



بنك الإمارات دبي الوطني
Emirates NBD

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FX Week

USD/JPY inspires broad USD gains

After spending much of the last month within ranges, the USD rallied strongly on Friday, rebounding from its lows of earlier in the week. In the process it made significant progress towards meeting our medium term forecasts, reaching and in some cases exceeding some of our 1-month targets. USD/JPY's break of 100 was the catalyst for its gains, reaching a new cycle high of 101.98, but the moves were also broad based, with EUR/USD closing below 1.30, the AUD dropping below parity, and USD/CHF also breaching our 1-month forecast. USD gains were also recorded in other currency pairs including against GBP, CAD and the NZD.

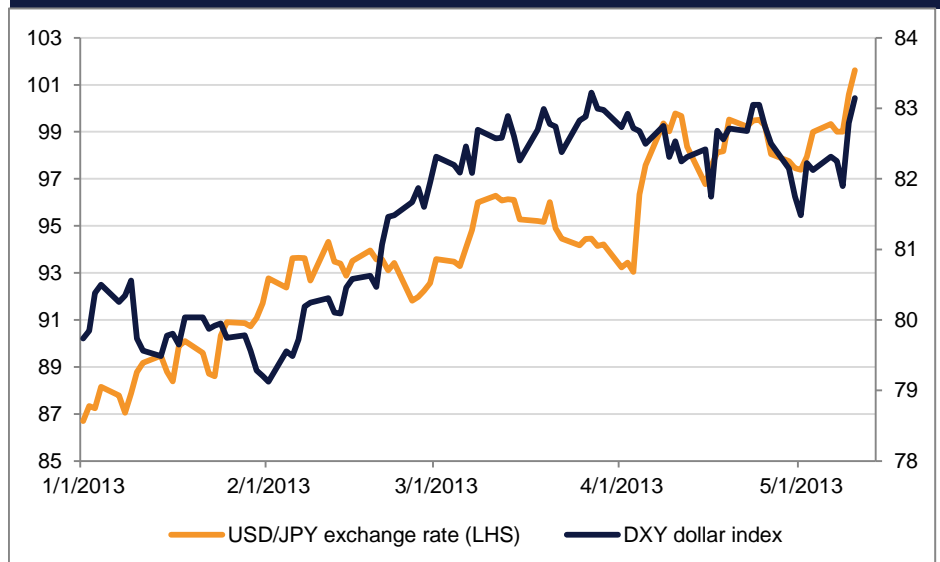
Fed's QE reduction still on course

The context for these moves came with economic data showing the US labour market continuing to improve in May, maintaining the prospect of some kind of reduction in QE over the rest of the year. Indeed, the Wall Street Journal (WSJ) published an article over the weekend suggesting that the Fed has already worked out a strategy for winding down its bond buying program. By contrast, other central banks are now much more actively engaged in pursuing their own forms of monetary stimulus, from the BOJ to the ECB, BOE, SNB and RBA, along with a number of emerging market central banks. This contrast should help to keep the USD supported against these currencies.

According to the WSJ article the Fed will reduce their asset purchase program in very slow and gradual steps, varying purchases depending on unemployment and inflation numbers. Fed Chairman Bernanke's comments over the weekend were also instructive as he warned against excessive risk-taking, a hint perhaps that the era of cheap money in the US may finally be nearing an end.

The coming week, may not show the consistency of improvement in the US economy that might be wished for, with retail sales and industrial production data expected to be relatively soft, falling by -0.3% and -0.1% respectively in April. However, CPI will be of particular interest given the recent decline in the Fed's preferred inflation measure that is currently 1.1%, well below the Fed's 2.5% target.

USD/JPY inspires broad USD gains



Source: Bloomberg, Emirates NBD Research

While the headline CPI rate is expected to decline to 1.3% from 1.5% in March, the core rate is expected to remain more stable at 1.8%, helping to reduce the argument for any fresh monetary stimulus for the time being. Focus will also fall on the regional Fed surveys, as well as on weekly jobless claims which sparked the USD's rally last Thursday and which are a good leading indicator of the unemployment rate.

