

Forex Market Weekly

US, China economic indicators could miss market consensus

- Stronger yen / weaker dollar as US threatens Mexico with tariffs
- Are more Britons now in favor of remaining in EU than leaving?
- This week's forex outlook: Worsening US, China indicators could weigh on USD/JPY

This week's USD/JPY forecast range

3 - 7 Jun: Y107.5 – 109.5/\$ (Y108.3 at end-previous week)

Forex Market View DSFE238
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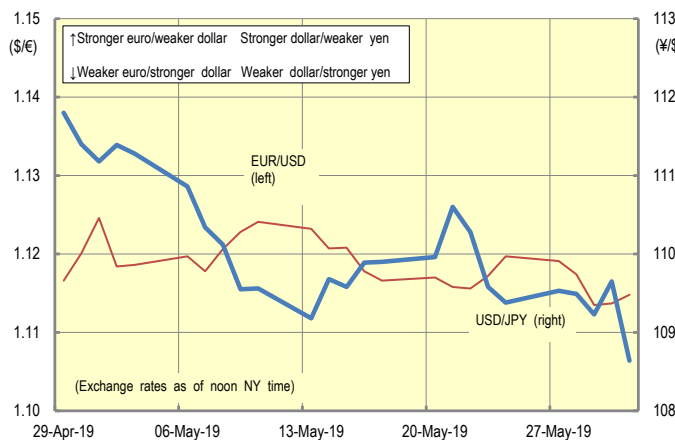


Overview of last week's forex market

Stronger yen / weaker dollar as US threatens Mexico with tariffs

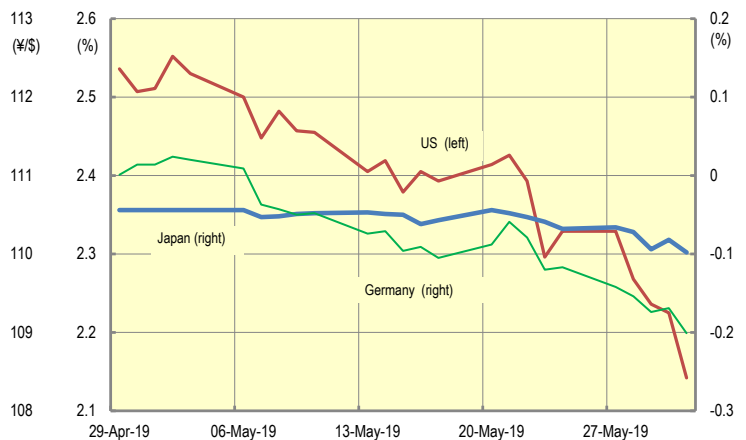
The yen depreciated, possibly due to easing concerns about US pressuring Japan on the trade front after US President Donald Trump did not mention currency levels or restricting Japan automobile exports to the US during his recent visit to Japan. Risk-off yen appreciation emerged with Italian government bond yields rising and the euro declining on a fiscal austerity standoff between Italy and the EU (EU eyes possible sanctions against Italy for breaking budget rules, Italian Deputy Prime Minister Matteo Salvini said Italy prepared to break such rules if necessary). US equities tumbled on fears China could restrict its exports of rare earth metals to the US. The US Treasury Department's semiannual "Report on Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States" did not label any of America's major trading partners as currency manipulators. Still, the USD/JPY fell on a prevailing risk-off mood. The euro declined with Germany's May unemployment rate rising more than expected and with the Finnish central bank governor saying the ECB is unlikely to raise rates any time soon and is prepared to act if the current economic deceleration is prolonged. The USD/JPY rebounded with interest rates rising after a US government bond auction and the pair touched 109.93 after Trump made positive remarks about the state of trade negotiations with China. However, US interest rates and the USD/JPY fell back on a crude oil price drop. The dollar weakened and the yen strengthened to USD/JPY108.27 after Trump threatened to impose a 5% tariff on all imported Mexican goods from 10 June, with incremental increases to 25% by October unless Mexico halts the flow of illegal immigrants across the US southern border.

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



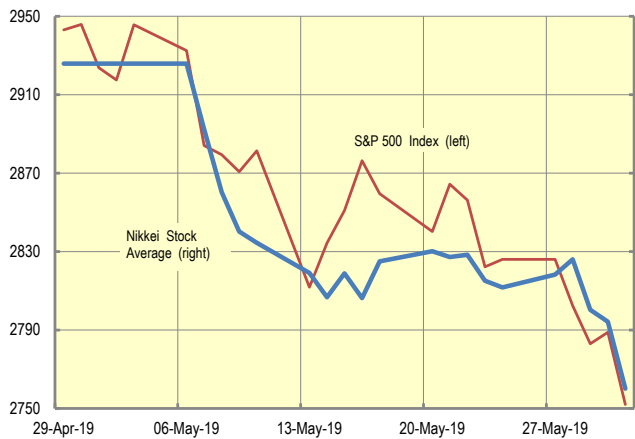
Source: Thomson Reuters; compiled by Daiwa Securities.

