

Forex Market Weekly

Tariff avoidance would serve as temporary risk-on factor

- USD/JPY solid on expectations for avoidance of US tariffs on Mexican imports
- Dovish remarks by US policymakers causing lower interest rates/weaker dollar
- This week's forex outlook: Suspension of US tariffs on Mexican goods to serve as temporary risk-on factor

This week's USD/JPY forecast range

10-14 Jun: Y107.5-109.5/\$ (Y108.2/\$ at end of previous week)

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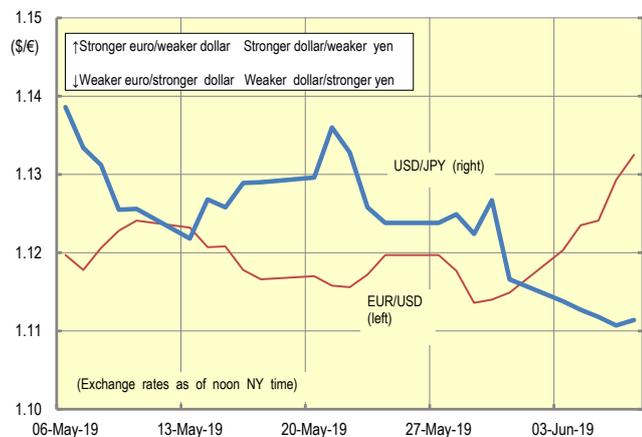
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Overview of last week's forex market

USD/JPY solid on expectations for avoidance of US tariffs on Mexican imports

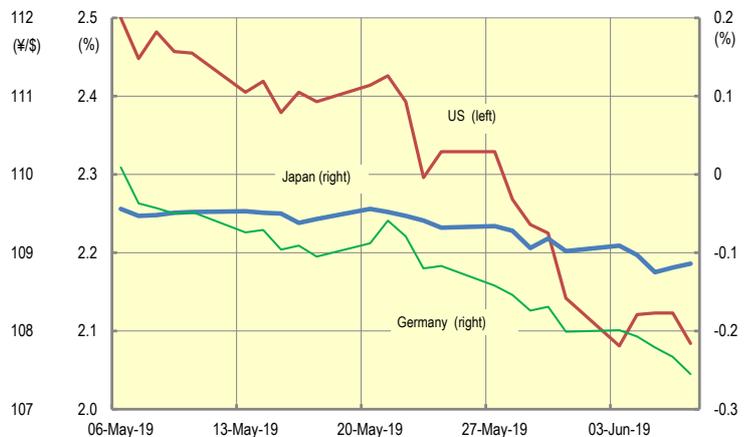
In addition to the announcement at the end of the week before last that US president Donald Trump planned to impose additional tariffs on Mexico, media reports that the chairman of the CEA (Council of Economic Advisers) would shortly leave his post led to a weaker dollar/stronger yen. Share prices declined due to concerns about the Department of Justice's antitrust probes on major IT firms. The St. Louis Fed president supports a rate cut in the near future, given deterioration in the trade outlook, pushing down the 10Y US Treasury yield to the 2.06% level and the USD/JPY rate below 108. Counter-accusation on US-China trade negotiations also served as a risk-off factor. Subsequently, the USD/JPY rate rebounded to the 108 level, but declined due to news that China considered strengthening controls on rare earth exports. As Chinese importers accepted applications for waivers on retaliatory tariffs levied on US goods, the USD/JPY rate rebounded. However, growth in May US ADP private-sector employment was well below expectations, pushing down the USD/JPY rate to 107.81. As White House adviser Peter Navarro indicated the possibility that US tariffs on Mexican goods would not take effect, the USD/JPY rate rebounded again. After the pullback due to unsuccessful negotiations between the US and Mexico, media reports that the US was considering a suspension of tariffs on Mexico pushed up the USD/JPY rate to 108.57. However, the rate retreated as growth in the number of US non-farm payrolls was far below the estimate. Since then, the rate has recovered slightly on expectations for the suspension of US tariffs on Mexico.

