

Forex Market Weekly

Brexit prospects could become increasingly clouded

- USD/JPY fell on FRB's dovish turn, worsening US/Europe manufacturing PMIs
- Switch to risk-on stance unlikely even if interest rates fall
- This week's forex outlook: Upward pressure on yen from clouded Brexit prospects

This week's USD/JPY forecast range

25 - 29 Mar: Y108.8 – 110.8/\$ (Y109.9 at end-previous week)

Forex Market View DSFE222
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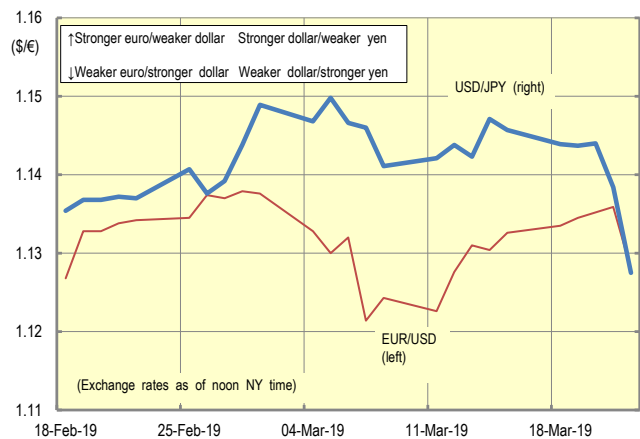


USD/JPY fell on FRB's dovish turn, worsening US/Europe manufacturing PMIs

Overview of last week's forex market

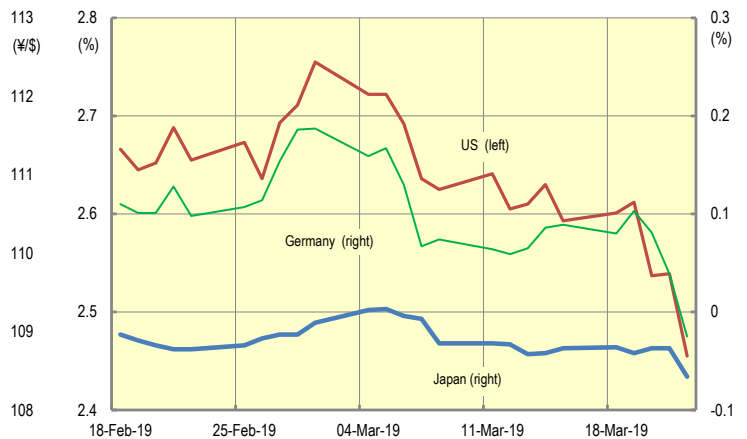
The USD/JPY held steady around 111.5 as Chinese equities rose amid expectations for economic stimulus measures from the Chinese government. However, the yen appreciated when the British pound fell on reports that Speaker of the House of Commons John Bercow ruled out voting again on the government's plan for leaving the EU that was rejected a second time earlier this month. US long-term interest rates rose and the USD/JPY rebounded on 19 March, one day before the FOMC statement. The USD/JPY rose to 111.69 on some reports that China was pushing back against US demands in trade talks. The pound trended lower with the European Commission voicing opposition to British Prime Minister Theresa May's request to extend the Brexit deadline until June 30 (cautioned against Brexit after the European Parliamentary elections). US interest rates and the US dollar fell after the FOMC left rates unchanged, said it sees no further rate hikes in 2019, and added that it will end its asset drawdown in September. However, the dollar again rose on the back of improving US economic indicators. Even though the pound dropped to close to \$1.3 on reports that May would support a no-deal Brexit if Parliament again rejects the government's Brexit plan, it rebounded after the EU agreed to a short-term extension of the Brexit deadline. The yen appreciated on declining equities and interest rates in Western countries after March manufacturing PMI's for Germany and the US missed market consensuses.

