8 May 2019
Japanese report: 7 May 2019 (DSFX363)

Forex Market Weekly

Yen should strengthen if US-China trade talks are suspended

- April manufacturing PMIs worsen in US and China, USD/JPY declines
- Unease over US economic growth and administration's pressure to cut rates cause the dollar to weaken
- This week's FX outlook: Yen should strengthen if US-China trade talks are suspended

This week's USD/JPY forecast range

6 - 10 May: Y109.5 – 111.5/$ (Y111.1 at end-previous week)

Forex Market View DSFE231
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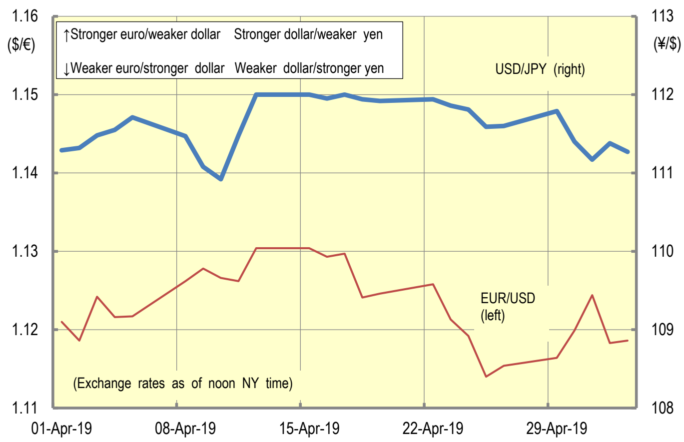
April manufacturing PMIs worsen in US and China, USD/JPY declines

Overview of last week's forex market

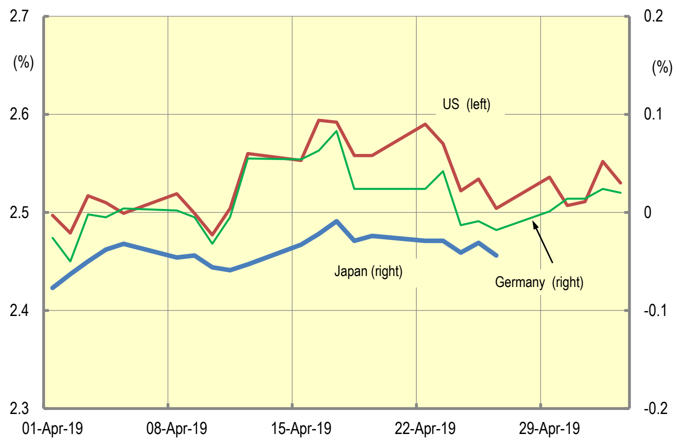
After release of the preliminary Jan-Mar US GDP data, which came in at 3.2% annualized q/q growth and beat expectations, the USD/JPY rose to 112.02, then fell back as both the GDP breakdown and core PCE prices came in below expectations. The USD/JPY rose when US private consumption for March came in stronger than expected, then fell back when China's manufacturing PMI for April unexpectedly worsened. The euro zone's GDP for Jan-Mar and Germany's CPI for April beat expectations, strengthening the euro. The ISM manufacturing PMI for April was weaker than expected and language on core inflation in the FOMC statement was softened, sending the USD/JPY down to 111.04. The Fed chairman's press conference turned out less dovish than the market expected, however, and both US interest rates and the dollar rebounded, but the USD/JPY did not rise as much as the rise in US interest rates would suggest, trading around the mid-111 level. The number of US jobs and the unemployment rate were stronger than the market expected in April, and the USD/JPY rose immediately after the jobs data were announced, but then fell back in reaction to tepid wage growth. The US Vice President said a rate cut should be considered while numerous regional Fed bank presidents also suggested rate cuts may be necessary depending on economic conditions, pushing the USD/JPY lower.