G7 underpins USD/JPY

Over the weekend the G7 appeared to give the green light to the Japanese authorities to continue with their recent pro-growth policies, seemingly accepting Japan's argument that its reflationary policies are aimed at reviving the domestic economy primarily and not at depressing the JPY. This should help to keep USD/JPY underpinned in the coming week. Data released on Friday also suggested that Japanese investors are finally beginning to invest their money overseas rather than repatriate it home. Released after USD/JPY had already moved over 100, the weekly flow of funds data from the Bank of Japan showed that Japanese investors have started to buy foreign bonds again. This was taken as validation of USD/JPY's move higher and provided its gains with further impetus. Japanese data to be released this week may be secondary to the broad message from the G7, but Q1 GDP is still expected to show the Japanese economy on a recovering trend, something that will also help to keep policymakers believing that they are moving in the right direction.

EUR concerns to grow

Q1 GDP will also be reported for the Eurozone in the coming week, but here the expectation is for another quarter of negative growth, effectively turning the Eurozone's downturn into its longest ever recession. It is not surprising that against this background Eurozone officials are becoming more concerned about the potential ramifications of a strong EUR exchange rate. The ECB has maintained that it is ready to act again on interest rates if necessary, although it is unclear what a benefit a further 25bps rate cut will actually achieve from its existing 0.50%. In contrast talking the EUR down might be a more effective way of providing a stimulus to the Eurozone economy. An external devaluation of the EUR would aid competitiveness at a time when internal devaluations through cost cutting are starting to face stiff opposition. We would not be surprised therefore if the French government for instance starts to agitate more forcefully for a weaker EUR, given that its economy is one of the largest in the region that is struggling to implement austerity measures and reforms.

GBP falls from a higher base

GBP also lost ground as the USD rallied, falling below 1.54, but its starting point was already much higher than we envisaged a month ago as the UK's economic outlook has begun to show a few signs of improvement. Indeed, reports over the weekend suggest that revisions to 2012 data when they are released next month will show that the UK never experienced a double-dip recession in 2012 after all. In general GBP should continue to reflect the USD's firmer tone, especially as the upcoming labour market data is not expected to be particularly encouraging.

More attention, however, will probably fall on the Bank of England's *Inflation Report*, and the trajectory envisaged for inflation over the coming two years. Greater confidence that the inflation rate will return towards the Bank's 2.0% target will provide more grounds for expecting the Bank to endorse further asset purchases in coming months, probably once the new Governor Mark Carney takes office from July. Although some improvement in the UK's data might be discernible, it is a long way from becoming a self-sustaining recovery, with our own forecasts being for growth of just 0.7% this year. In particular, with the UK's trade balance still in heavy deficit in March (-GBP9bn), the argument for further GBP weakness remains persuasive in our view.

AUD struggles to hold parity

The AUD's fall on Friday was also striking, taking it briefly below parity before it ended the week below our 1-month forecast of 1.01. Last week of course the RBA cut interest rates to 2.75%, which had been our expectation, but it came earlier than many others in the market had expected. The elevated AUD as well as relatively benign inflation paved the way for the move, but we suspect that the authorities are becoming more concerned about the outlook for the mining sector, as capital expenditure (capex) investment in this area starts to slow. This being the case we would not rule out a further cut in interest rates should the evidence of reduced capex continue, which will further erode the AUD's support in coming months.

As always, the outlook for demand in Australia's chief export markets such as China will be an important variable as well. The last month has seen mixed Chinese data overall, with weaker than expected GDP growth in Q1, subdued PMI activity data, but firmer than expected exports for the month of April. This week will see industrial production, retail sales, and fixed asset investment complete the picture for the first month of Q2. The markets expect a small improvement from March, especially following stronger credit growth, but should a rebound fail to materialize then it will only compound the gloom around the commodity sector, and by extension the AUD.