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



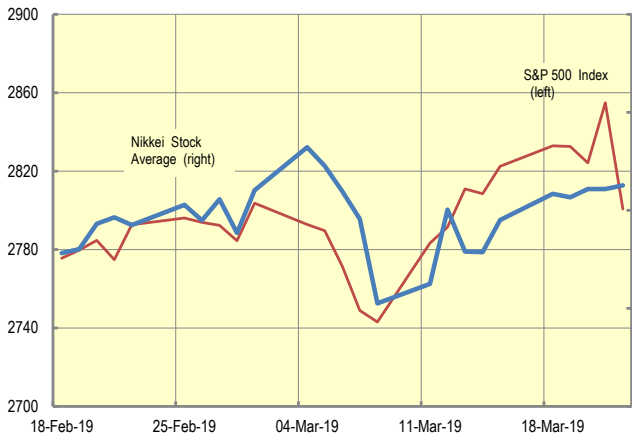
Source: Thomson Reuters; compiled by Daiwa Securities.

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



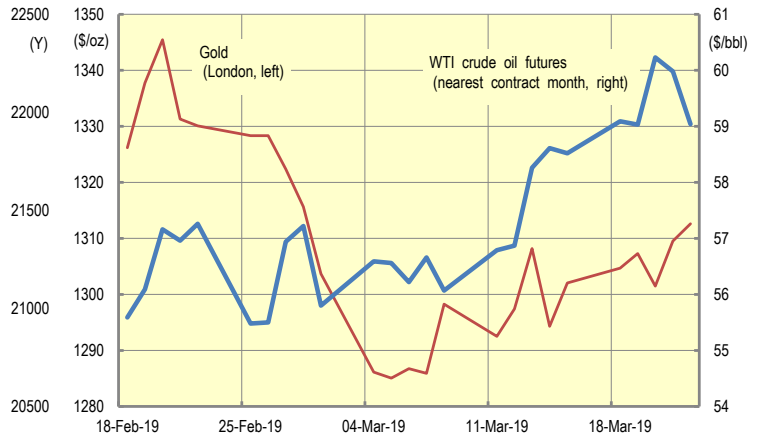
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



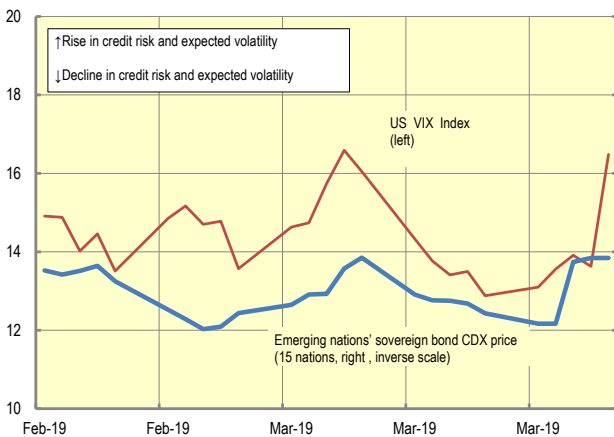
Source: Thomson Reuters; compiled by Daiwa Securities.

Conditions could support yen appreciation

Switch to risk-on stance unlikely even if interest rates fall

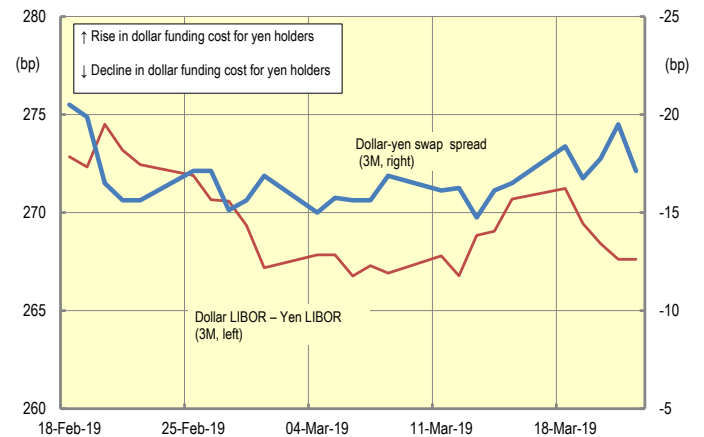
The dollar trended lower on a drop for US interest rates after the FRB took a more dovish turn than the market expected, saying it sees no further rate hikes in 2019 and plans to end its asset drawdown in September. At one point the USD/JPY fell to 110.29. A subsequent brief rebound for the pair was probably due more to a rebound for US equities / interest rates on a stronger-than-expected improvement for the Federal Reserve Bank of Philadelphia Business Outlook Survey rather than risk-on stock buying / yen selling on lower US interest rates. Indeed, the yen was generally lackluster against other currencies after the FOMC statement and risk-on yen selling did not gain much traction. We expect only a limited risk-on effect from the FRB's dovish turn. Concerns about economic slowdowns are again emerging as manufacturing indices in the US and Europe worsen more than expected. Against such a backdrop, equities are unlikely to get much of a boost from falling US interest rates, which means that the yen could easily appreciate on declining interest rates and stocks.

