

# Forex Market View

## Has risk-on yen weakening peaked?

- Worsening of US manufacturing sentiment likely to affect the market
- Nonmanufacturing sentiment may also worsen with a slight lag
- Expect risk-off yen appreciation on US economic slowdown concerns

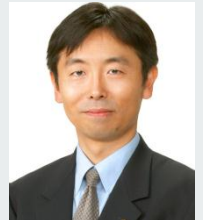
### USD/JPY forecast range (latest: noon New York time)

20 Mar- 19 Apr: Y108.5-112.5/\$ (Y111.37/\$ as of 19 Mar)

Forex Market View DSFE221

FICC Research Dept.

Chief FX Analyst  
**Yuji Kameoka**  
 (81) 3 5555-8764  
 yuji.kameoka@daiwa.co.jp



Daiwa Securities Co. Ltd.

**When US manufacturing sentiment worsens, stocks tend to weaken and the yen to strengthen**

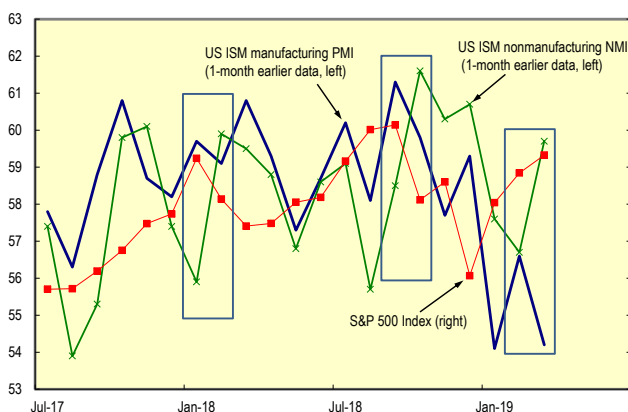
### Worsening of US manufacturing sentiment likely to affect the market

In the US, manufacturing indicators tend to affect the market more than nonmanufacturing indicators. For example, the January manufacturing indicators announced in early February 2018 worsened (the ISM manufacturing PMI dropped 0.6ppt m/m to 59.1 and the new orders index fell 4.0ppt to 65.4) while the nonmanufacturing indicators improved (the ISM nonmanufacturing NMI rose 4.0ppt m/m to 59.9 and the new orders index rose 7.2ppt to 61.5); the S&P 500 ended February down 3.9% m/m and the USD/JPY declined 2.69 m/m. In another example, the September manufacturing indicators announced in early October 2018 worsened (the ISM manufacturing PMI dropped 1.5ppt m/m to 59.8 and the new orders index fell 3.3ppt to 61.8) while the nonmanufacturing indicators improved (the ISM nonmanufacturing NMI rose 3.1ppt m/m to 61.6 and the new orders index rose 0.3ppt to 61.5); the S&P 500 ended October down 6.9% m/m and the USD/JPY declined 0.62 m/m. With the February manufacturing indicators announced in early March 2019 worsening and the nonmanufacturing indicators improving, it will be interesting to see whether US stocks weaken and the USD/JPY falls in step with the manufacturing sector.

**Manufacturing indicators have a leading bias**

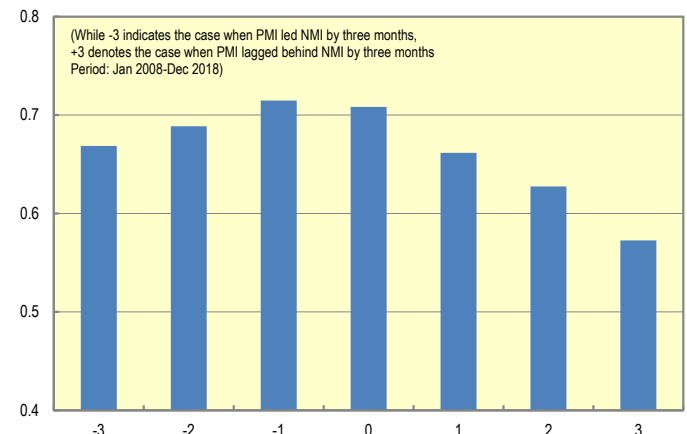
Although nonmanufacturing has a much higher value-added weighting in the US economy, it is probably because manufacturing indicators tend to be leading ones that they affect the market more easily. For example, over the 10-year period from 2009 to 2018, the time-lagged correlation between the ISM manufacturing PMI and the nonmanufacturing NMI showed the highest correlation coefficient when the PMI led the NMI by one month. In other words, when the manufacturing PMI worsens and the nonmanufacturing NMI improves, the NMI is likely to worsen one month after the PMI does, making the market more susceptible to a weakening of stocks and strengthening of the yen.

