

Forex Market Weekly

Focus on US trade stance regarding cars

- Yen rose on China's retaliatory tariffs, fell after US postponed car tariffs
- Declining US interest rates as USD/JPY weakening factor
- This week's forex outlook: Focus on US trade stance regarding cars

This week's USD/JPY forecast range

20 - 24 May: Y108.7 – 110.7/\$ (Y110.1 at end-previous week)

Forex Market View DSFE234
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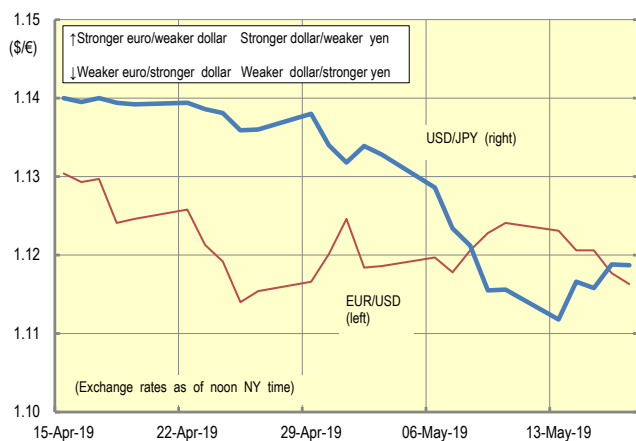
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Overview of last week's forex market

Yen rose on China's retaliatory tariffs, fell after US postponed car tariffs

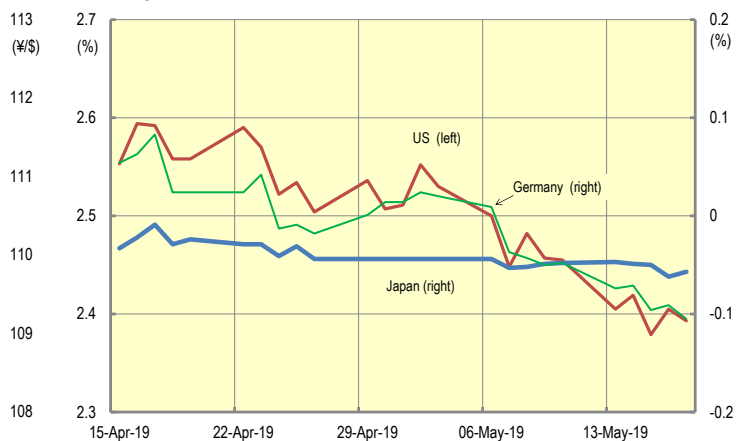
The USD/JPY pulled back slightly with US/China trade negotiations reaching a stalemate. The US is demanding that China agrees to very strong trade agreement enforcement clauses (making revised items legally binding), but China has indicated it will not make concessions on matters of principle. The USD/JPY slipped to 109.02 after China announced it will hike tariffs on \$60 billion in US goods from June 1, 2019, increasing them by as much as 25%. The US Trade Representative (USTR) indicated it is planning a fourth round of tariffs, this time involving a list of 3,805 categories of products imported from China that could be subject tariffs of up to 25%. However, US President Donald Trump said he feels trade talks will go very well, which contributed to a USD/JPY rebound. Meanwhile, the euro dropped after Italian Deputy Prime Minister Matteo Salvini said his country is prepared to break EU budget rules if necessary. The USD/JPY fell on a risk-off sentiment and declining US interest rates, but the pair bounced back on reports Trump will delay tariffs on cars produced in Japan and Europe by up to six months. Despite the US moving to ban Huawei, US stocks and interest rates rose on good US economic indicators, which lifted the USD/JPY to 110. The yen rose on risk-off sentiment following reports that China may now have lost interest in trade talks with the US, but the USD/JPY again rebounded back over 110 with the US postponing car tariffs and following better economic indicators.