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



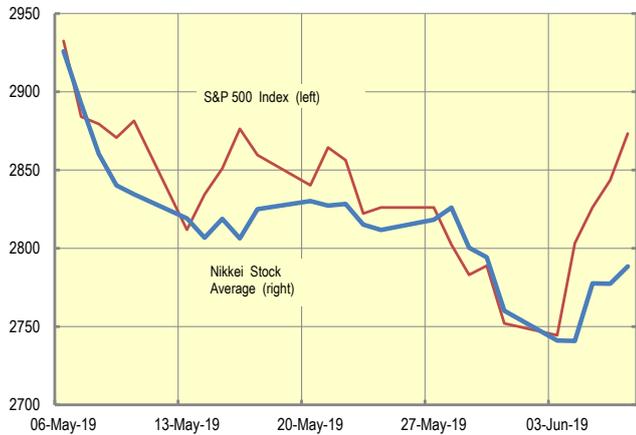
Source: Thomson Reuters; compiled by Daiwa Securities.

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



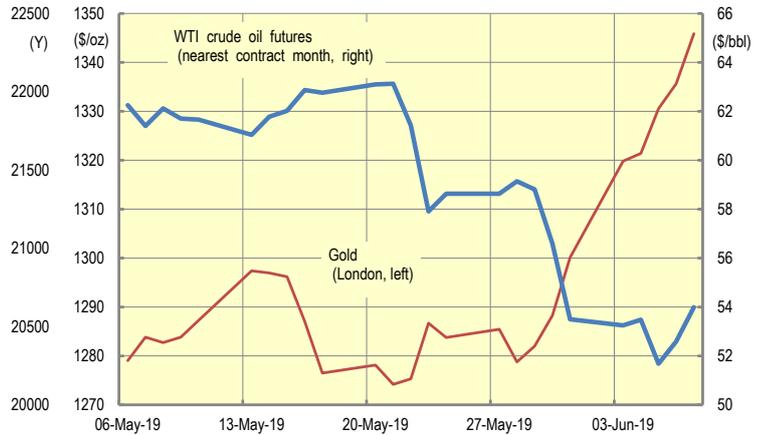
Source: Thomson Reuters; compiled by Daiwa Securities.

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



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Commodity Market: Crude Oil Futures, Gold



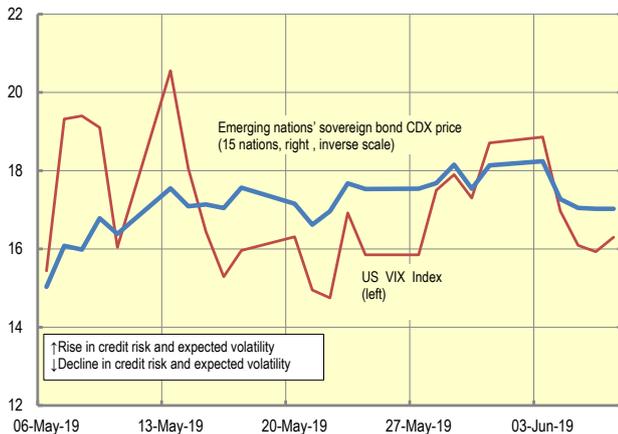
Source: Thomson Reuters; compiled by Daiwa Securities.

**Lower interest rates/
weaker dollar due to
dovish remarks by US
policymakers**

Dovish remarks by US policymakers causing lower interest rates/weaker dollar

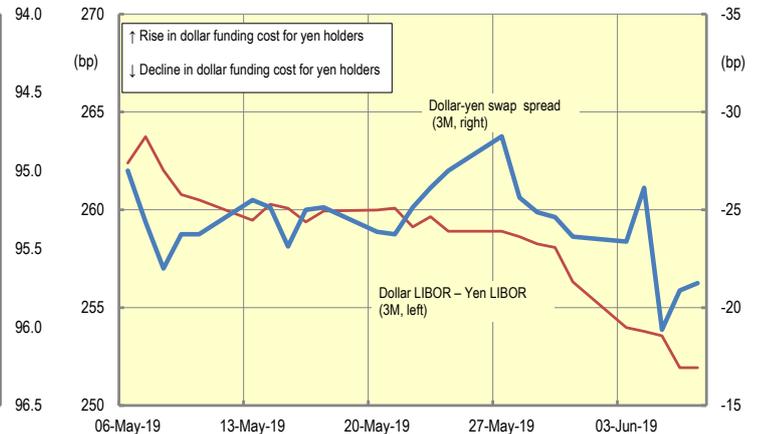
Dovish remarks by US policymakers are causing lower interest rates/weaker dollar. Specifically, St. Louis Fed president James Bullard stated on 3 June that a downward move “may be warranted soon,” Fed governor Lael Brainard said on 5 June that “We’ll be prepared to adjust policy to sustain the expansion,” and Dallas Fed president Robert Kaplan stated on 6 June that “Some of these decisions can change. We may see a new announcement and new decisions in the next four or five weeks.” Although policymakers will not make any remarks during the blackout period from 11 June to the FOMC meeting, the Fed may imply the start of consideration of a rate cut and a July rate cut at the June meeting.

