

Forex Market View

The USD/JPY direction implied by yuan weakening

- Will China make removal (or delay) of US tariffs a condition for talks?
- China's tolerance of yuan weakening indicates a confrontational posture with the US
- Declining US interest rates and risk-off moves putting downward pressure on the USD/JPY

USD/JPY forecast range (latest: noon New York time)

29 Aug – 27 Sep: Y104.00 – 108.0/\$ (Y105.86/\$ as of 28 Aug)

Forex Market View DSFE251

FICC Research Dept.

Chief FX Analyst
Yuji Kameoka
 (81) 3 5555-8764
 yuji.kameoka@daiwa.co.jp



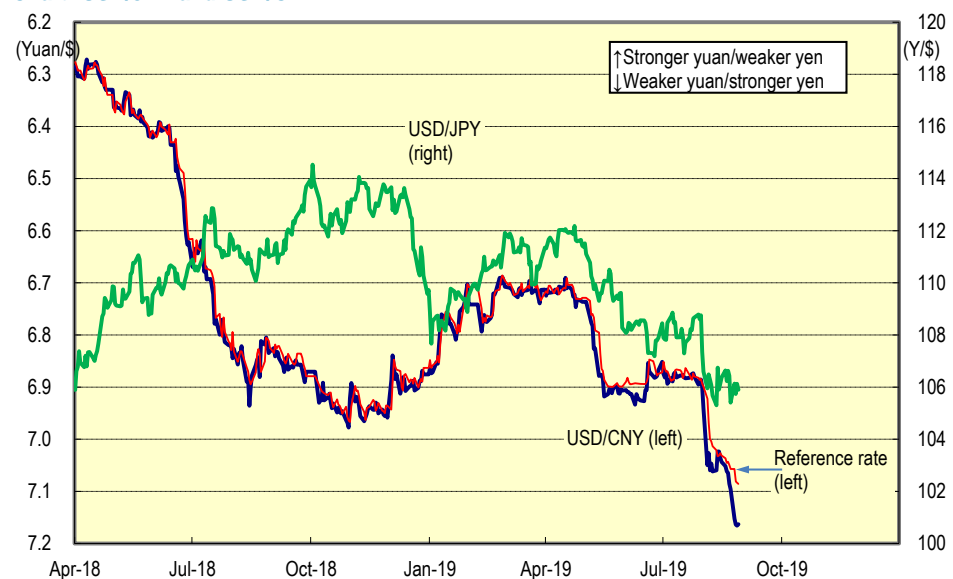
Daiwa Securities Co. Ltd.

USD/JPY, pushed lower by US-China tariff retaliation, rebounds on Trump comments

Will China make removal (or delay) of US tariffs a condition for talks?

In retaliation for the fourth round of additional tariffs on Chinese goods announced by the US on August 23, China announced additional tariffs of as much as 10% on \$75 billion worth of imports from the US, effective on September 1 for some products and on December 15 for the rest. The US immediately retaliated, announcing plans to raise the additional tariffs already placed on \$250 billion worth of Chinese goods from 25% to 30% (effective on October 1) and raise the tariff rate to be applied in the fourth round of additional tariffs from 10% to 15%. Markets turned risk off, and the USD/JPY fell below 104.5 at one point on August 26 before rebounding. Its rebound can be attributed to dollar buybacks driven by the sense that the USD/JPY had become too cheap and to an easing of concerns over the US-China confrontation in response to Chinese officials keeping their reference rate for the CNY/USD at 7.0570, nearly the same as the 7.0572 rate the day prior, as well as to comments from China's deputy prime minister expressing a desire to solve the trade dispute with the US through "calm" negotiations. Later, the USD/JPY extended its gains following comments from President Trump saying that China communicated the night before that it wants to resume talks with US trade negotiators and that he thinks China will soon agree to resume negotiations. China's foreign ministry assumed a confrontational posture, announcing it was resolutely opposed to new US tariffs and that if the US imposes new tariffs China will protect its interests by implementing new measures, but forex markets responded favorably to Trump's comments.

Chart: USD/JPY and USD/CNY



Source: Thomson Reuters; compiled by Daiwa Securities.

Will China make removal (or delay) of US tariffs a condition for talks?

The USD/JPY retreated on August 27, however. This retreat was probably caused not only by dollar selling based on real demand but also by doubts, created by messages from China's side the day prior, over whether the US-China trade dispute can be resolved. Then on August 27, China's Foreign Ministry said that it had not heard about a conference call with the US on trade and that it expects the US to stop its wrongful behavior and create an environment conducive to holding talks. This message could be interpreted to mean that China's stance is that it will not participate in trade talks unless the US removes or delays its additional tariffs and that it is prepared to take countermeasures.