**Chart: US ISM Manufacturing PMI, Nonmanufacturing NMI, and Stock Price Index**



Source: Thomson Reuters; compiled by Daiwa Securities.

**Chart: Time-lagged Correlation Coefficient Between US ISM Manufacturing PMI and Nonmanufacturing NMI**



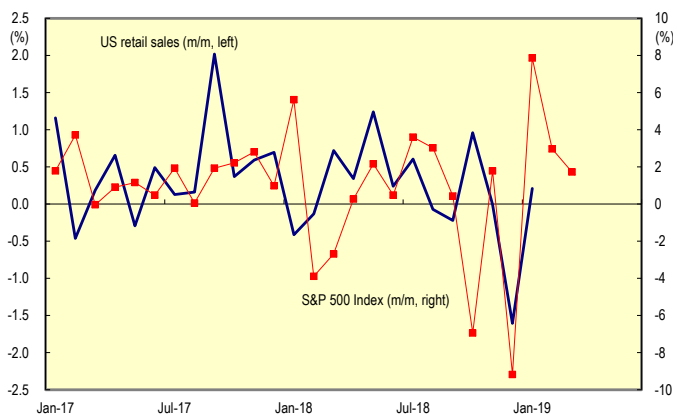
Source: Thomson Reuters; compiled by Daiwa Securities.

### Nonmanufacturing sentiment may also worsen with a slight lag relative to manufacturing sentiment

### Nonmanufacturing sentiment may also worsen with a slight lag

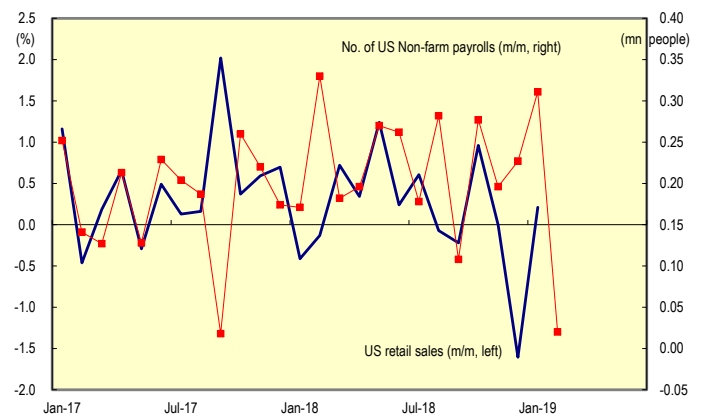
Together with the US manufacturing and nonmanufacturing sectors, exports slow in response to a slowdown in overseas economies. Whether overseas factors cause sentiment to worsen probably depends on the trend in private consumption and other components of domestic demand. A rebound in US share prices is a positive for private consumption, triggering improvement in consumer sentiment and a recovery in consumer spending. The rate of share price growth was weaker in February and March than it was in January, however, making it unlikely that growth in consumption will accelerate. The weakening of employment growth is also having a negative impact on private consumption. The pace at which the economy added jobs decelerated sharply in February 2019, and the trend into March of new unemployment claims also points to a weakening trend in employment growth. Impacts from domestic demand have not been conducive to sustained improvement in US corporate sentiment, making it likely that nonmanufacturing sentiment will enter a worsening trend with a lag relative to manufacturing sentiment.

Chart: US Stock Price Index and Retail Sales



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: No. of US Employees and Retail Sales



Source: Thomson Reuters; compiled by Daiwa Securities.

