بنك الإمارات دبي الوطني
Emirates NBD

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FX Week

USD strength broadens out

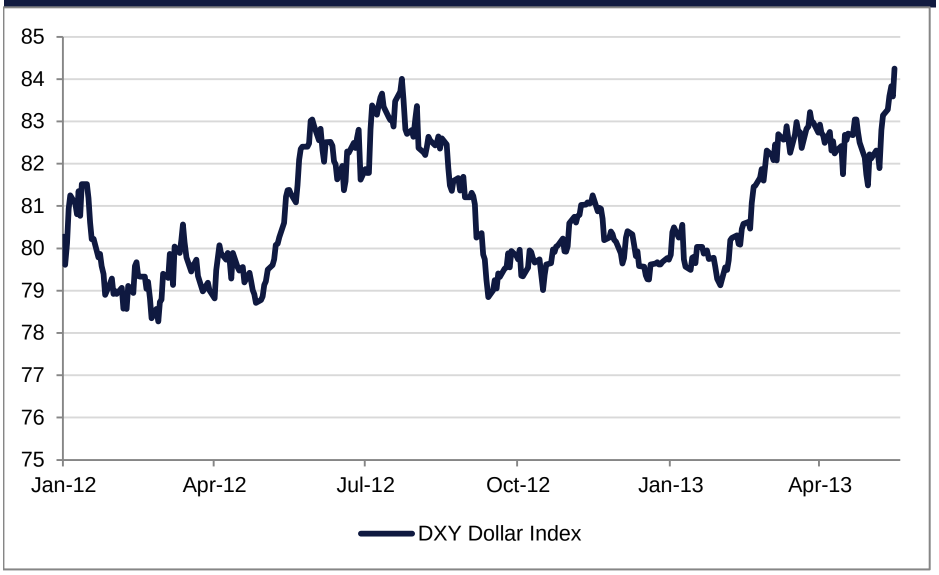
A week ago we warned that the upcoming US data may prove something of a challenge for the USD, but despite last week's economic news being disappointing overall the USD continued to strengthen. USD/JPY made new cycle highs above 103, EUR/USD briefly reached 1.28 and the AUD continued its recent sharp descent, nearing our three-month forecast of 0.97. In our latest Monthly Insights publication released last week, we upgraded our one-month forecasts to allow for more USD strength but in many cases these targets are already close to being met if they have not been already. Consequently the DXY dollar index has also reached new ten-month highs above 84.0.

…As QE withdrawal debate heats up

Although the economic data was softer than expected (regional Fed surveys fell back, industrial production sank, inflation eased and weekly jobless claims rose) the markets have been inclined to look through it, instead focusing on the better than expected releases (retail sales, consumer confidence) and on the bigger weaknesses elsewhere. Also despite the relative softness of the latest US data there has been no shortage of Fed officials still discussing the likely timing of QE withdrawal. The latest of these was San Francisco Fed President Williams who even suggested that the Fed could start to relax its asset purchases by the summer. This seems a little premature to us, but what does seem certain is that the Fed will be the first to start to withdraw its monetary stimulus, when others are still actively engaged in theirs, and the pricing in of this process will create a policy divergence which will be USD supportive for some time to come.

This week's testimony by Fed Chairman Bernanke will be the main event of the week, and could further complicate matters, as Bernanke is thought unlikely to encourage any premature easing speculation. On the same day (Wednesday), however, the minutes of the May FOMC meeting will also be released which can be expected to show how far along the 'tapering' discussion actually is. Separately, the USD's structural underpinnings appear to be also improving, with the US Congressional Budget Office forecasting the budget deficit to shrink to 4.0% in 2013-2014, and to 2.1% by 2015, down sharply from the double digit readings of 2009. The US trade deficit is also narrowing, helped by falling oil prices as well as lower oil imports, which are a result of America's shale oil boom.

USD index reaches new ten-month highs



Source: Bloomberg, Emirates NBD Research

Thus it is not only short-term cyclical factors that are propping the USD up, but longer-term structural improvements are also underway. Durable goods orders, existing and new home sales, as well house price data make up the main US economic releases of the week.

