

Forex Market Weekly

Difficulty of resolving US-China conflict may strengthen yen

- US raising tariffs on Chinese goods leads to a risk-off yen appreciation
- Pound may rebound on heightening expectations of 2nd UK referendum
- This week's FX outlook: Difficulty of resolving US-China conflict may strengthen yen

This week's USD/JPY forecast range

13 - 17 May: Y108.5 – 110.5/\$ (Y109.9 at end-previous week)

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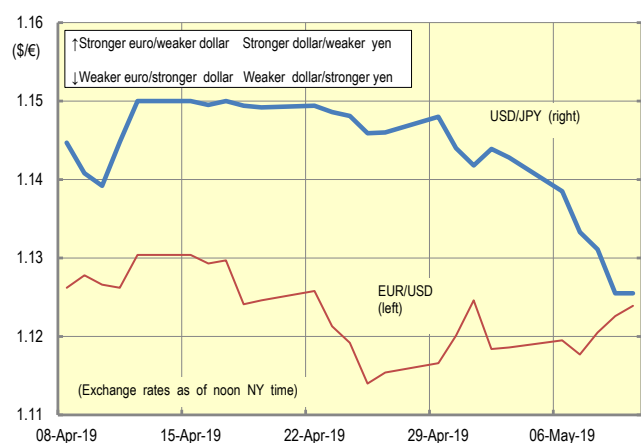


Overview of last week's forex market

US raising tariffs on Chinese goods leads to a risk-off yen appreciation

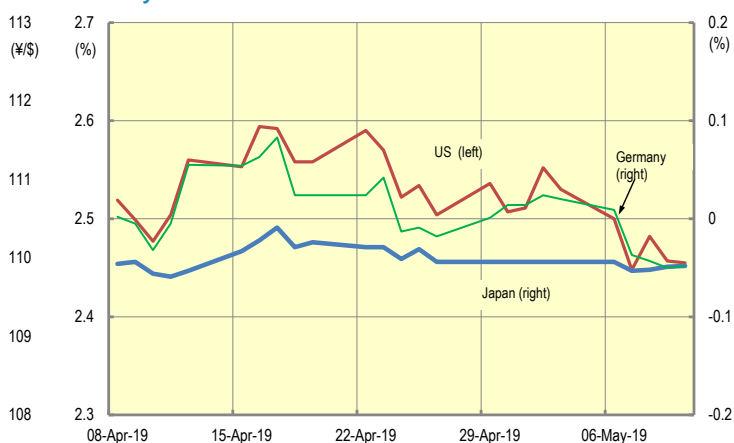
Because President Trump threatened to raise the additional tariffs on Chinese goods to 25% and there were reports that China was considering suspending its trade talks with the US, the USD/JPY dropped below 111 early last week. Although the yen weakened when China indicated it planned to send its negotiating team to the trade talks, it returned to risk-off strengthening when the USTR indicated the possibility of the tariffs being raised to 25% on May 7. The Australian dollar rose following the Reserve Bank of Australia's decision to leave rates unchanged, then retreated in response to indications of an easing bias. On May 8, the US government submitted formal notification that tariffs on \$200 billion of Chinese goods would be raised from 10% to 25% at 12:01 AM (1:01 PM Japan time) on May 10. With the US president also tweeting that China had reneged on a deal struck at the trade talks, the yen continued strengthening, and the USD/JPY fell as low as 109.47. Comments from Mr. Trump that he had received a "wonderful" letter from China's president Xi Jinping raised expectations of a US-China trade agreement, causing the yen to weaken, but then the US raised the tariff to 25% in line with its notification, and the yen strengthened. The risk-off yen appreciation was limited, however, because of lingering expectations that the US-China talks will continue.

