

# Forex Market View

## USD/JPY going where after FOMC meeting?

- With strong expectations of Fed rate cuts, US interest rates and the USD/JPY would top out
- Market's rate cut expectations change based on FOMC interest rate outlook
- If the Fed postures continued rate cuts, USD/JPY may peak below 109

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

18 Sep – 17 Oct: Y105.00 – 109.0/\$ (Y108.11/\$ as of 17 Sep)

Forex Market View DSFE252

FICC Research Dept.

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



Daiwa Securities Co. Ltd.

## With strong expectations of Fed rate cuts, US interest rates and USD/JPY would top out

### The USD/JPY has risen in step with US interest rates

US interest rates had been declining until the US implemented a portion of its fourth round of tariffs on Chinese goods on September 1 and then the August ISM manufacturing index dropped below 50 (to 49.1) for the first time in three years on September 3, but they have since rebounded. The trigger for this in mid-September was the decision by the US and China to hold face-to-face trade talks in early October. The passage in the UK of legislation delaying Brexit, China's removing of additional tariffs on some US goods, the US postponing its tariff hike for some Chinese goods, the fading of expectations of additional easing from the ECB, and the strength of US economic data all contributed to rising interest rates, lifting the 2-year Treasury yield to 1.81% and the 10-year yield to 1.90%. US rates declined somewhat after that in response to the sharp rise in oil prices caused by concerns that the attack on Saudi Arabian oil facilities would cut the kingdom's oil output in half. The USD/JPY, which had risen above 108 in step with rising US interest rates, could be pushed in either direction over the near term, depending on whether expectations of a US-China trade deal lead to a further increase in US interest rates or sharply rising oil prices amplify concerns over an economic slowdown and turn US interest rates to a declining trend.

### With strong expectations of Fed rate cuts, US interest rates and the USD/JPY would top out

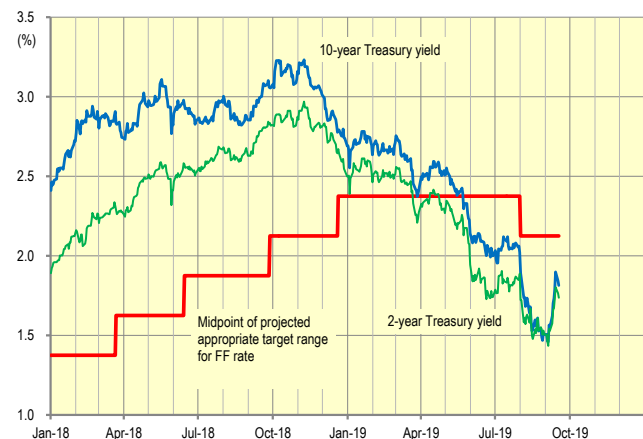
Depending on Fed rate-cut expectations, however, US long-term rates may have reached a level where they are unlikely to rise further. During the first half of past Fed rate cut cycles, the 10-year Treasury yield seemed to be capped at the fed funds rate. After that, the 10-year Treasury yield rose above the fed funds rate while the 2-year Treasury yield and the fed funds rate continued declining to the point where the 2-year Treasury yield was higher than the fed funds rate, after which the rate cuts stopped. In other words, during the first half of the rate-hike cycle, both intermediate and long-term rates dropped below the short-term

Chart: FF Rate Target, 2-year and 10-year US Treasury Yields



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: FF Rate Target, 2-year and 10-year US Treasury Yields



Source: Thomson Reuters; compiled by Daiwa Securities.

rate, inverting the yield curve, while in the second half of that cycle first the long-term rate then the intermediate rate rose back above the short-term rate and eliminated the yield inversion.

The Fed will likely lower its target range for the fed funds rate by a quarter point to 1.75-2.00% on 18 September, which would put the 10-year Treasury yield in the middle of that range at 1.875%. If the assumption is that Fed rate cuts will continue, both intermediate and long-term yields in the US would be likely to peak, as with the USD/JPY. If the assumption is that Fed rate cuts will not continue, however, first long-term rates then intermediate rates would rise above the short-term rate, and this would make a further rise in the USD/JPY more likely.