China has set the yuan's value cheap relative to the currency basket

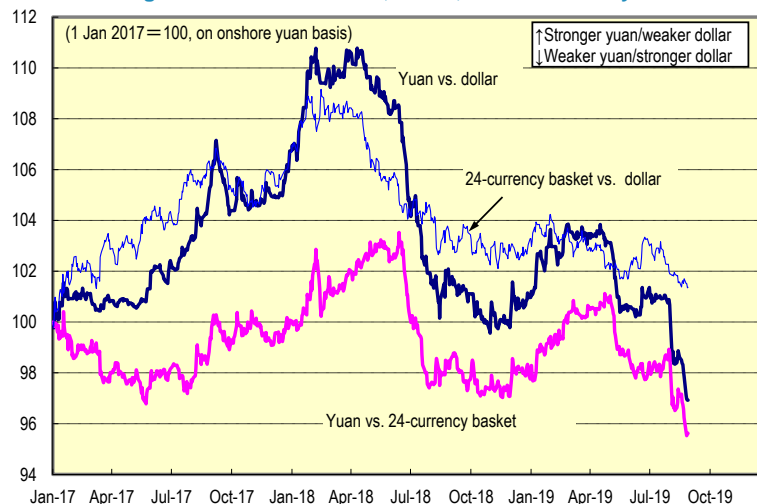
China's tolerance of yuan weakening indicates a confrontational posture with the US

The yuan fell in offshore markets on August 23 and dropped further when markets opened on Monday morning August 26. Nevertheless, the yuan's reference rate against the dollar was not lowered on August 26 relative to the previous trading day because on August 23 the yuan's weakening in offshore markets was limited and the euro and many other currencies rose against the dollar. The basket of 24 major currencies used as a reference by China's central bank appreciated by about 2% against the dollar. The central bank's decision to leave the yuan's reference rate nearly unchanged despite the rise in the currency basket is equivalent to its setting the yuan at a cheap level. After the currency basket weakened against the dollar on August 26, the People's Bank of China set its yuan reference rate at 7.0810 on August 27, a considerably weaker yuan level than the 7.0570 on the previous day, August 26.

China's tolerance of yuan weakening indicates a confrontational posture with the US

Because the yuan's reference rate against the dollar is considerably higher than the yuan's actual value in offshore markets (around 7.16), the reference rate could easily be lower, but if the authorities did not accept the lower market value of the yuan, they would have moved the reference rate in the direction of a stronger yuan. That they did not do so but instead moved it in the direction of a weaker yuan makes it likely that China is tolerating (or encouraging) a weaker yuan. In the past when the US has announced additional tariffs on China, the yuan has fallen significantly against not only the dollar but also the currency basket, as the authorities have tolerated a weaker yuan. This recent weakening of the yuan also suggests that China is not willing to resume trade talks unless the US removes or delays its additional tariffs and that it is prepared to take countermeasures.

Chart: Exchange Rate Indices of Yuan, Dollar, and 24-currency Basket

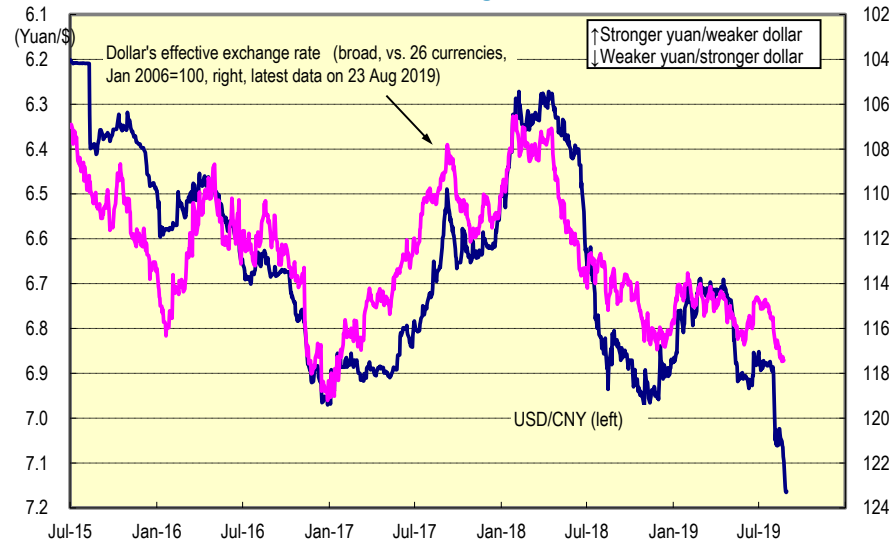


Declining US interest rates and risk-off moves putting downward pressure on the USD/JPY