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



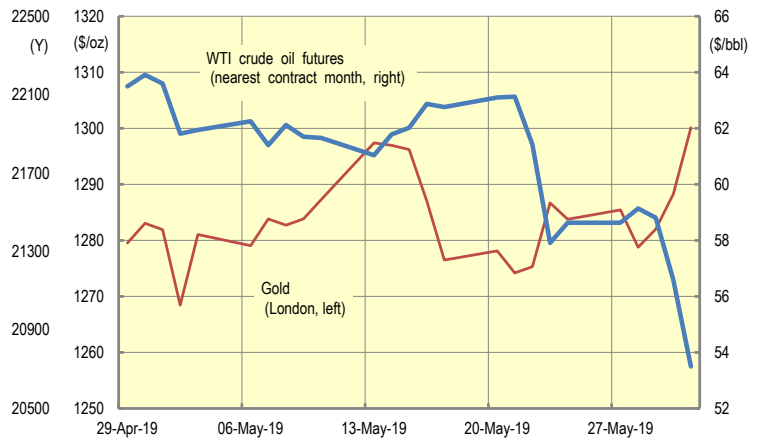
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



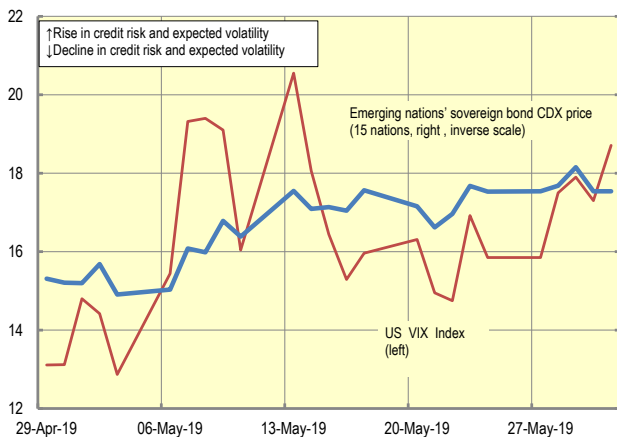
Source: Thomson Reuters; compiled by Daiwa Securities.

Britain's two main parties lose seats

Are more Britons now in favor of remaining in EU than leaving?

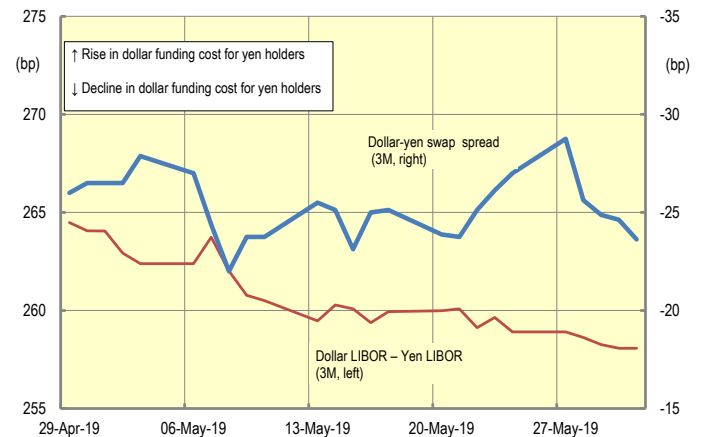
According to provisional results for the European Parliament elections, the center-right EPP lost 38 seats and the center-left S&D lost 33 seats (as a result, EPP and S&D unable to form “grand coalition” on their own), while the center-right ECR lost 13 seats and the left-wing GUE/NGL lost 14 seats. Meanwhile, the extreme right-wing ENF gained 21 seats, the extreme right-wing EFDO added 13 seats, the liberal ALDE&R won 37 seats, and the Green Party (Green/EFA) added 17 seats. While anti-EU extreme right-wing parties gained seats, support also flowed from the center-right and left-wing parties to pro-EU liberal and green parties. Likewise, in the UK, the Conservatives (ECR) lost 15 seats and the Labour Party (S&D) surrendered 8 seats, while the anti-EU Brexit Party (EFDO) gained 11 seats, the pro-EU liberals (ALDE&R) won 15 seats, and the Green Party (Green/EFA) added 5 seats. With support for England's two main political parties declining, public support for remaining in EU may now be stronger than support for leaving the EU.

