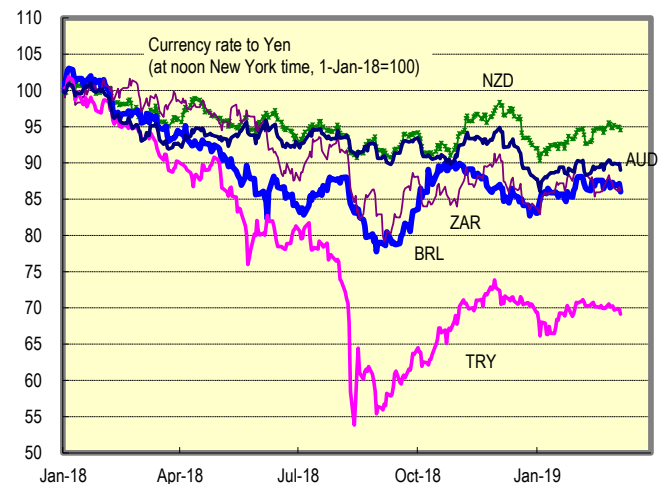
Source: Thomson Reuters; compiled by Daiwa Securities.

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	110.0 104-113	110.0 104-113	107.0 104-112	105.0 101-110	105.0 101-110
EUR-JPY	131.9	126.3	124.0 118-128	125.5 118-130	121.0 117-129	118.0 115-127	118.0 115-127
AUD-JPY	82.1	77.7	77.0 73-81	78.0 73-82	75.0 72-81	72.5 70-79	72.5 70-79
CAD-JPY	88.0	81.0	81.0 78-86	81.5 77-86	79.0 76-85	77.0 74-83	77.0 74-83
NZD-JPY	75.2	74.0	74.0 70-78	75.0 69-78	72.0 69-78	69.5 66-75	69.5 66-75
TRY-JPY	18.8	20.9	20.0 17-22	21.0 17-22	19.5 17-22	18.5 16-21	18.5 16-21
ZAR-JPY	8.0	7.7	7.6 7.2-8.3	7.9 7.0-8.3	7.4 7.0-8.3	7.0 6.7-8.0	7.0 6.7-8.0
BRL-JPY	28.1	28.5	28.5 26-31	30.0 26-31	27.5 26-31	26.5 25-30	26.5 25-30
KRW-JPY (100 KRW)	10.2	9.9	9.7 9.2-10.0	9.8 9.1-10.1	9.4 9.1-10.1	9.2 8.8-9.8	9.2 8.8-9.8
CNY-JPY	16.5	16.1	16.2 15.2-16.8	16.5 15.5-17.0	15.8 15.5-17.0	15.3 15.0-16.5	15.3 15.0-16.5

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.

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- 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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#### [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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