### Fed's monetary policy stance affects US interest rates

**Market's rate cut expectations change based on FOMC interest rate outlook**  
Expectation of a US-China trade agreement is a factor that lessens concerns over an economic slowdown, but an increase in oil prices caused by supply shortages is one that increases slowdown concerns. For the time being, the balance between those two factors will likely affect the trend in US interest rates, but there are other factors affecting US interest rates, namely the strength of US economic data and the monetary policy stance of the Fed. The economic and interest rate forecasts of FOMC members to be announced on September 18 will provide an important clue to ascertaining the Fed's monetary policy stance. In June, the last time that FOMC members announced their economic forecasts, relative to their forecasts in March they cut their inflation forecast for 2019 and 2020, and cut their long-term fed funds rate forecasts for 2020 and 2021, which changed their median forecast from rate hike to unchanged. Even in June, however, eight of the 17 members forecast a rate cut during 2019 (seven of them forecasting a 50bp reduction and one forecasting a 25bp reduction), and the Fed wound up cutting rates 25bp in July.

### Market's rate cut expectations change based on FOMC interest rate outlook

There has recently been an increase in the number of hawkish members traditionally opposed to a rate cut who have commented that a rate cut may be necessary depending on economic conditions. We expect there will be few members forecasting another rate cut in 2019 following a reduction in the fed funds rate in September to 1.75-2.00% (median of 1.875%), and the majority of interest rate forecasts will probably be split between no change and rate cut. If a large number of them forecast no change and the median of their fed funds rate forecasts for end-2019 winds up at 1.875%, we expect that to disappoint the market's rate cut expectations and trigger an increase in US interest rates. In contrast, if a large number of them forecast another rate cut and the median of their fed funds rate forecasts for end-2019 winds up at 1.625%, it would align the rate forecast of Fed officials, which had been high relative to the market forecast, with that of the market, and we expect that would amplify slightly the market's rate cut expectations and trigger a decline in US interest rates.

Chart: Economic Projections by FOMC Members

(as of Jun 2019; %)	Median				Central tendency			
	19	20	21	Longer run	19	20	21	Longer run
Change in real GDP	2.1	2.0	1.8	1.9	2.0-2.2	1.8-2.2	1.8-2.0	1.8-2.0
(Mar 2019 projection)	2.1	1.9	1.8	1.9	1.9-2.2	1.8-2.0	1.7-2.0	1.8-2.0
Unemployment rate	3.6	3.7	3.8	4.2	3.6-3.7	3.5-3.9	3.6-4.0	4.0-4.4
(Mar 2019 projection)	3.7	3.8	3.9	4.3	3.6-3.8	3.6-3.9	3.7-4.1	4.1-4.5
PCE inflation	1.5	1.9	2.0	2.0	1.5-1.6	1.9-2.0	2.0-2.1	2.0
(Mar 2019 projection)	1.8	2.0	2.0	2.0	1.8-1.9	2.0-2.1	2.0-2.1	2.0
Core PCE inflation	1.8	1.9	2.0		1.7-1.8	1.9-2.0	2.0-2.1	
(Mar 2019 projection)	2.0	2.0	2.0		1.9-2.0	2.0-2.1	2.0-2.1	
Appropriate FF rate	2.4	2.1	2.4	2.5	1.9-2.4	1.9-2.4	1.9-2.6	2.5-3.0
(Mar 2019 projection)	2.4	2.6	2.6	2.8	2.4-2.6	2.4-2.9	2.4-2.9	2.5-3.0

Source: Fed; compiled by Daiwa Securities.

Notes: Projections of change in real GDP and inflation are percent changes from fourth quarter of the previous year to fourth quarter of year indicated. Projections for unemployment rate are average in fourth quarter of year indicated. Projections for FF rate show midpoint of year-end target range.

Chart: FF Rate Projections by FOMC Members

Appropriate FF rate level projected by FOMC members and no. of members (FF rate as of Jun 2019 was 2.375%)	End-2019		End-2020		End-2021		Longer run	
	Mar-19		Jun-19		Mar-19		Jun-19	
	Mar-19	Jun-19	Mar-19	Jun-19	Mar-19	Jun-19	Mar-19	Jun-19
3.625					1			
3.5							1	
3.375			1		1			
3.25							1	2
3.125			2	1	1	1		
3							4	2
2.875	2		3		4	1		
2.75							4	3
2.625	4	1	4	2	5	3		
2.5							6	8
2.375	11	8	7	5	5	5		1
2.125		1		2		2		
1.875			7			5		
Median	2.375	2.375	2.625	2.375	2.625	2.375	2.750	2.500
Weighted average	2.493	2.169	2.669	2.213	2.743	2.316	2.797	2.695

Source: Fed; compiled by Daiwa Securities.