EUR trading heavily

The Eurozone's cyclical and structural backdrop is very different, with growth sinking again in Q1 (by -0.2%), and with its big structural challenges of reducing deficits and introducing reforms being postponed ever further into the future. Demonstrations over the weekend in Italy illustrate the tension resulting from the requirement to meet prescribed deficit targets and the need to maintain social and political harmony. The loss of momentum in the 'core' was the most striking feature of the GDP reports, showing France back in recession and Germany barely growing. That the ECB eased monetary policy earlier this month largely for the benefit of these countries is an ominous sign for the rest whose economies have been contracting for longer. It suggests that monetary policy that already appears 'too little and too late' for the 'core' countries is even more inappropriately set for the periphery, which will maintain pressure for more interest rate cuts before the end of the year.

It is also proving difficult to get a consensus for other steps aimed at easing the region's credit crunch, with German Finance Minister Schaeuble describing a proposal to purchase asset backed securities by the ECB as 'covert state financing'. May PMI data for the Eurozone will be released in the coming week as will the German IFO survey. These will shed further light on Q2 growth prospects, with few signs so far that a significant rebound is likely. In this context the EUR is expected to remain vulnerable and trade heavily, with a test of the year's lows against the USD at 1.2745 quite likely.

USD/JPY still in the driving seat

USD/JPY remains the pivotal currency pair of the moment, with the immediate focus being on Japanese investors and their appetite for overseas assets. So far it seems there has been a modest increase in net outflows in recent weeks. A Bank of Japan meeting in the coming week is unlikely to add to the stimulus already announced (a doubling of the BOJ's balance sheet, a doubling in base money supply, and doubling of the inflation target), with the latest Q1 GDP data (3.5%) already partly testament to the more positive policy noises coming from the Abe government over that period. The BoJ is, however, expected to discuss the impact of the surge in JGB yields, as there have been concerns over the volatility that has seen the 10-year JGB yield climb from 0.436% on April 4 when the Bank announced its' massive buyback operation, to an intraday high at 0.92% last Wednesday. Policymakers will also discuss the various risks associated with the move up in rates, and the potential impact on the 2% inflation target. They may also revise their economic outlook higher.

Meanwhile, PM Abe outlined his plans to keep that recovery on track on Friday, including a focus on agriculture, tourism, transport and energy. These subjects will be included in a broader policy review which is expected to be delivered in June before the next G8 meeting, intended to help fix Japan's structural inefficiencies, and prevent the current fiscal and monetary expansion from being wasted. Certainly momentum is with the Japanese government at the moment with sharp JPY losses feeding equity market gains in a virtuous circle that should eventually boost confidence. The key now will be how businesses respond as capital spending was the prominent missing link in the latest GDP report. Should this begin to lift, then the prospects for the economy will improve dramatically, with our 1.5% forecast for this year already looking too cautious. We raised our one-month USD /JPY forecast to 103 last week, with our three-month forecast also raised to 105.

GBP/USD playing catch-up

GBP has also lost ground as the USD rallied, falling below 1.53 over the last week, after threatening to move above 1.56 earlier this month. However, its starting point is clearly much higher than we envisaged a month ago as the UK's economic outlook has begun to show a few signs of improvement. In general, GBP should continue to reflect the USD's firmer tone, and may see some further catch-up with the losses being experienced elsewhere, as the likelihood of further monetary stimulus by the Bank of England only appears to have been postponed, not removed.

Nonetheless, we still have to acknowledge that the starting point for GBP/USD is better than we had thought, and we are consequently making a few adjustments to our forecasts as a result. Our one-month forecast has been raised to 1.50, and our 3-month forecast to 1.48, but beyond this timeframe we still suspect that renewed BOE asset purchases in H213 will exert further downward pressure on the GBP over six months and beyond. The coming week will see UK April Inflation data, which should show a welcome fall, providing further room for the BoE to ease policy as and when necessary. The conclusion of IMF meetings in the UK should also be of interest, given previous criticism that the Chancellor was engaging in too much austerity rather than promoting growth. But with the Q1 GDP revision also likely to remind that the latest growth data was at least positive, any such criticism may be quite muted.