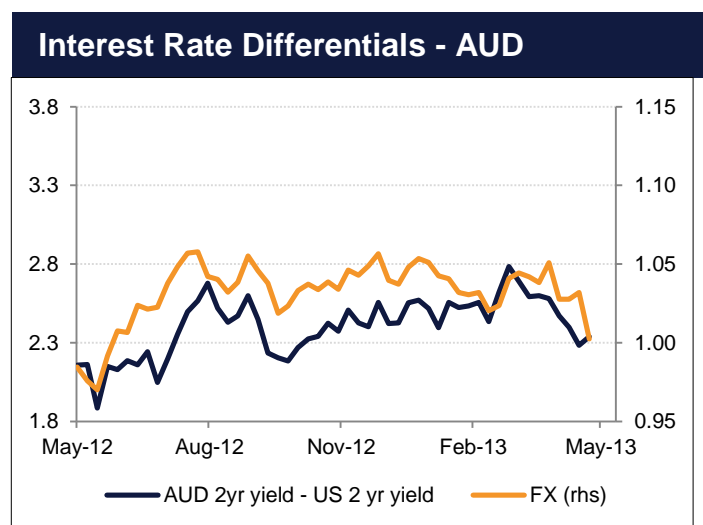
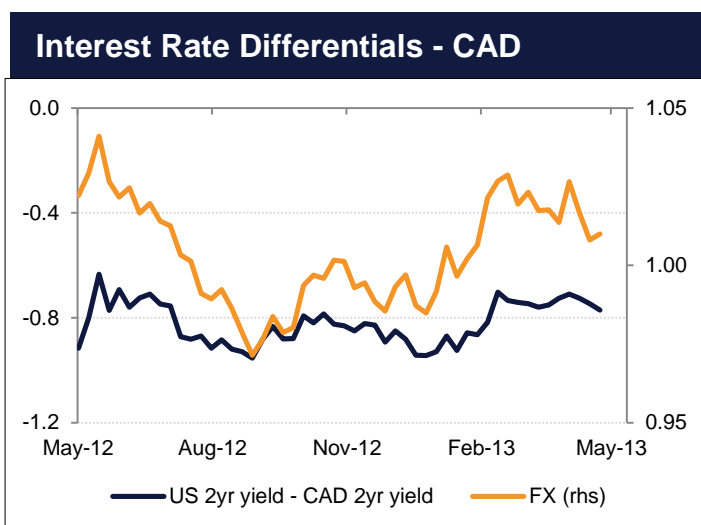
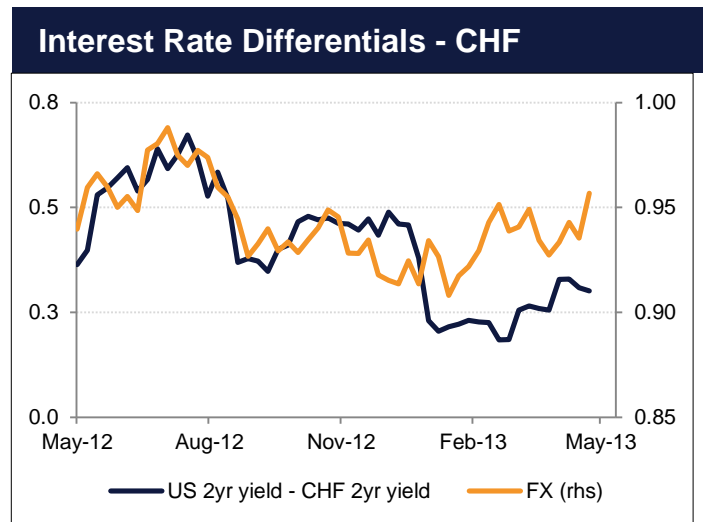
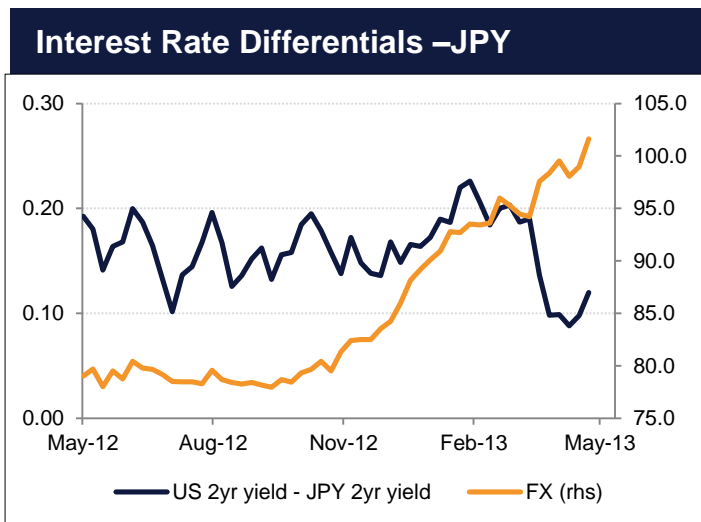
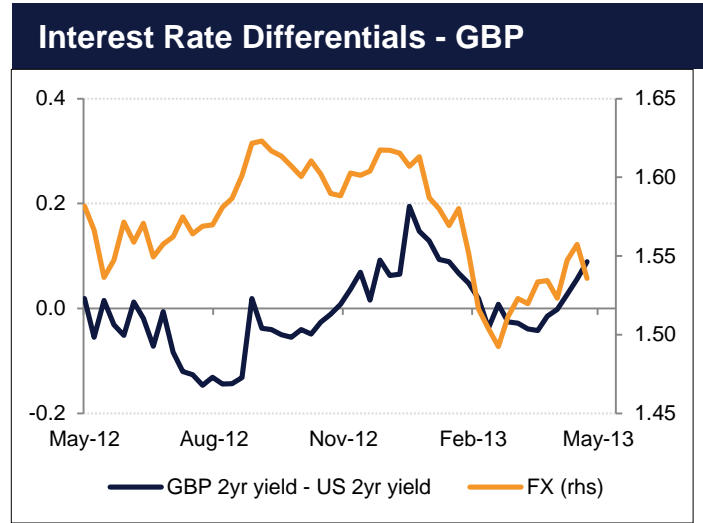
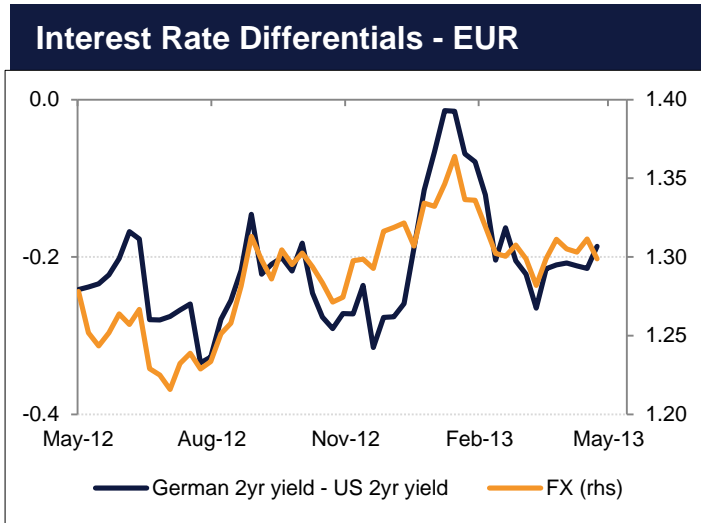
We will be updating our FX forecasts in the coming week when we release our May Monthly Insights publication.