### Intermediate to long-term rates and the USD/JPY will change in response to Fed rate cut expectations

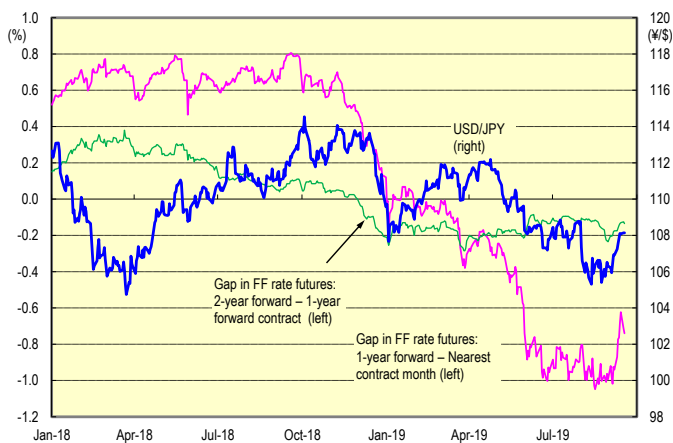
### If the Fed postures continued rate cuts, USD/JPY may peak below 109

The market is currently forecasting a 75bp reduction in rates over the next year and expects a very small rate cut for the year after that. If rate cut expectations for the next year change in response to FOMC members' fed funds rate forecast, intermediate and long-term rates are also likely to change in response. A weakening of rate cut expectations could possibly spark risk-off moves as a result of the market seeing that as being negative for the economy, but we think the upward impact on interest rates from a weakening of rate cut expectations would be stronger than the downward impact on interest rates from risk-off moves, and therefore think intermediate and long-term rates are more likely to rise. Conversely, a strengthening of rate cut expectations could possibly spark risk-on moves as a result of the market seeing that as being positive for the economy, but we think the downward impact on interest rates from a strengthening of rate cut expectations would be stronger than the upward impact on interest rates from risk-on moves, and therefore think intermediate and long-term rates are more likely to decline. This is why the market's fed funds rate forecast and the USD/JPY tend to change in the same direction.

### If the Fed postures continued rate cuts, USD/JPY may peak below 109

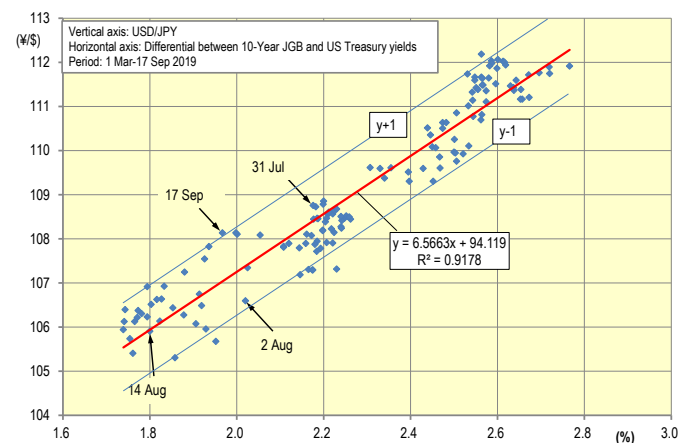
There has been a clear correlation between the Japan/US 10-year government bond spread and the USD/JPY since March this year, with a 0.1ppt widening (narrowing) of that spread tending to be associated with a 0.66 increase (decline) in the USD/JPY. The Japan/US 10-year government bond spread as of September 17 was about 1.97ppt, and based on the correlation the USD/JPY should be at  $107.0 \pm 1$ , vs. its actual level of 108.1. This means the USD/JPY is nearly at the top of the range estimated using the correlation with the Japan/US rate spread. Because the market has tended toward risk-on recently, the USD/JPY has been above its median estimate based on correlation with the rate spread (if the market turns risk-off, it would likely drop below that median). We think the Fed will probably signal a continuation of rate cuts at its September FOMC meeting, slightly strengthening the market's rate cut expectations and leading to a decline in US intermediate and long-term rates. With the Japan/US 10-year government bond spread at 1.85-2.05%, under risk-on conditions we think the USD/JPY is likely to trade within a range of 106.3-108.6.