AUD to test 2012 lows

The AUD's fall has also been striking, taking it below parity and well beneath 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 relatively benign inflation environment paved the way for the move, but we suspect that the authorities are becoming more concerned about the strength of the AUD, at a time when other regional central banks like the RBNZ are taking specific actions to depress their exchange rates. Concerns are also rising about the outlook for the mining sector, as capital expenditure investment in this area starts to slow. This being the case we would not rule out a further cut in interest rates, the prospect of which will further erode the AUD's support in coming months. A re-test of the 2012 lows of 0.9582 would appear to be on its way, from which we would not be surprised to see it bounce a little consistent with our three-month forecast of 0.97.

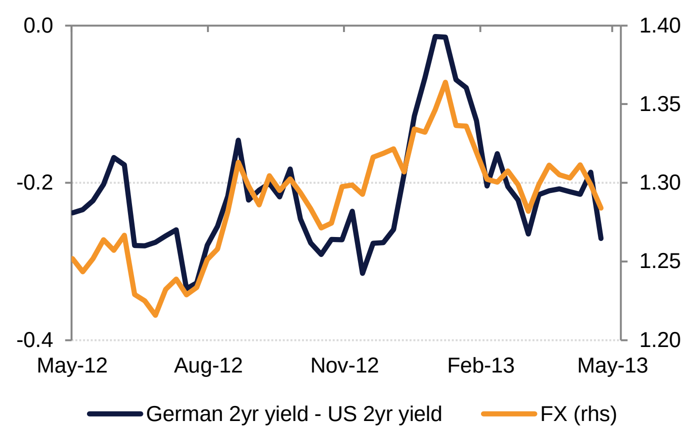
FX Forecasts - Major						Forwards		
	Spot 17.05	1M	3M	6M	12M	3M	6M	12M
EUR / USD	1.2839	1.27	1.25	1.20	1.15	1.2847	1.2858	1.2884
USD /JPY	103.21	103.0	105.0	107.0	110.0	103.16	103.09	102.88
USD / CHF	0.9727	0.98	1.00	1.04	1.08	0.9718	0.9706	0.9678
GBP / USD	1.5169	1.50	1.48	1.45	1.45	1.5161	1.5154	1.5148
AUD / USD	0.9730	0.98	0.97	0.94	0.90	0.9667	0.9609	0.9498
USD / CAD	1.0281	1.03	1.05	1.07	1.10	1.0303	1.0325	1.0367
EUR / GBP	0.8461	0.85	0.84	0.83	0.79	0.8471	0.8481	0.8502
EUR / JPY	132.51	131.0	131.0	128.4	126.5	132.51	132.51	132.51
EUR / CHF	1.2484	1.24	1.25	1.25	1.24	1.2481	1.2476	1.2464

FX Forecasts - Emerging						Forwards		
	Spot 17.05	1M	3M	6M	12M	3M	6M	12M
USD / SAR*	3.7503	3.75	3.75	3.75	3.75	3.7503	3.7505	3.7512
USD / AED*	3.6734	3.67	3.67	3.67	3.67	3.6734	3.6733	3.6730
USD / KWD	0.2862	0.282	0.285	0.282	0.28	0.2873	0.2877	0.2887
USD / OMR*	0.3850	0.38	0.38	0.38	0.38	0.3847	0.3847	0.3847
USD / BHD*	0.3770	0.376	0.376	0.376	0.376	0.3775	0.3778	0.3785
USD / QAR*	3.6413	3.64	3.64	3.64	3.64	3.6434	3.6451	3.6500
USD / INR	54.8850	53.50	53.00	52.00	51.00	54.8927	54.9003	54.9163
USD / CNY	6.1412	6.23	6.22	6.20	6.25	6.2031	6.2126	6.2386