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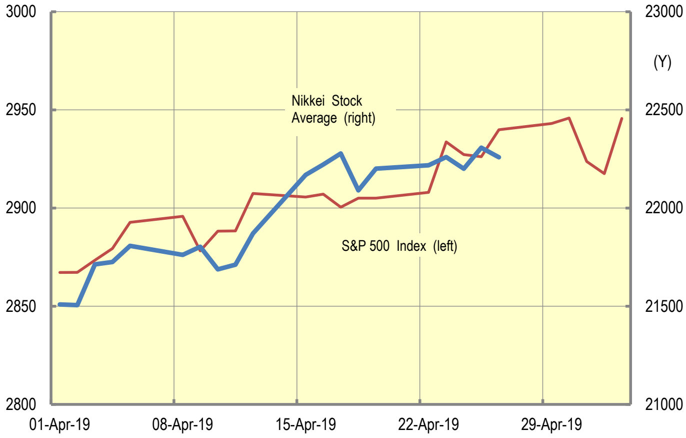
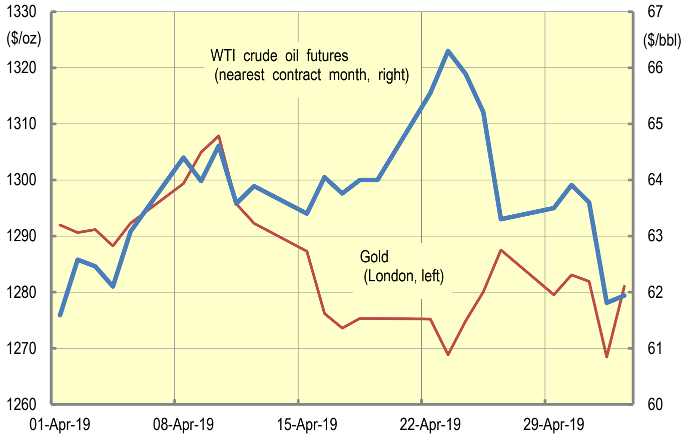
Chart: Stock Market: US S&P 500, Nikkei Stock Average



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



Source: Thomson Reuters; compiled by Daiwa Securities.

Unease over US economic growth and administration's pressure to cut rates cause the dollar to weaken

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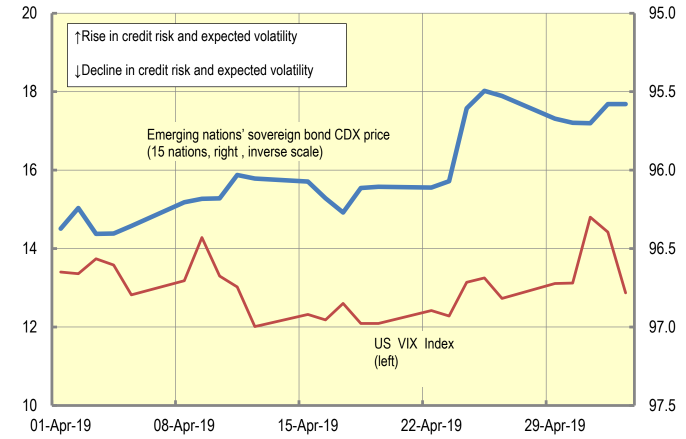
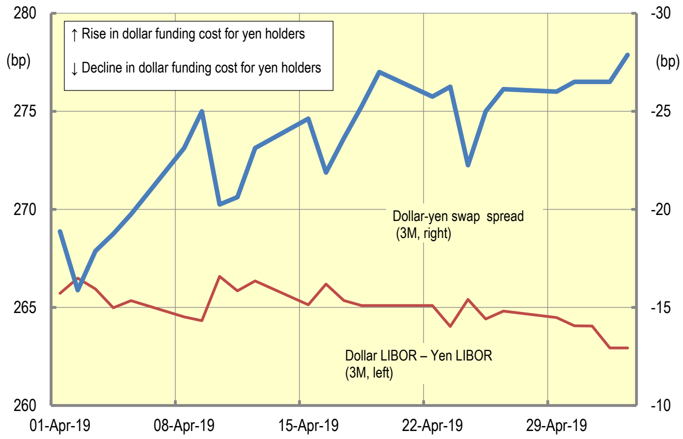
There was a notable weakening of the dollar after US economic data was announced. Although US GDP data for Jan-Mar beat market expectations, it was largely due to a decline in exports and growth in inventories, and this sparked concern over growth in Apr-Jun. The Chicago PMI and ISM manufacturing PMI for April worsened more than expected. Although the growth in nonfarm payrolls and decline in unemployment rate were unexpectedly strong, there are doubts over its sustainability because the number of new unemployment claims turned to a rising trend, and the market reacted to slower wage growth. With the Trump administration ramping up pressure to cut rates, a number of Fed board members made dovish comments, and risks to the USD/JPY are now probably more to the downside.