Chart: USD/JPY, Rate Outlook by FF Rate Futures



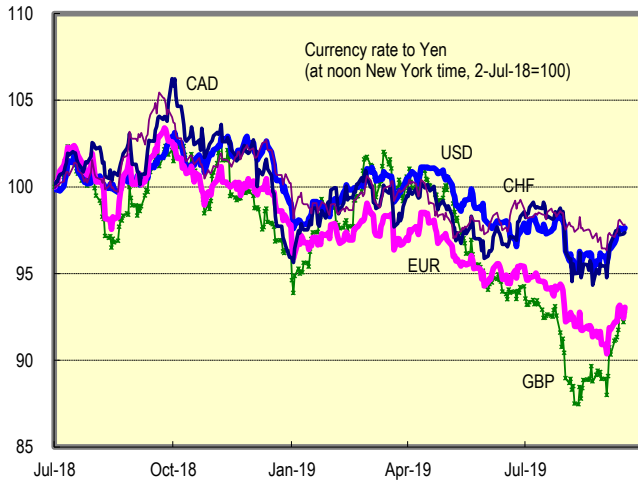
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: USD/JPY, Yield Spread Between 10-Year JGBs and US Treasuries



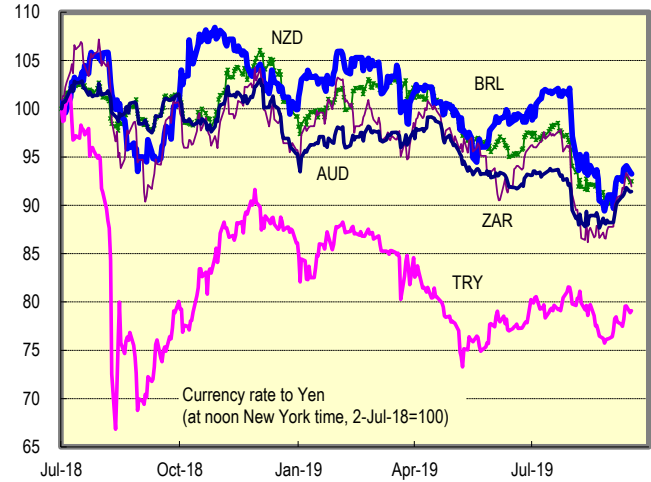
Source: Thomson Reuters; compiled by Daiwa Securities.

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	107.0	105.0	105.0	106.0	108.0
			104-110	101-109	101-109	101-110	103-112
EUR-JPY	124.3	122.7	119.0	115.5	115.5	118.5	123.0
			115-127	113-125	113-125	113-125	115-127
GBP-JPY	144.2	137.0	132.5	127.0	127.0	130.5	135.0
			125-138	123-136	123-136	123-136	126-139
AUD-JPY	78.6	75.6	73.0	70.5	70.5	73.5	76.5
			70-79	68-77	68-77	68-77	70-79
CAD-JPY	82.8	82.4	80.5	78.0	78.0	80.0	82.5
			77-86	75-84	75-84	75-84	77-86
NZD-JPY	75.5	72.4	68.5	66.5	66.5	69.0	72.5
			66-75	64-73	64-73	64-73	66-75
TRY-JPY	20.0	18.7	18.5	17.2	17.2	18.5	19.5
			16-20	15-19	15-19	15-19	16-20
ZAR-JPY	7.7	7.6	7.2	6.8	6.8	7.1	7.5
			6.7-7.9	6.4-7.6	6.4-7.6	6.4-7.6	6.7-7.9
BRL-JPY	28.5	28.2	26.0	25.0	25.0	26.5	28.5
			25-30	24-29	24-29	24-29	25-30
KRW-JPY (100 KRW)	9.7	9.3	8.8	8.4	8.4	8.7	9.0
			8.5-9.5	8.1-9.1	8.1-9.1	8.1-9.1	8.4-9.4
CNY-JPY	16.5	15.7	15.0	14.6	14.6	15.0	15.5
			14.4-15.9	14.2-15.7	14.2-15.7	14.2-15.7	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](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 16<sup>th</sup>, 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](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 13<sup>th</sup>, 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