Chart: US VIX Index and CDX Emerging Markets Index



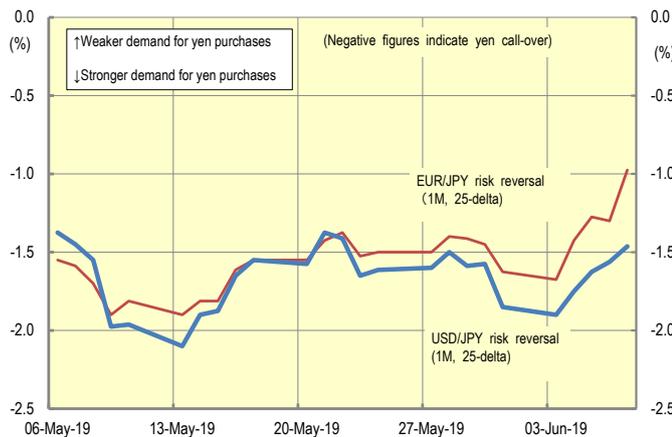
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: LIBOR Gap and Currency Swap Spread



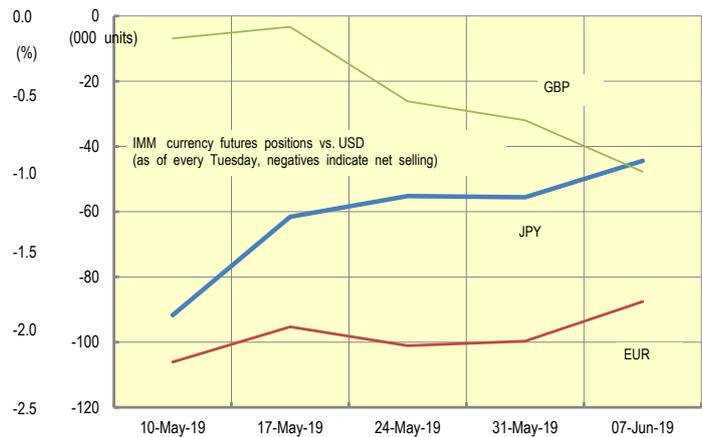
Source: Thomson Reuters; compiled by Daiwa Securities.

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: Suspension of US tariffs on Mexican goods to serve as temporary risk-on factor

Suspension of US tariffs on Mexican goods to serve as temporary risk-on factor

The US president decided to indefinitely suspend tariffs scheduled to be implemented on Mexican goods. He stated that he would consider additional measures unless the US is able to gain anticipated effects from measures to reduce illegal immigration from Mexico. However, such news would lead to risk-on activities. We think that implications of trade pressure vs. China (caused by battle for tech hegemony) and those of pressure vs. Mexico are different. President Trump was probably aiming at exhibiting the effects of measures to reduce illegal immigrant numbers ahead of the start of the presidential election. As there is a strong objection even within the Republican Party, the risk of the imposition of tariffs on Mexican goods is low. Market caution about the resurgence of the tariff issue would thus be small. In addition, Mexico needs to make a compromise with the US, given the strongly adverse impact from the tariffs. It is thus highly possible that the measures to reduce illegal immigrant numbers will be effective to some extent, which would support the USD/JPY rate, even temporarily.

Will US touch on regulations on auto exports?