Chart: US VIX Index and CDX Emerging Markets Index



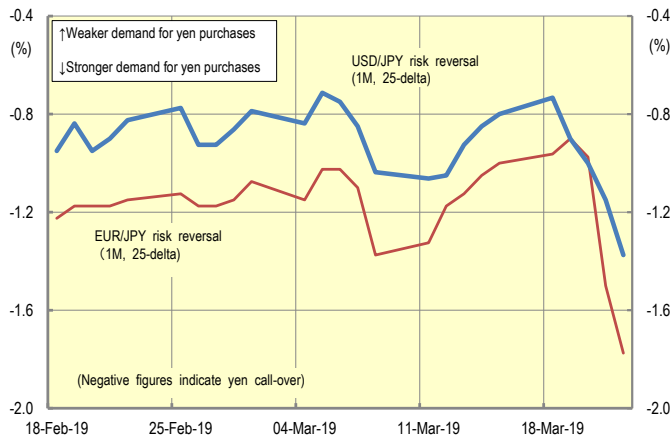
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



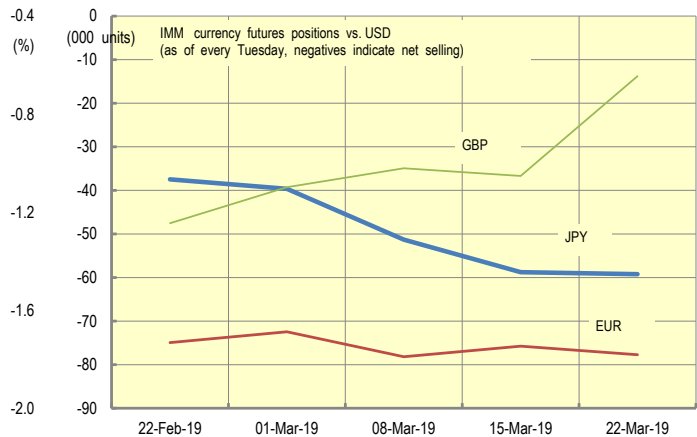
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