FX Forecasts - Major						Forwards		
	Spot 10.05	1M	3M	6M	12M	3M	6M	12M
EUR / USD	1.2989	1.28	1.25	1.20	1.15	1.2996	1.3004	1.3024
USD / JPY	101.62	100.0	103.0	105.0	110.0	101.57	101.50	101.30
USD / CHF	0.9568	0.95	0.98	1.02	1.08	0.9559	0.9549	0.9522
GBP / USD	1.5358	1.48	1.45	1.42	1.45	1.5349	1.5342	1.5333
AUD / USD	1.0025	1.01	0.97	0.94	0.90	0.9961	0.9900	0.9782
USD / CAD	1.0100	1.03	1.05	1.07	1.10	1.0121	1.0143	1.0186
EUR / GBP	0.8457	0.86	0.86	0.85	0.79	0.8466	0.8475	0.8494
EUR / JPY	132.00	128.0	129.0	126.0	126.5	132.00	132.00	132.00
EUR / CHF	1.2432	1.22	1.22	1.22	1.24	1.2427	1.2421	1.2405
FX Forecasts - Emerging						Forwards		
	Spot 10.05	1M	3M	6M	12M	3M	6M	12M
USD / SAR*	3.7503	3.75	3.75	3.75	3.75	3.7504	3.7508	3.7515
USD / AED*	3.6735	3.67	3.67	3.67	3.67	3.6736	3.6736	3.6736
USD / KWD	0.2852	0.282	0.285	0.282	0.28	0.2856	0.2867	0.2862
USD / OMR*	0.3850	0.38	0.38	0.38	0.38	0.3849	0.3847	0.3847
USD / BHD*	0.3770	0.376	0.376	0.376	0.376	0.3774	0.3778	0.3785
USD / QAR*	3.6409	3.64	3.64	3.64	3.64	3.6430	3.6446	3.6492
USD / INR	54.8000	53.50	53.00	52.00	51.00	54.8074	54.8153	54.8317
USD / CNY	6.1417	6.23	6.22	6.20	6.25	6.1973	6.1977	6.2221