### Decline in USD/JPY small relative to decline in US interest rates

### Expect risk-off yen appreciation on US economic slowdown concerns

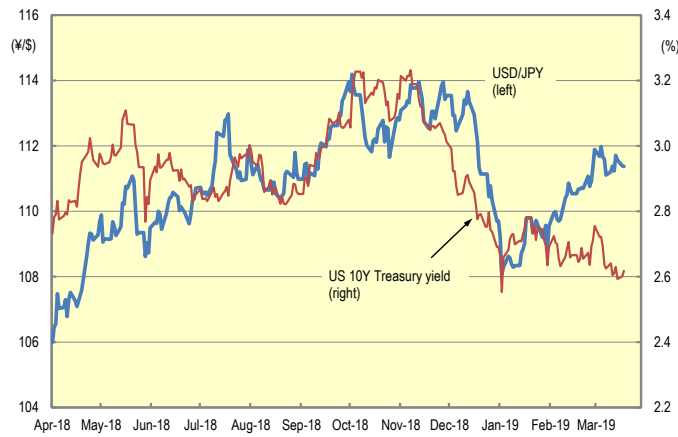
US long-term rates peaked in early March 2019, and the 10-year Treasury yield declined from 2.768% to around 2.6%. Although expectations of the Fed becoming more dovish and the outlook for an ECB rate hike being pushed farther into the future have also had impacts, we think the economic data that has raised concerns over a US economic slowdown, including the February US ISM manufacturing PMI coming in at 54.2, below both the market forecast of 55.5 and the January reading of 56.6, may also be having a downward impact on interest rates. The USD/JPY rose to 112.13 immediately after the February US ISM nonmanufacturing index came in at 59.7, above the market forecast of 57.3, but subsequently declined and is now trading in the mid-111 range. The USD/JPY has barely declined relative to the decline in US interest rates, however, and we attribute that to yen weakening pressures from rising US share prices and risk-on moves.

### Yen may start strengthening as risk-on factors diminish

Up until March 8, when the February US nonfarm payrolls showed growth of only 20,000, well below the market forecast of 180,000, US share prices were declining in step with long-term rates, but they rebounded after that even as US interest rates continued to decline. The rebound in share prices was too large for it to be explained simply by the decline in US interest rates and risk-on sentiment driven by expectations of a US-China trade agreement. We think it was expectations of the UK avoiding a no-deal Brexit and extending the Brexit deadline that put markets in risk-on mode, strengthened the pound, weakened the dollar, and fueled the rise in US share prices. If the UK decides to delay the Brexit date, however, it will probably mark the peak of Brexit's risk-on yen depreciating impacts. Furthermore, amid speculative news reports of the US and China extending their trade talks, yen-weakening impacts brought by expectations of a US-China trade agreement appear to be hitting a top. If FOMC members cut their US economic growth and fed funds rate forecasts, risk-on yen weakening impacts are likely to shrink relative to the dollar-weakening impacts from declining US interest rates. This lessening of risk-on factors

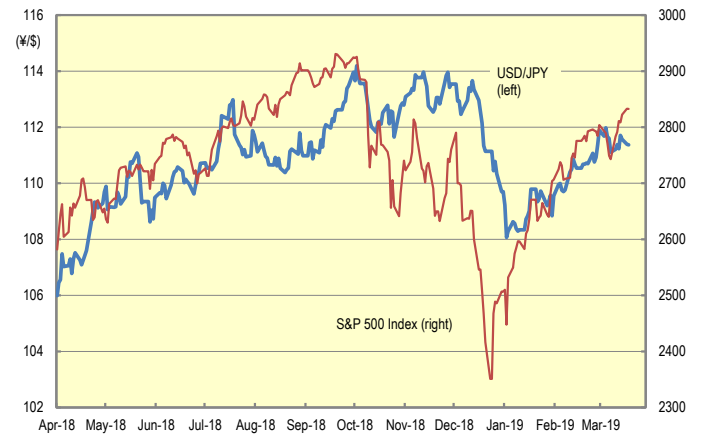
makes it likely that concerns over a US economic slowdown will push the yen into risk-off appreciation mode.