This week's forex outlook: Upward pressure on yen from clouded Brexit prospects

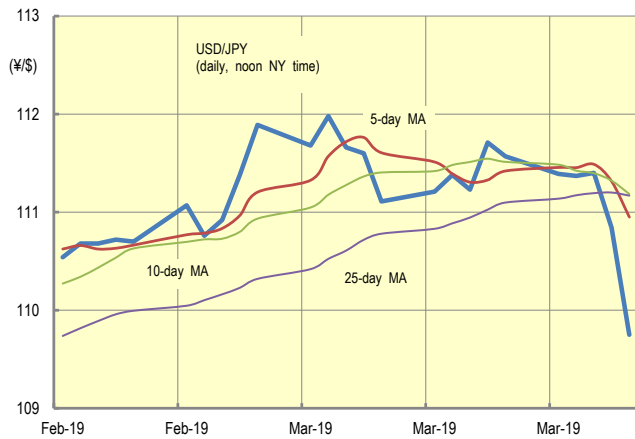
12 April looming as key date

One key focal point is developments surrounding Britain's exit from the EU. If the government's Brexit plan is approved through a third vote by Parliament, the deadline for leaving the EU would be pushed back until 22 May. However, there is little chance of success unless the government makes significant changes to the plan that was rejected the last time Parliament voted. If Parliament refuses to vote again, or if it rejects the plan for a third time, Britain would need to announce by April 12 whether it intends to participate in the European Parliamentary elections. Once that date passes, Britain will be unable to participate in the election even it decides to do so. If Britain decides to participate in these elections, it would request a Brexit extension that the EU would likely approve. Increased expectations for abandoning Brexit through a majority vote against leaving the EU in a second referendum would likely result in risk-on pound appreciation and yen depreciation. However, if the Brexit deadline is extended beyond the end of the year, there would be increased likelihoods of Brexit supporters within the ruling Conservative Party refusing to support the May Cabinet, May's resignation as prime minister / no-confidence vote, and snap elections. As such, a robust risk-on trend seems unlikely. Conversely, if Britain decides not to participate in European Parliamentary elections, a no-deal Brexit would take effect on 12 April, with inevitable risk-off pound depreciation and yen appreciation. Britain has a grace period until 12 April to make its final decision. However, increasingly uncertain prospects for Brexit as this deadline approaches could easily produce a risk-off mood.

Noteworthy currency: TRY

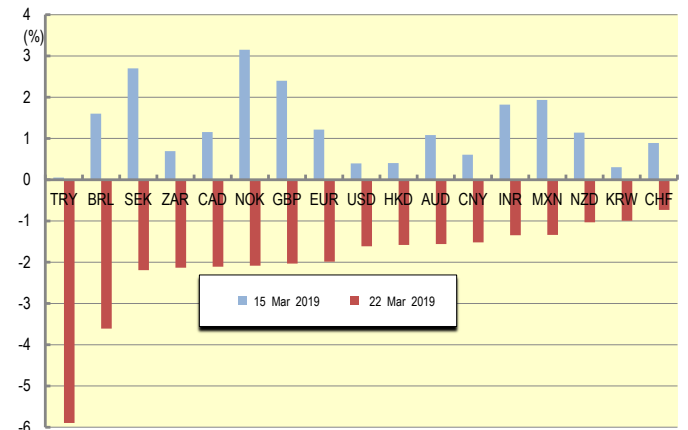
The Turkish lira fell sharply on concerns about a further deterioration in relations between Turkey and the US. On 22 March, US President Donald Trump recognized Israel's claim to the Golan Heights areas, which Turkey and other Middle Eastern countries assert belongs to Syria. Furthermore, emerging economy currencies in general fell in risk-off trading amid increasing concerns about a global economic slowdown as economic indicators in the US and Europe are deteriorating. In addition to weakening externals, Turkey's 31 March local elections will serve as a vote of confidence in the dictatorial rule of President Recep Tayyip Erdogan. Instability for the lira is likely amid such uncertainty and a further decline after the election is possible depending on how conditions unfold. Erdogan is taking steps to strongly restrict lira selling, but whether such steps can serve as an effective deterrent is unclear.

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

- 25-Mar ● Mar German IFO business climate index
- 26-Mar ○ Summary of Opinions at the BOJ's MPM on 14-15 Mar
Feb US housing starts
Jan US S&P Case-Shiller Home Price Indices
● Mar Consumer Confidence Index (Conference Board)
- 27-Mar ○ MPM at New Zealand's central bank
Jan US trade statistics
- 28-Mar ● Mar eurozone Economic Sentiment Indicator (ESI)
○ MPM at South African central bank
● Oct-Dec US GDP final
- 29-Mar ● US negotiators to visit China on US-China trade talks (until 29th)
Feb Japan industrial production, shipments, inventories
Mar German jobs data
Mar eurozone CPI
Feb US Personal Consumption Expenditures Price Index
● Mar US Chicago Purchasing Manager's Index
Feb US new home sales
Mar US University of Michigan's Consumer Sentiment Index (final)
- 31-Mar ● Mar China manufacturing PMI (National Bureau of Statistics of China)

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 Mar 2019 (actual)		25 - 29 Mar 2019 (forecasts)	
	Range	End of week	Range	End of week
USD/JPY	109.7-111.7	109.9	108.8-110.8	109.7
EUR/JPY	123.8-126.8	124.2	122.7-125.7	124.0
EUR/USD	1.127-1.145	1.131	1.123-1.138	1.130

Noteworthy currencies and factors

TRY	If outcome of local elections entails large margin, lira may weaken
ZAR	If Moody's downgrades outlook of South Africa's rating, currency would depreciate
GBP	If Brexit leans on long-term postponement, pound would strengthen; otherwise it would weaken

Source; Compiled by Daiwa Securities.

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■ Credit Rating Agencies

[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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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>)

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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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