Chart: US VIX Index and CDX Emerging Markets Index



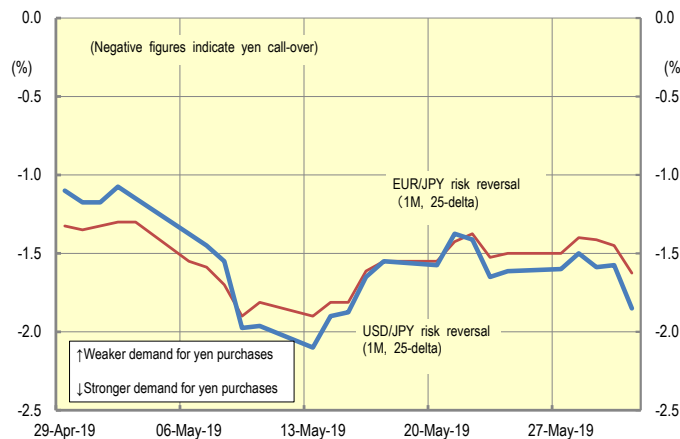
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



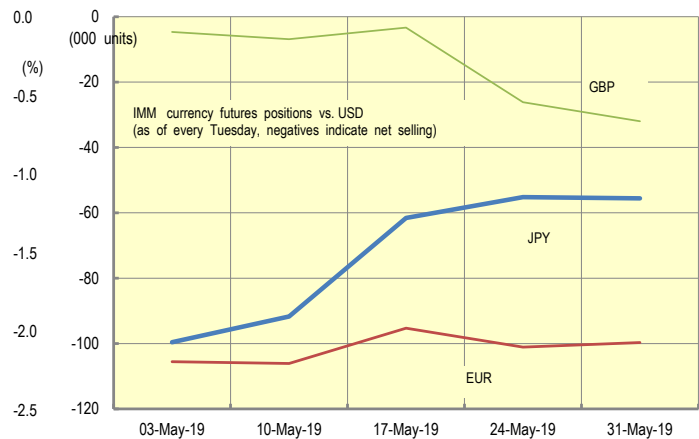
Source: Thomson Reuters; compiled by Daiwa Securities.

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: Worsening US, China indicators could push down USD/JPY

Concerns about economic slowdown could increase

US and China economic indicators could weigh on the USD/JPY this week. There are considerable risks of May China's Caixin Manufacturing PMI and the US ISM Manufacturing PMI missing the market expectations of 50.0 and 53.0, respectively. In terms of US jobs data, the market consensus calls for slower jobs growth compared to April (+190,000 jobs from +263,000), a higher unemployment rate (3.7% from 3.6%), and only a modest 3.2% y/y increase in hourly wages. Concerns about an economic slowdown could increase, even if these indicators are as expected.

Tariffs could hit Mexico hard, force steps to halt immigration

Any tariffs imposed by the US on Mexico would increase the prices of Mexican products coming into the US and could have negative impacts in terms of reducing not only the exports of Mexican goods, but also goods produced in Mexico by companies based in other countries. While these impacts will not be as strong as those from US tariffs on Chinese goods, such tariffs on Mexican goods could contribute to a further slowing of the global economy, which in turn could produce additional risk-off yen appreciation pressure. The US imports roughly \$350.0bn in Mexican goods each year, which account for around 14% of all US imports. However, shipments to the US account for roughly 80% of all Mexican exports. As such tariffs could have a tremendous impact on Mexico's economy, the country will likely be pressed to take steps to halt immigration across the US southern border. Risk-off sentiment could ease if Mexico presents a policy to address immigration.