**Chart: US Long-term Interest Rate and USD/JPY**



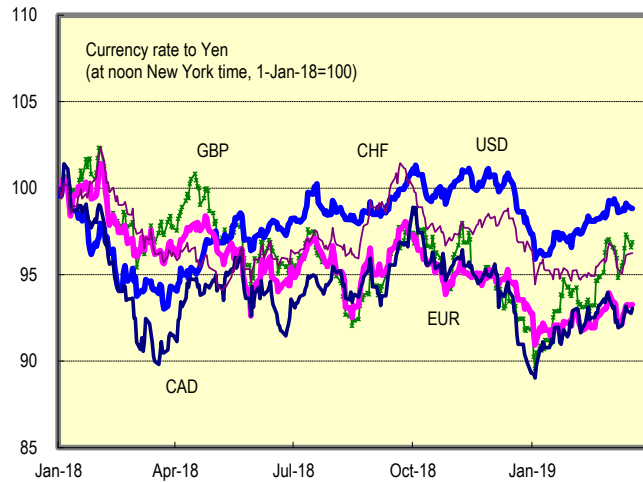
Source: US Department of Commerce; compiled by Daiwa Securities.

**Chart: US Stock Price Index and USD/JPY**



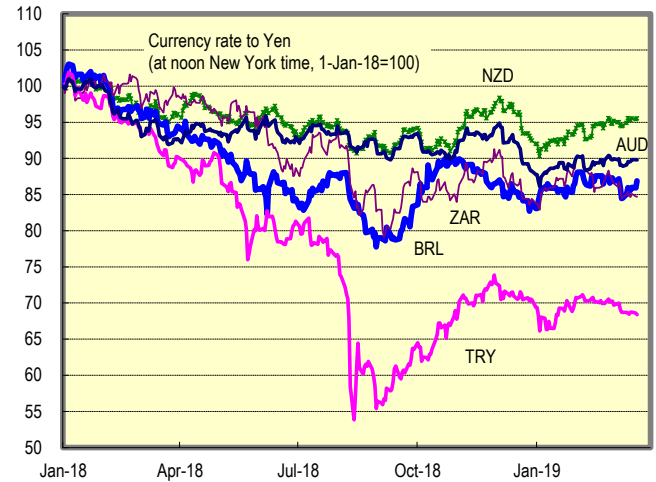
Source: Thomson Reuters; compiled by Daiwa Securities.

**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	110.0	107.0	105.0	105.0
			104-113	104-113	104-112	101-110	101-110
EUR-JPY	131.9	126.3	124.0	125.5	121.0	118.0	118.0
			118-128	118-130	117-129	115-127	115-127
AUD-JPY	82.1	77.7	77.0	78.0	75.0	72.5	72.5
			73-81	73-82	72-81	70-79	70-79
CAD-JPY	88.0	81.0	81.5	82.0	79.5	77.5	77.5
			78-86	77-86	76-85	74-83	74-83
NZD-JPY	75.2	74.0	74.0	75.0	72.0	69.5	69.5
			70-78	69-78	69-78	66-75	66-75
TRY-JPY	18.8	20.9	20.0	21.0	19.5	18.5	18.5
			17-22	17-22	17-22	16-21	16-21
ZAR-JPY	8.0	7.7	7.6	7.9	7.4	7.0	7.0
			7.2-8.3	7.0-8.3	7.0-8.3	6.7-8.0	6.7-8.0
BRL-JPY	28.1	28.5	28.5	30.0	27.5	26.5	26.5
			26-31	26-31	26-31	25-30	25-30
KRW-JPY (100 KRW)	10.2	9.9	9.7	9.8	9.4	9.2	9.2
			9.2-10.0	9.1-10.1	9.1-10.1	8.8-9.8	8.8-9.8
CNY-JPY	16.5	16.1	16.2	16.5	15.8	15.3	15.3
			15.2-16.8	15.5-17.0	15.5-17.0	15.0-16.5	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.

## Explanatory Document of Unregistered Credit Ratings

In order to ensure the fairness and transparency in the markets, Credit Rating Agencies became subject to the Credit Rating Agencies' registration system based on the Financial Instruments and Exchange Act. In accordance with this Act, in soliciting customers, Financial Instruments Business Operators, etc. shall not use the credit ratings provided by unregistered Credit Rating Agencies without informing customers of the fact that those Credit Rating Agencies are not registered, and shall also inform customers of the significance and limitations of credit ratings, etc.

### ■ The Significance of Registration

Registered Credit Rating Agencies are subject to the following regulations:

- 1) Duty of good faith.
- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
- 3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

In addition to the above, Registered Credit Rating Agencies are subject to the supervision of the Financial Services Agency ("FSA"), and as such may be ordered to produce reports, be subject to on-site inspection, and be ordered to improve business operations, whereas unregistered Credit Rating Agencies are free from such regulations and supervision.