Chart: US VIX Index and CDX Emerging Markets Index



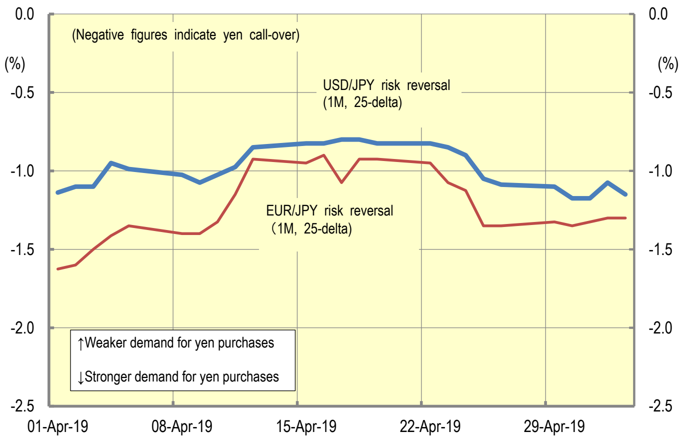
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



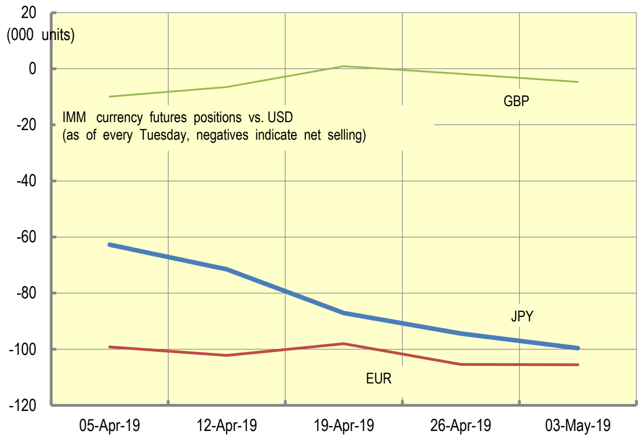
Source: Thomson Reuters; compiled by Daiwa Securities.

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: Yen should strengthen if US-China trade talks are suspended

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On May 5, the US president threatened to raise tariffs from 10% to 25% on $200 billion of Chinese products on May 10, and possibly apply new 25% tariffs on another $325 billion worth of Chinese products "shortly." "The Trade Deal with China continues, but too slowly, as they attempt to renegotiate." He was expressing growing dissatisfaction with China's stance as it backtracks from commitments to address technology transfers and several other problems. In keeping with its policy of not negotiating under threat, China is apparently considering canceling the Vice Premier's trip to the US planned for this week. Risk-off moves would likely ease if the US-China talks continue, but if the talks are suspended, expectations of a US-China trade agreement would sharply weaken, and concern over an increase in tariffs on Chinese goods would probably lead to a risk-off strengthening of the yen.