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



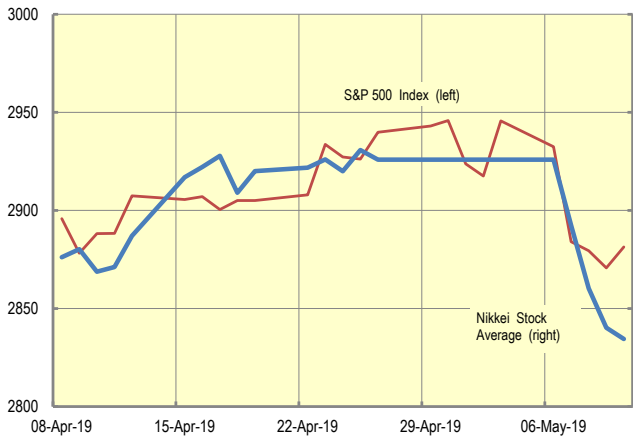
Source: Thomson Reuters; compiled by Daiwa Securities.

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



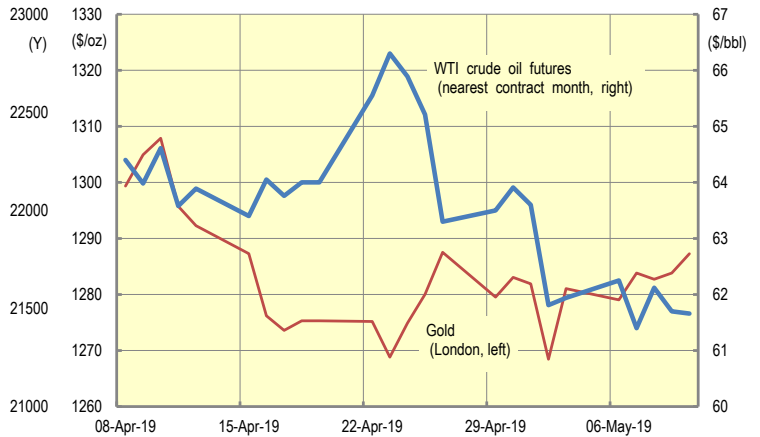
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



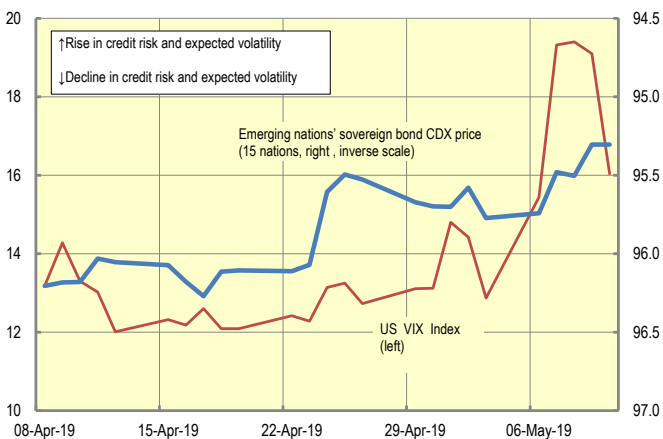
Source: Thomson Reuters; compiled by Daiwa Securities.

Pound may rebound on heightening expectations of 2nd UK referendum

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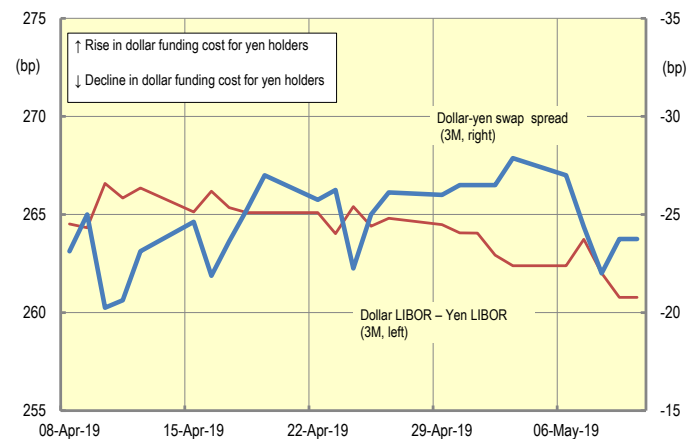
Pound may rebound on heightening expectations of 2nd UK referendum. In the UK, both the ruling Conservatives and Labour, the largest opposition party, did poorly in local elections, prompting the head of the Labor Party to pronounce the need for a Brexit agreement. This momentarily raised expectations of an agreement and the pound strengthened, but when those expectations retreated so did the pound. Possibly because the ruling and opposition parties cannot reach a compromise on Brexit, the UK government announced it would participate in the European Parliament elections. While there were reports indicating the possibility of rapid progress in Tory-Labor talks, there were also reports that the talks were on the verge of collapse and that Prime Minister Theresa May was getting ready for a second referendum. If the talks do collapse, the pound will probably weaken on concerns over a no-deal Brexit, but if another referendum looks likely, the pound should rebound on expectations of Brexit being canceled.