According to media reports, topics of the Japan-US finance minister meeting last weekend did not appear to include a currency clause. Regarding Japan-US trade talks, working-level and ministerial-level talks (by US Trade Representative Robert Lighthizer and Minister in charge of Economic Revitalization Toshimitsu Motegi) are to be held on 10-11 and 13 June, respectively. While the US would request Japan to increase imports of US agricultural products and auto production in the US, Japan would basically show a stance of accepting such requests. US remarks regarding regulations on auto exports would cause risk-off-driven yen appreciation, but the lack of such remarks would lead to risk-on-driven yen depreciation. The former would entail a greater market fluctuation than the latter.

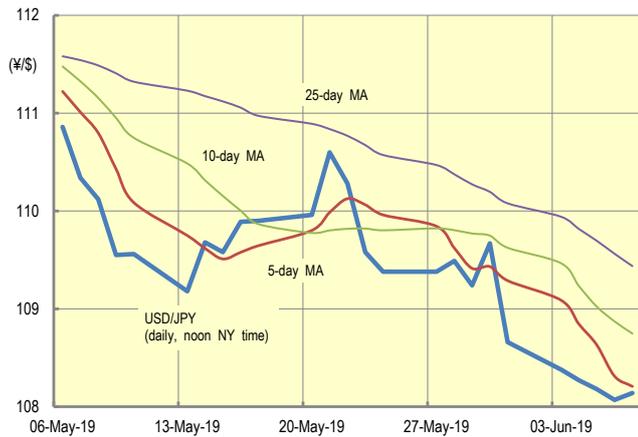
Sluggish Chinese imports and exports may cause risk-off sentiment

The market consensus of May China exports is -3.8% y/y (-2.7% in Apr) and that of imports is -3.8% y/y ($+4.0\%$). If a slowdown in exports and imports becomes visible due to the impact of US imposition of additional tariffs on Chinese goods on 10 May, this would cause risk-off-driven yen appreciation, despite a last-minute increase in imports ahead of the imposition of China's retaliatory tariffs on US goods from 1 June. The market consensus of May US retail sales is $+0.6\%$ m/m (-0.2% in Apr), partly on favorable auto sales. If the figure rises in line with expectations, it would work on risk-on-driven yen depreciation. However, signs of peaking out in employment and consumer sentiment may prevent the reading from exceeding the estimate.

Noteworthy currency: AUD

May Australian jobs data is to be released on 13 June. The market consensus of the unemployment rate is 5.1% vs. the 5.2% in April. If the rate declines in line with expectations after worsening for two consecutive months, it may serve as a factor toward market fluctuation (AUD appreciation) as the market is now factoring in a third rate cut. That said, expectations for a rate cut are unlikely to disappear easily amid mounting speculation for a rate cut by the Fed. The AUD/USD rate is moving in around the $0.686-0.7$ range, and the fluctuation range would depend on the level before the announcement of jobs data.

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

- 10-Jun **May China trade statistics**
 - Working-level Japan-US trade talks (till 11th)
- 11-Jun May US PPI
- 12-Jun May China CPI
- May US CPI
- 13-Jun May Australian jobs data
- Apr eurozone industrial production
- **Ministerial-level talks Japan-US trade talks**
- 14-Jun May China industrial production, retail sales
- May US retail sales**
- May US industrial production, capacity utilization rate
- Jun US University of Michigan's Consumer Sentiment Index**

Source; Compiled by Daiwa Securities.

Notes: Dates based on JST. ● indicates political/international events.

Chart: Weekly Forex Forecasts, Noteworthy Currencies/factors

| | 3 - 7 Jun 2019 (actual) | | 10 - 14 Jun 2019 (forecasts) | |
|---------|-------------------------|-------------|------------------------------|-------------|
| | Range | End of week | Range | End of week |
| USD/JPY | 107.8-108.7 | 108.2 | 107.5-109.5 | 108.5 |
| EUR/JPY | 120.7-122.8 | 122.6 | 121.6-123.6 | 122.6 |
| EUR/USD | 1.115-1.135 | 1.133 | 1.122-1.137 | 1.130 |

Noteworthy currencies and factors

| | |
|-----|---|
| AUD | Although unemployment rate is expected to decline, AUD is unlikely to strengthen beyond the range |
| CAD | Will higher crude oil prices work on appreciation of CAD, following improvement in jobs data? |
| CNY | Will China accept weak yuan, alongside stricter control on exports to US? |

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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