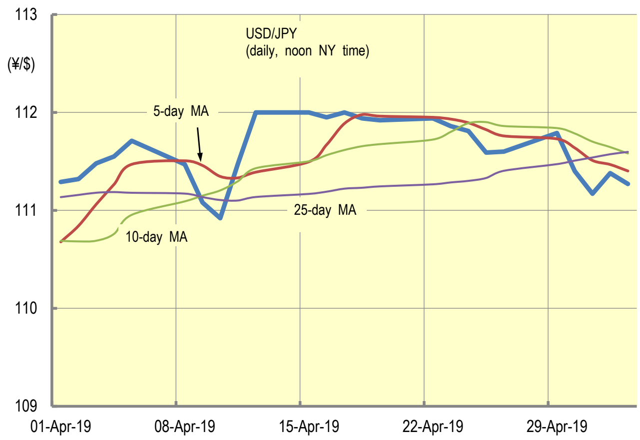
Noteworthy currencies: AUD and NZD

Monetary policy meetings are scheduled for May 7 by Australia's central bank and for May 8 by New Zealand's central bank. In Australia, core inflation came in below forecast for Jan-Mar 2019 and the market has been pricing in a rate cut. The focus is on whether it will cut rates, suggest a rate cut, or suggest the possibility of consecutive rate cuts (we expect a 25bp rate cut in May along with an announcement that future rate cuts are data dependent). The market has already priced in a rate cut, and if there is a suggestion of consecutive rate cuts it may exacerbate the decline in Australian interest rates and weakening of the Australian dollar. If the Australian central bank cuts rates and signals a clear rate-cutting stance, it would mark the first example of a rate cut since the Fed and ECB assumed a more cautious policy stance. Such a rate cut would likely impact on global markets. For example, we may see a decline in interest rates and weakening of currencies in the advanced economies, such as EU and Canada. Along with pushback from Fed chair Jerome Powell by way of statements that there will be no rate cuts anytime soon, it could lead to a strengthening of the dollar. If markets tip more toward risk-off, it could lead to a strengthening of the yen.

Even if Australia's central bank chooses not to cut rates, caution will remain about a rate cut by New Zealand's central bank on the following day. In New Zealand, the CPI came in below the central bank's outlook and the jobs environment worsened. Because the central bank has already shifted to a rate-cut bias, the market is increasingly expecting a rate cut at the May meeting.

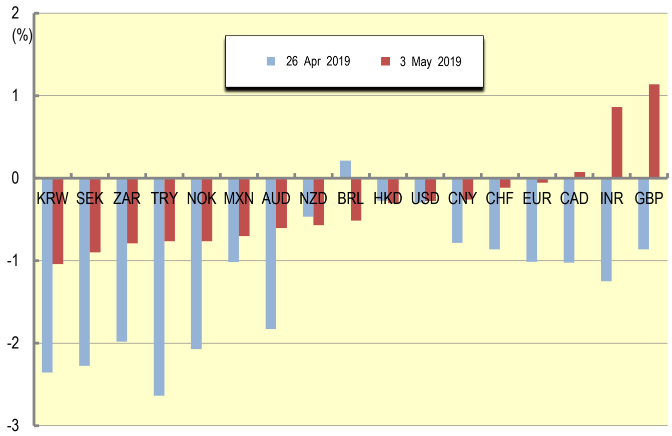
If interest rates are cut in both Australia and New Zealand, it would signal increased pessimism over the global economy and amplify the global impacts. Conversely, if both decide to stand pat and not cut rates, it would bring to a halt in dovish moves among central banks in advanced economies. Antipodean central bank meetings would be extremely important events.

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

6-May		Mar eurozone retail sales
7-May	○	RBA monetary policy meeting
		Mar German manufacturing sector orders
8-May		Mar US outstanding consumer credit
	○	MPM at New Zealand central bank
		Mar German industrial production
		Apr China trade statistics
	●	US-China ministerial trade talks (Washington)
9-May	○	MPM at Brazilian central bank
		Apr China CPI
		Mar US trade statistics
		Fed chair Powell's speech (Washington)
	●	Informal EU summit meeting (Romania)
10-May		Mar German trade statistics
		Jan-Mar UK GDP
		Apr US CPI

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

	29 Apr - 3 May 2019 (actual)		6 - 10 May 2019 (forecasts)	
	Range	End of week	Range	End of week
USD/JPY	111.0-111.9	111.1	109.5-111.5	110.5
EUR/JPY	124.2-125.3	124.5	122.5-125.0	123.5
EUR/USD	1.113-1.127	1.120	1.110-1.125	1.118

Noteworthy currencies and factors

AUD	AUD would weaken if RBA implies rate cut or consecutive rate cuts
NZD	NZD would depreciate if central bank implies rate cut or consecutive rate cuts
ZAR	Rand may depreciate if ruling parties lose seats at general election on 8 May
BRL	Possible cut in pension reform spending would weigh on real
CNY	Yuan would weaken if US-China talks are suspended, in addition to easing by PBOC
GBP	Pound would strengthen if Brexit talks proceed between ruling and opposition parties

Source; Compiled by Daiwa Securities.

Daiwa Securities

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.

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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.
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■ Credit Rating Agencies

[Standard & Poor's]

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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)

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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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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.

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

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

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[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)

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May 2018

IMPORTANT

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.

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The Financial Futures Association of Japan
Japan Investment Advisers Association
Type II Financial Instruments Firms Association