Declining US interest rates and risk-off moves putting downward pressure on the USD/JPY

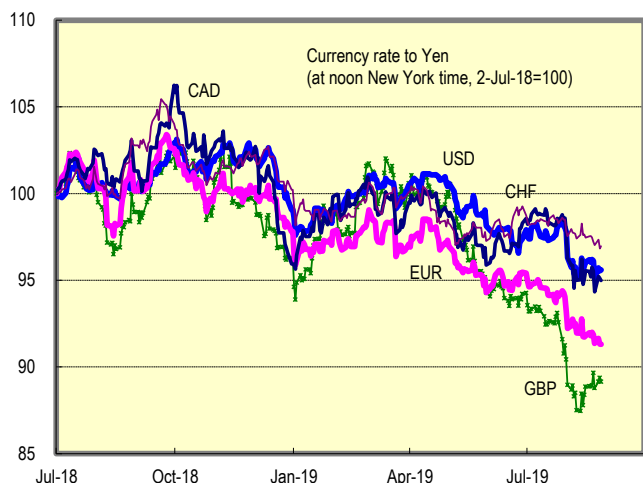
The view that US-China trade friction will have a negative impact on the US economy is consistent with expecting downward pressure on the dollar from a decline in US interest rates, but this time around it is upward pressures on the dollar from risk-off moves that are dominant. The dollar's broad effective exchange rate index is approaching the peak it reached in December 2016, right after the US presidential election. The weakening of the yuan has contributed greatly to this dollar appreciation. Yuan depreciation is likely to continue reinforcing risk-off dollar strengthening as long as the US-China conflict continues. President Trump, who wants to increase his support from workers employed in the agricultural and manufacturing sectors ahead of the US presidential election in 2020, would like to avoid a situation in which risk-off dollar appreciation occurs simultaneous with a decline in share prices. The US Treasury Secretary said there is "no intention of intervention at this time," but he also said that "situations could change in the future." The Trump administration has continued to pressure the Fed to cut rates, probably out of a desire to see US interest rates declines lead to a weaker dollar and higher share prices. A weakening of the dollar from declining US interest rates would probably soften the upward pressures on the dollar from risk-off moves and cause the dollar's real effective exchange rate to turn to a decline, but until markets turn risk on, the combination of dollar weakening from US interest rate declines and yen strengthening from risk-off moves is likely to have a downward impact on the USD/JPY.

Chart: USD/CNY and Dollar's Effective Exchange Rate



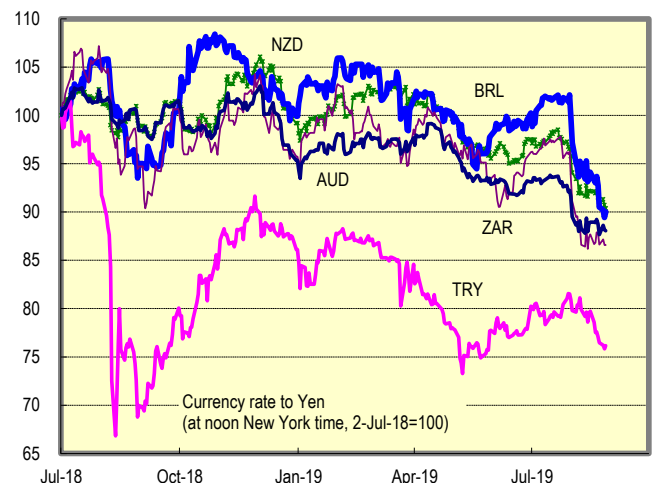
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Major Currencies/JPY FX Index



Source: Fed, Thomson Reuters; compiled by Daiwa Securities.

Chart: EM Currencies/JPY FX Index



Source: Fed, Thomson Reuters; compiled by Daiwa Securities.