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



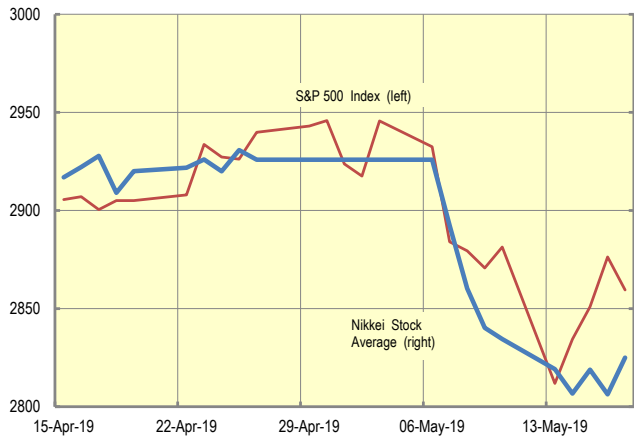
Source: Thomson Reuters; compiled by Daiwa Securities.

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



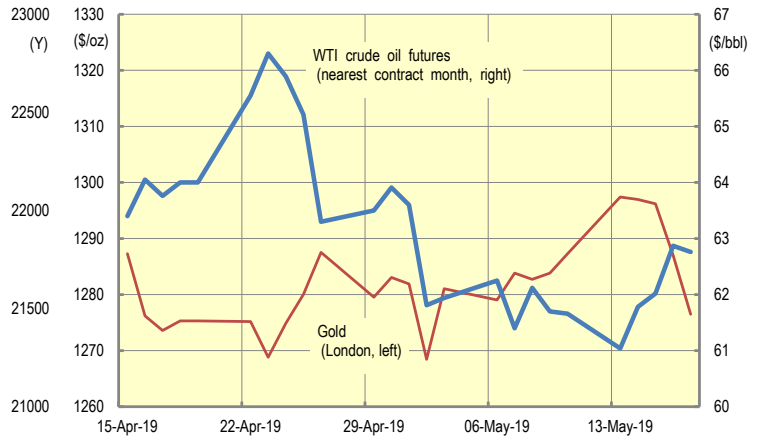
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



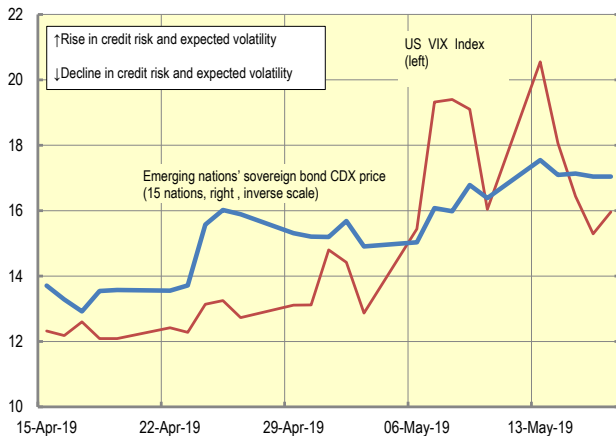
Source: Thomson Reuters; compiled by Daiwa Securities.

Expected inflation rate, real interest rates both declining

Declining US interest rates as USD/JPY weakening factor

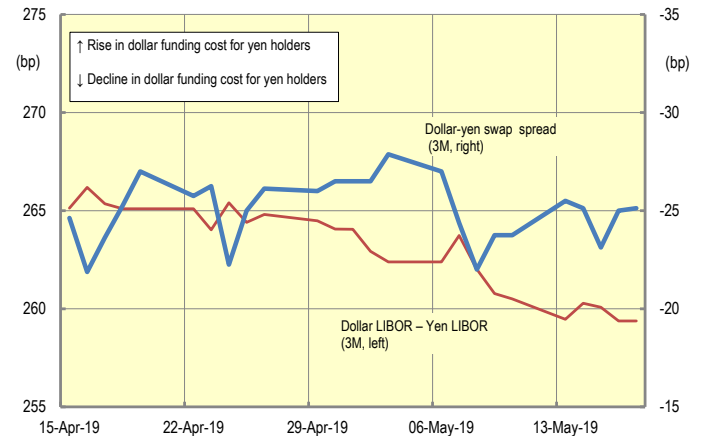
US interest rates are in a downward trend. Although the oil price is climbing amid increased tensions between the US and Iran, this does not necessarily mean that the expected inflation rate is rising and real interest rates (inflation-linked government bond yields) are falling. Actually, both the expected inflation rate and real interest rates are in declining trends. Both nominal and real interest rates seem to be declining on concerns about slowing economies amid reignited trade friction between the US and China. Some US economic indicators last week were better than expected. However, if the number of indicators missing expectations increases or if members of the Federal Reserve make clearly dovish statements, nominal and real interest rates would likely decline further and pull the USD/JPY lower.