*Denotes USD peg

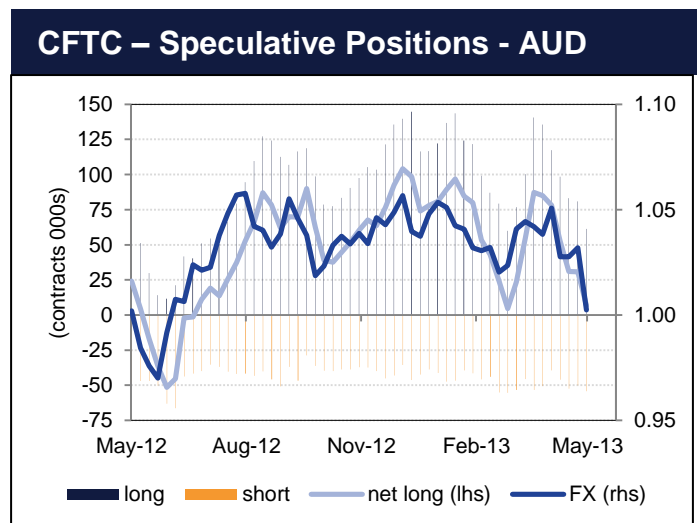
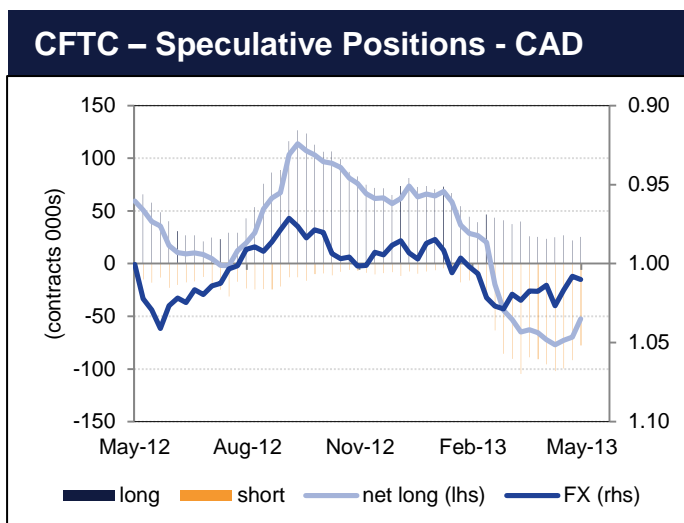
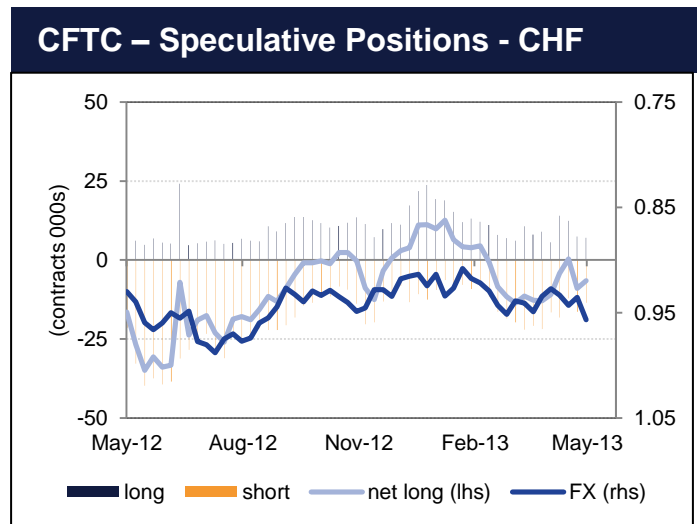
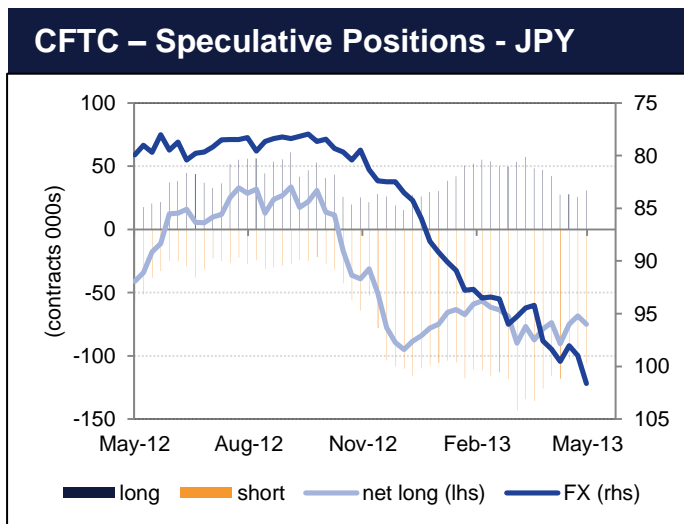
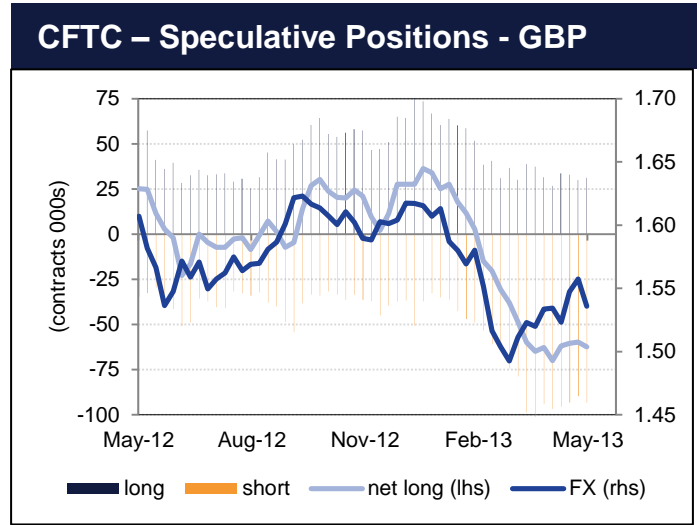
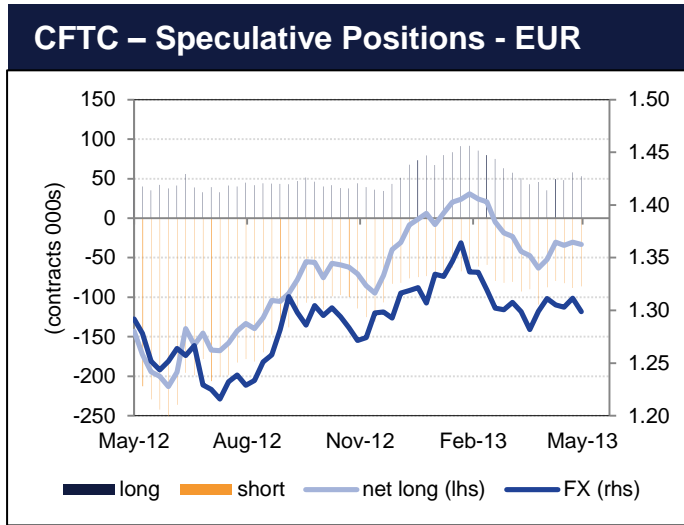
Source: Bloomberg, Emirates NBD Research

Major Currency Pairs and Interest Rates



Source: Bloomberg, Emirates NBD Research

Major Currency Positions



Source: Bloomberg, Emirates NBD Research

Economic Calendar

Date	Country	Event
13-May	China	Industrial Production
	China	Retail Sales
	Switzerland	Retail Sales
	US	Advance Retail Sales
	India	CPI
14-May	Russia	Refinancing Rate
	Germany	CPI
	Italy	CPI
	India	WPI
	Eurozone	Industrial Production
15-May	Germany	ZEW Survey
	Japan	Tertiary Industry Index
	France	GDP
	France	CPI
	Italy	GDP
	UK	ILO Unemployment Rate
	Eurozone	GDP
	UK	Bank of England Inflation Report
	US	MBA Mortgage Applications
	Brazil	Retail Sales
	US	Empire Manufacturing
	US	PPI
	Canada	Existing Homes Sales
16-May	US	Industrial Production
	US	NAHB Housing Market Index
	Japan	GDP
	Japan	Industrial Production
	Italy	Trade Balance
	Eurozone	CPI
	US	CPI
17-May	US	Initial Jobless Claims
	US	Housing Starts
	US	Philadelphia Fed
	Canada	CPI
	US	U of Michigan Confidence

Source: Bloomberg

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