Chart: Currency Exchange Rate Forecasts

	Actual		Forecast				
	29 Mar 2019	28 Jun 2019	Jul-Sep 2019	Oct-Dec 2019	Jan-Mar 2020	Apr-Jun 2020	Jul-Sep 2020
USD-JPY	110.7	107.8	106.0 104-112	105.0 101-110	105.0 101-110	106.0 101-110	108.0 103-112
EUR-JPY	124.3	122.7	117.5 115-127	115.5 113-125	115.5 113-125	119.0 113-125	123.0 115-127
GBP-JPY	144.2	137.0	128.5 125-138	126.0 123-136	126.0 123-136	129.5 123-136	134.0 126-139
AUD-JPY	78.6	75.6	72.0 70-79	70.5 68-77	70.5 68-77	73.5 68-77	76.5 70-79
CAD-JPY	82.8	82.4	79.0 77-86	78.0 75-84	78.0 75-84	80.0 75-84	82.5 77-86
NZD-JPY	75.5	72.4	68.0 66-75	66.5 64-73	66.5 64-73	69.0 64-73	72.5 66-75
TRY-JPY	20.0	18.7	18.0 16-20	17.0 15-19	17.0 15-19	18.0 15-19	19.0 16-20
ZAR-JPY	7.7	7.6	7.0 6.7-7.9	6.7 6.4-7.6	6.7 6.4-7.6	7.0 6.4-7.6	7.4 6.7-7.9
BRL-JPY	28.5	28.2	26.0 25-30	25.0 24-29	25.0 24-29	26.5 24-29	28.5 25-30
KRW-JPY (100 KRW)	9.7	9.3	8.7 8.5-9.5	8.4 8.1-9.1	8.4 8.1-9.1	8.7 8.1-9.1	9.0 8.4-9.4
CNY-JPY	16.5	15.7	14.8 14.4-15.9	14.6 14.2-15.7	14.6 14.2-15.7	15.0 14.2-15.7	15.5 14.5-16.0

Source: BIS, Fed, Thomson Reuters; compiled by Daiwa Securities.

Notes: 1) Actual shows market rates at noon NY time.

2) Forecast upper row; as of quarter end, lower row; range during quarter.

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.

■ The Significance of Registration

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.
- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

In addition to the above, Registered Credit Rating Agencies are subject to the supervision of the Financial Services Agency ("FSA"), and as such may be ordered to produce reports, be subject to on-site inspection, and be ordered to improve business operations, whereas unregistered Credit Rating Agencies are free from such regulations and supervision.

■ Credit Rating Agencies

[Standard & Poor's]

The Name of the Credit Rating Agencies group, etc

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)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

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>)

Assumptions, Significance and Limitations of Credit Ratings

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.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of March 7th, 2017, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

[Moody's]

The Name of the Credit Rating Agencies Group, etc

The name of the Credit Rating Agencies group: Moody's Investors Service ("MIS")

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

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website (https://www.moody.com/pages/default_ja.aspx))

Assumptions, Significance and Limitations of Credit Ratings

Credit ratings are Moody's Investors Service's ("MIS") current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. MIS defines credit risk as the risk that an entity may not meet its contractual, financial obligations as they come due and any estimated financial loss in the event of default. Credit ratings do not address any other risk, including but not limited to: liquidity risk, market value risk, or price volatility. Credit ratings do not constitute investment or financial advice, and credit ratings are not recommendations to purchase, sell, or hold particular securities. No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such rating or other opinion or information, is given or made by MIS in any form or manner whatsoever.

Based on the information received from issuers or from public sources, the credit risks of the issuers or obligations are assessed. MIS adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MIS considers to be reliable. However, MIS is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of April 16th, 2018, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Moody's Japan K.K. (https://www.moody.com/pages/default_ja.aspx)

[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)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Outline of Rating Policies" in the section of "Regulatory Affairs" on the website of Fitch Ratings Japan Limited (<https://www.fitchratings.co.jp/web/>)

Assumptions, Significance and Limitations of Credit Ratings

Ratings assigned by Fitch are opinions based on established criteria and methodologies. Ratings are not facts, and therefore cannot be described as being "accurate" or "inaccurate". Credit ratings do not directly address any risk other than credit risk. Credit ratings do not comment on the adequacy of market price or market liquidity for rated instruments. Ratings are relative measures of risk; as a result, the assignment of ratings in the same category to entities and obligations may not fully reflect small differences in the degrees of risk. Credit ratings, as opinions on relative ranking of vulnerability to default, do not imply or convey a specific statistical probability of default.

In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The assignment of a rating to any issuer or any security should not be viewed as a guarantee of the accuracy, completeness, or timeliness of the information relied on in connection with the rating or the results obtained from the use of such information. If any such information should turn out to contain misrepresentations or to be otherwise misleading, the rating associated with that information may not be appropriate. Despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

For the details of assumption, purpose and restriction of credit ratings, please refer to "Definitions of ratings and other forms of opinion" on the website of Fitch Rating Japan Limited.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of May 13th, 2016, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Fitch Rating Japan Limited (<https://www.fitchratings.co.jp/web/>)

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

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.

Corporate Name: Daiwa Securities Co. Ltd.
Registered: Financial Instruments Business Operator
Chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships: Japan Securities Dealers Association
The Financial Futures Association of Japan
Japan Investment Advisers Association
Type II Financial Instruments Firms Association