Chart: US VIX Index and CDX Emerging Markets Index



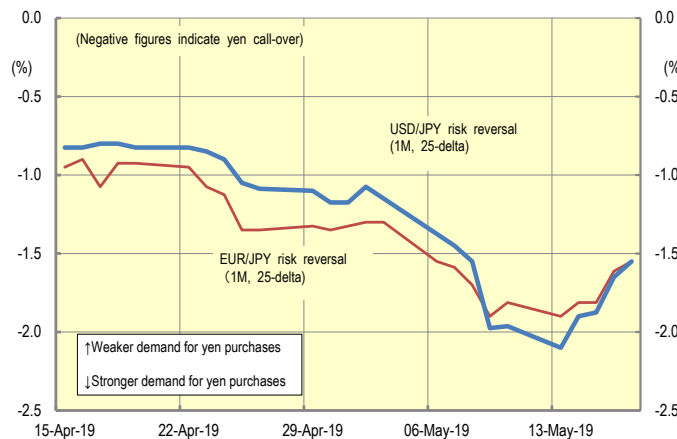
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



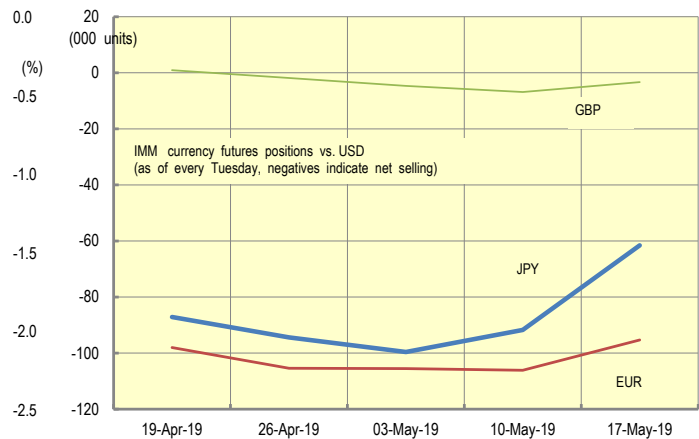
Source: Thomson Reuters; compiled by Daiwa Securities.

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.

Trade concerns likely to persist despite grace period

This week's forex outlook: Focus on US trade stance regarding cars

The US delayed by up to 180 days its decision on whether to impose additional tariffs on automobile and auto parts imports by as much as 25%, just before the original 18 May deadline. However, during this grace period the US will continue to pressure Japan and the EU to agree to limit their car exports to the US. There were also reports that the US is considering a plan to raise tariffs on imported cars if such agreements on export limits are not reached. The yen depreciated as trade worries eased somewhat on reports that Toshimitsu Motegi, Japan's Minister for Economic and Fiscal Policy, had been assured by a USTR representative that the US will not ask Japan to cap its automobile exports as part of a trade deal. However, concerns on the trade front persist. After all, even if Japan tries to avoid export restrictions and additional tariffs by increasing its car production in the US, thus producing positive impacts for the US economy, this might not be enough to satisfy the Trump administration as there would be no benefits for US carmakers. The US and Japan will hold working-level trade talks in Washington on 21 May. There is probably still some risk of yen appreciation if the US demands that Japan must limit its car exports.

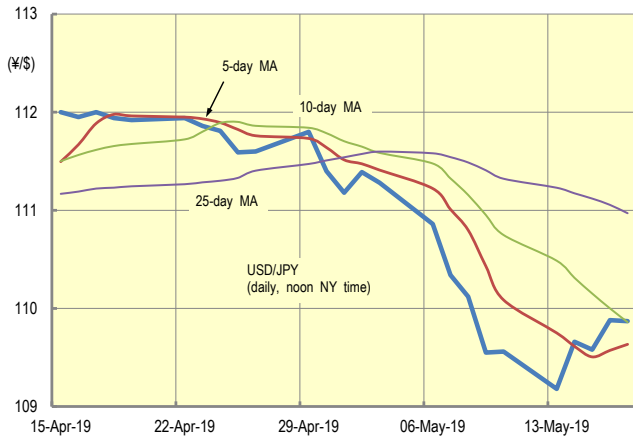
Pound depreciation risk if UK government not open to national referendum