Chart: US VIX Index and CDX Emerging Markets Index



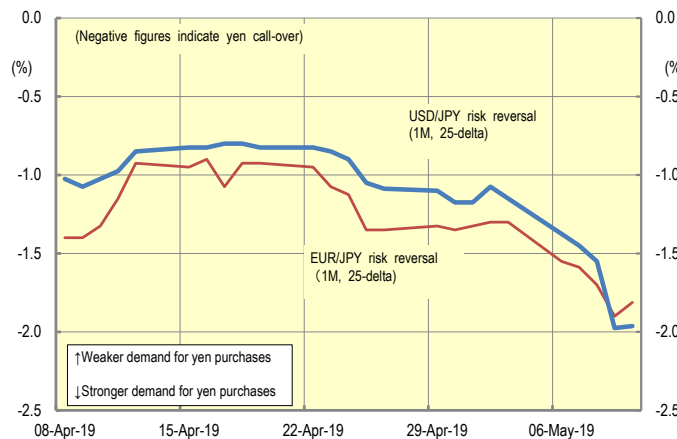
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



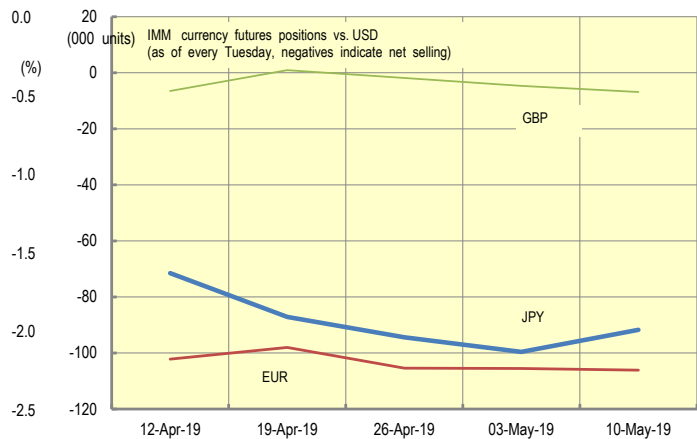
Source: Thomson Reuters; compiled by Daiwa Securities.

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: Difficulty of resolving US-China conflict may strengthen yen

This week's FX outlook: Difficulty of resolving US-China conflict may strengthen yen

The US raising tariffs on Chinese goods and China retaliating will have a negative impact on the global economy and put markets in risk-off mode. Although there are also lingering expectations of friction being mitigated by a continuation of US-China trade talks, if no schedule for those talks is set and the talks are de facto suspended, the US-China conflict is likely to deepen. If the US starts taking steps to impose additional tariffs on \$325 billion of Chinese goods that have so far been spared additional tariffs, it will increase the likelihood of China devaluing the yuan to offset (mitigate) the decline in demand for its exports that the additional tariffs will cause. Conversely, a weakening of the yuan would increase the likelihood of the US imposing additional tariffs on Chinese goods. As resolution of the US-China conflict comes to be seen as more difficult, a risk-off strengthening of the yen probably becomes more likely.

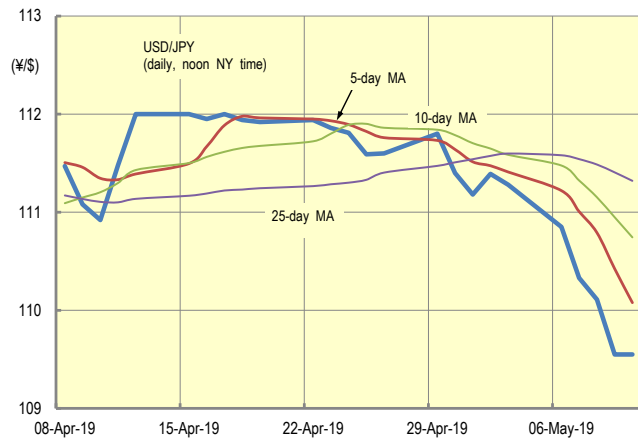
US economic data for May could also trigger yen appreciation