US focusing on yuan trends

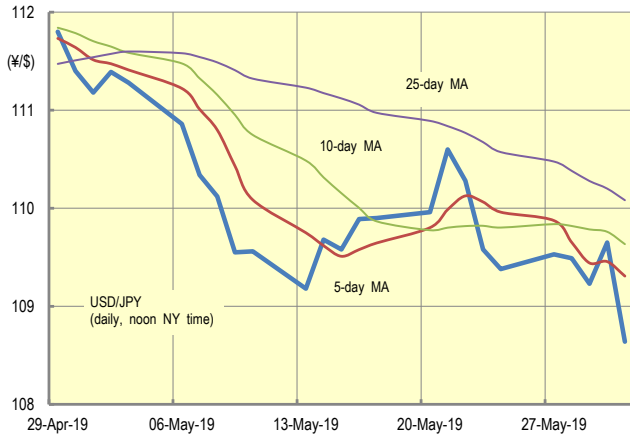
On 28 May, the US Treasury Department released its semiannual report on the currency practices of its major trading partners, which stated that the US Treasury continues to carefully monitor developments in the Chinese yuan. China met only one of the three criteria for being labeled a currency manipulator, namely a significant trade surplus with the US (other two conditions are significant current account surplus and one-sided forex market intervention). However, Chinese authorities conduct unfair trade practices, the country has an enormous trade surplus with the US, and its intervention on forex market is unclear, raising suspicion that it is promoting yuan weakness for competitive trading advantages. As such, China is at the top of the Treasury Department's "monitoring list" made up of nine countries. Further depreciation of the yuan will likely raise concerns that the US will use tariffs and other sanctions to cancel any benefits China might derive from a weak yuan.

Noteworthy currencies: AUD and EUR

This week the Reserve Bank of Australia (RBA) will hold its board meeting on 4 June and the European Central Bank (ECB) will hold its governing council meeting on 6 June. The RBA governor has suggested that a rate cut will be considered at this week's meeting. The impact of such a rate cut on the Australian dollar should be limited as the market has already factored in two rate cuts this year. That said, a further decline for the Australian dollar is possible if the board adopts a more dovish stance that makes investors aware of the potential for three or more rate cuts this year. Meanwhile, the ECB is expected to use

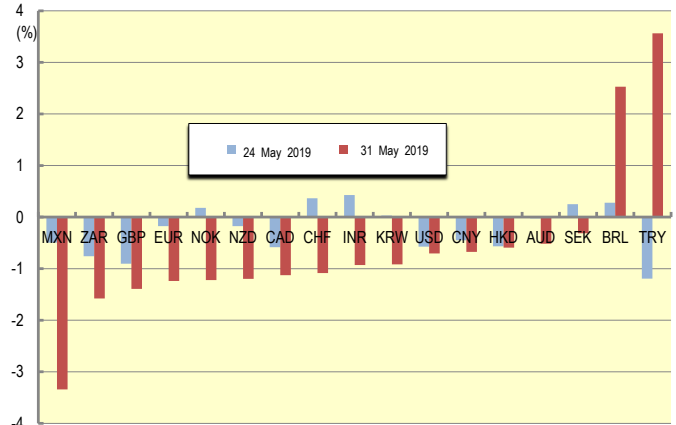
this week's meeting to set the conditions for its new series of targeted longer-term refinancing operations (TLTRO III), which it will start from September. Italian interest rate levels (relative to German interest rate levels) will change depending on the degree to which conditions are eased. Still, there is a strong probability that the euro will fall amid an environment in which a hawkish turn is not possible amid downward revisions for both economic outlooks and the risk balance, along with the euro rising against the yuan.

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

- 3-Jun ● May China manufacturing PMI (Caixin)
May US ISM manufacturing index
- 4-Jun ● May eurozone CPI, Apr eurozone unemployment rate
○ MPM at RBA
- 5-Jun ○ Apr eurozone retail sales
May US ADP national employment report
May US ISM non-manufacturing index
- 6-Jun ○ Beige Book (Fed)
Apr German manufacturing orders
○ ECB Governing Council meeting (president Draghi's press conference)
Apr US trade statistics
- 7-Jun ○ Apr German industrial production, trade statistics
May US jobs data
G20 Finance Ministers and Central Bank Governors Meeting (till 9th, Fukuoka, Japan)
- 8-Jun ●

Source; Compiled by Daiwa Securities.

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

	27 - 31 May 2019 (actual)		3 - 7 Jun 2019 (forecasts)	
	Range	End of week	Range	End of week
USD/JPY	108.2-110.0	108.3	107.5-109.5	108.2
EUR/JPY	120.9-122.8	120.9	119.6-122.1	120.8
EUR/USD	1.111-1.122	1.118	1.110-1.125	1.117

Noteworthy currencies and factors

AUD	Market has factored in rate cut; AUD would weaken if market is aware of three rate cuts
EUR	Euro may soften due to downward revision to economic projections and risk balance
CNY	Will authorities rein in weaker yuan if risk-off sentiment strengthens depreciation pressure on yuan?
MXN	Downside risk is left due to concerns about tariff; peso would rebound if gov't presents measures to address immigration

Source; Compiled by Daiwa Securities.

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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.
- 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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