In England, the opposition Labour Party has broken off talks with the ruling party as the government is weak and seems unwilling to compromise in order to reach a Brexit agreement. Apparently, the government is not in favor of the Labour Party's proposal to leave the EU, while remaining in the customs union. Opposition parties have indicated that they are against the Brexit agreement, while Brexit hardliners within the ruling party are opposed to again voting on a Brexit deal as a different outcome from the past unsuccessful votes seems unlikely. The new Brexit Party has been gaining support in opinion polls just before the 23-26 May European Parliament elections. Meanwhile, opinion polls show that former foreign minister Boris Johnson is the top choice to replace Theresa May as head of the Conservative Party. Such developments are tailwinds for Brexit hardliners. May plans to put her Brexit deal to another vote during the week of June 3, but another defeat seems very likely. As long as the Prime Minister is not open to a second national referendum, expectations for abandoning Brexit are unlikely to grow. Risk-off depreciation of the pound amid concerns of a no-deal Brexit seems likely.

Noteworthy currency: EUR

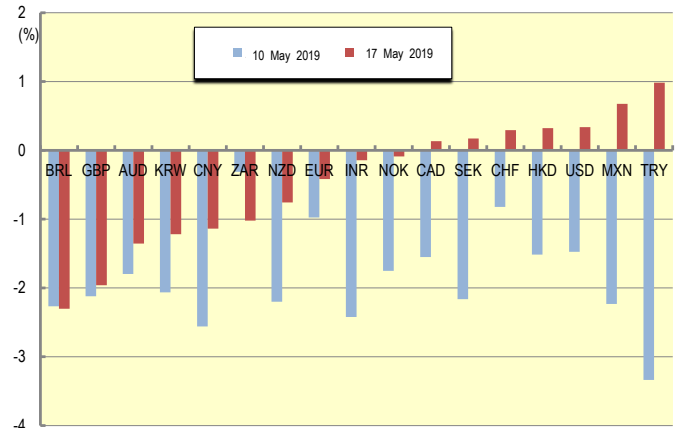
A 1Q recovery for the Eurozone economy has become clear. Hopes for a further recovery could grow, pushing up the euro, if May PMI readings for France and Germany (out on 23 May) beat expectations. That said, European Parliament elections are scheduled for 23-26 May. Pro-EU forces are expected to maintain their majorities. However, the focus is on (1) whether anti-EU forces can capture one-third of the vote (with England's participation in election) and (2) any changes in the balance of power among the political parties that make up Italy's coalition government. Markets are likely to turn sluggish as a wait-and-see mood takes hold before this election. Big moves for the euro are not expected with Brexit issues capping upside for the currency.

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

- 20-May Jan-Mar Japan GDP (1st preliminary)
- 21-May ○ Minutes of RBA MPM
Apr US existing home sales
- 22-May Apr Japan trade statistics, Mar machinery orders
- 23-May ○ Minutes of FOMC meeting (30 Apr-1 May)
May Germany Manufacturing/services PMI (Markit)
May German IFO business climate index
 - European elections (till 26th)
 - Apr US new home sales
 - MPM at South African central bank
- 24-May Apr US durable goods orders
- 25-May ● President Trump visit to Japan as state guest (till 28th)

Source; Compiled by Daiwa Securities.

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

| | 13 - 17 May 2019 (actual) | | 20 - 24 May 2019 (forecasts) | |
|---------|---------------------------|-------------|------------------------------|-------------|
| | Range | End of week | Range | End of week |
| USD/JPY | 109.0-110.2 | 110.1 | 108.7-110.7 | 109.7 |
| EUR/JPY | 122.0-123.6 | 122.8 | 121.5-124.0 | 122.5 |
| EUR/USD | 1.115-1.127 | 1.116 | 1.110-1.125 | 1.117 |

Noteworthy currencies and factors

| | |
|-----|--|
| EUR | Results of European elections awaited; moves may be limited due to confusion in UK |
| GBP | Amid concerns about no-deal Brexit, downward pressure to persist until new proposal is submitted by Prime Minister |
| AUD | Despite victory of ruling parties, market is still factoring in rate cut; AUD to meet upside resistance |

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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[Standard & Poor's]

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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.
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- 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.

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