With US stocks having followed an upward trend in April, we think the April retail sales data due out this week is unlikely to fall below the market forecast of 0.3% m/m growth. New unemployment claims having turned to a rising trend starting with the third week in April, however, and we think US business sentiment is unlikely to improve in May relative to April. Although the market expects the Philadelphia Fed Manufacturing Business Outlook Survey for May to improve relative to April, we think it likely that an unexpected worsening of sentiment will push the USD/JPY lower. Furthermore, because US share prices were declining during the period the survey for the University of Michigan Consumer Sentiment Index was taken (April 24-May 15), we think there is a high risk that, contrary to the market's expectation for improvement relative to April, a worsening of sentiment will cause the USD/JPY to decline.

Noteworthy currency: AUD

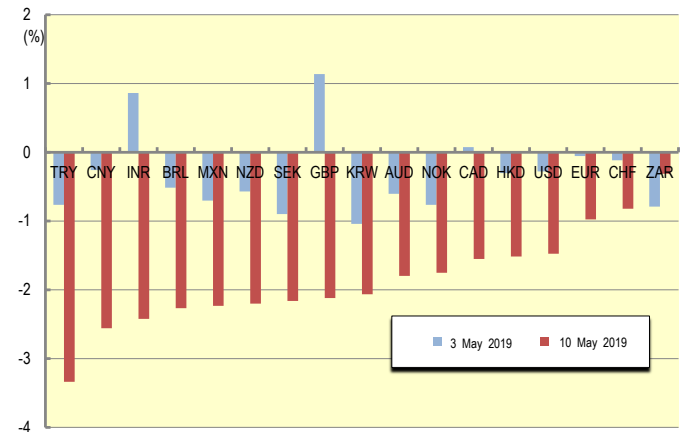
Australia's jobs data is scheduled for release on May 16 (the unemployment rate was 5.0% in March and is forecast to be 5.0% in April). The Reserve Bank of Australia decided not to cut rates at its May policy meeting because of the strong labor market, putting the spotlight on the jobs report. At its April policy meeting, it said one precondition for a rate cut was a trend increase in the unemployment rate. The unemployment rate rose in March and another increase in April would raise expectations of a rate cut. Strong growth in employment is what keeps inflation on an upward path, and a slowing of that growth would increase rate cut expectations. Even if the jobs data is stronger than expected, if it is not enough to push inflation higher the rate cut bias is unlikely to fade, leaving strong downward pressure on the AUD. The AUD is also under strong downward pressure from the worsening of US-China relations.

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

- 14-May May German ZEW Indicator of Economic Sentiment
Mar eurozone industrial production
- 15-May **Apr China industrial production, retail sales**
Jan-Mar German GDP
Jan-Mar eurozone GDP (revised)
Apr US retail sales, May NY Fed's Empire State Manufacturing Index
Apr US industrial production, capacity utilization rate
- 16-May Apr Australian jobs data
Mar eurozone trade balance
Apr US housing starts
May Philadelphia Fed's Business Outlook Survey Index
- 17-May Apr European new car sales
May US University of Michigan's Consumer Sentiment Index (preliminary)

Source; Compiled by Daiwa Securities.

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

	6 - 10 May 2019 (actual)		13 - 17 May 2019 (forecasts)	
	Range	End of week	Range	End of week
USD/JPY	109.4-111.0	109.9	108.5-110.5	109.5
EUR/JPY	122.4-124.4	123.5	121.6-124.1	122.8
EUR/USD	1.115-1.126	1.123	1.115-1.130	1.122

Noteworthy currencies and factors

AUD	Upside of AUD is limited due to deterioration in US-China relations and release of jobs report
EUR	If German indicators imply economic recovery, this would lead to stronger euro
CNY	Yuan would weaken owing to concerns about economic slowdown via additional tariffs on Chinese products
GBP	Pound would strengthen if Brexit negotiations proceed among ruling and opposition parties

Source; Compiled by Daiwa Securities.

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- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
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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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[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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