### ■ Credit Rating Agencies

#### [Standard & Poor's]

##### The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: S&P Global Ratings ("Standard & Poor's")

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)

##### How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating Information" (<http://www.standardandpoors.co.jp/unregistered>) in the "Library and Regulations" section on the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

##### Assumptions, Significance and Limitations of Credit Ratings

Credit ratings assigned by Standard & Poor's are statements of opinion on the future credit quality of specific issuers or issues as of the date they are expressed and they are not indexes which show the probability of the occurrence of the failure to pay by the issuer or a specific debt and do not guarantee creditworthiness. Credit ratings are not a recommendation to purchase, sell or hold any securities, or a statement of market liquidity or prices in the secondary market of any issues.

Credit ratings may change depending on various factors, including issuers' performance, changes in external environment, performance of underlying assets, creditworthiness of counterparties and others. Standard & Poor's conducts rating analysis based on information it believes to be provided by the reliable source and assigns credit ratings only when it believes there is enough information in terms of quality and quantity to make a conclusion. However, Standard & Poor's does not perform an audit, due diligence or independent verification of any information it receives from the issuer or a third party, or guarantee its accuracy, completeness or timeliness of the results by using the information. Moreover, it needs to be noted that it may incur a potential risk due to the limitation of the historical data that are available for use depending on the rating.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of March 7th, 2017, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

#### [Moody's]

##### The Name of the Credit Rating Agencies Group, etc

The name of the Credit Rating Agencies group: Moody's Investors Service ("MIS")

The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

##### How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website ([https://www.moody.com/pages/default\\_ja.aspx](https://www.moody.com/pages/default_ja.aspx)))

##### Assumptions, Significance and Limitations of Credit Ratings

Credit ratings are Moody's Investors Service's ("MIS") current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. MIS defines credit risk as the risk that an entity may not meet its contractual, financial obligations as they come due and any estimated financial loss in the event of default. Credit ratings do not address any other risk, including but not limited to: liquidity risk, market value risk, or price volatility. Credit ratings do not constitute investment or financial advice, and credit ratings are not recommendations to purchase, sell, or hold particular securities. No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such rating or other opinion or information, is given or made by MIS in any form or manner whatsoever.

Based on the information received from issuers or from public sources, the credit risks of the issuers or obligations are assessed. MIS adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MIS considers to be reliable. However, MIS is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of April 16<sup>th</sup>, 2018, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Moody's Japan K.K. ([https://www.moody.com/pages/default\\_ja.aspx](https://www.moody.com/pages/default_ja.aspx))

#### [Fitch]

##### The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: Fitch Ratings ("Fitch")

The name and registration number of the Registered Credit Rating Agency in the group: Fitch Ratings Japan Limited (FSA commissioner (Rating) No.7)

##### How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Outline of Rating Policies" in the section of "Regulatory Affairs" on the website of Fitch Ratings Japan Limited (<https://www.fitchratings.co.jp/web/>)

##### Assumptions, Significance and Limitations of Credit Ratings

Ratings assigned by Fitch are opinions based on established criteria and methodologies. Ratings are not facts, and therefore cannot be described as being "accurate" or "inaccurate". Credit ratings do not directly address any risk other than credit risk. Credit ratings do not comment on the adequacy of market price or market liquidity for rated instruments. Ratings are relative measures of risk; as a result, the assignment of ratings in the same category to entities and obligations may not fully reflect small differences in the degrees of risk. Credit ratings, as opinions on relative ranking of vulnerability to default, do not imply or convey a specific statistical probability of default.

In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The assignment of a rating to any issuer or any security should not be viewed as a guarantee of the accuracy, completeness, or timeliness of the information relied on in connection with the rating or the results obtained from the use of such information. If any such information should turn out to contain misrepresentations or to be otherwise misleading, the rating associated with that information may not be appropriate. Despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

For the details of assumption, purpose and restriction of credit ratings, please refer to "Definitions of ratings and other forms of opinion" on the website of Fitch Rating Japan Limited.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of May 13<sup>th</sup>, 2016, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Fitch Rating Japan Limited (<https://www.fitchratings.co.jp/web/>)

**IMPORTANT**

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

**Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law**

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- 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.

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.  
 Registered: Financial Instruments Business Operator  
 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