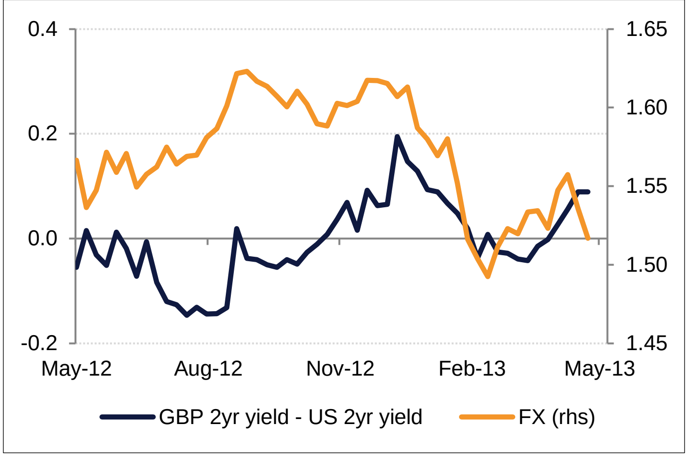
**Denotes USD peg*
Source: Bloomberg, Emirates NBD Research

Major Currency Pairs and Interest Rates

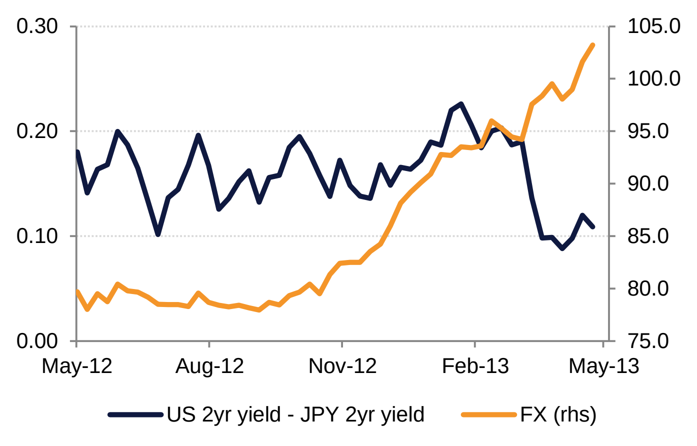
Interest Rate Differentials - EUR



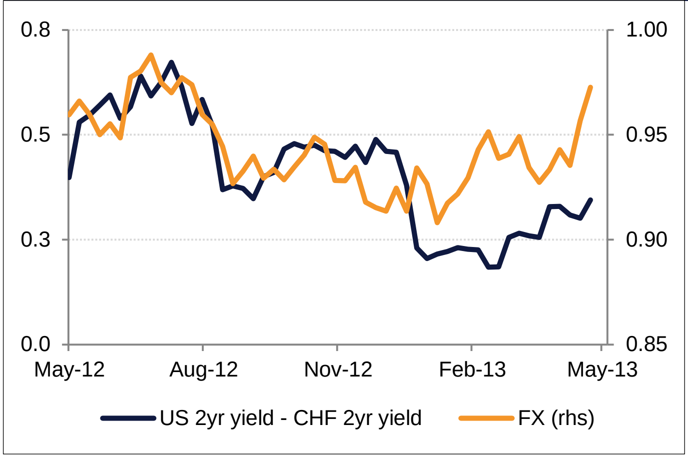
Interest Rate Differentials - GBP



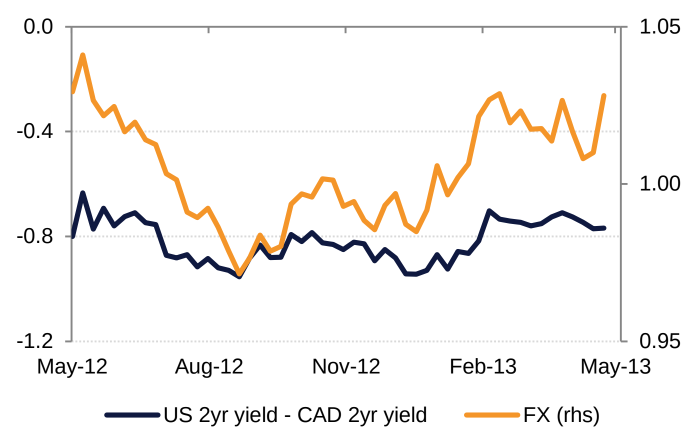
Interest Rate Differentials –JPY



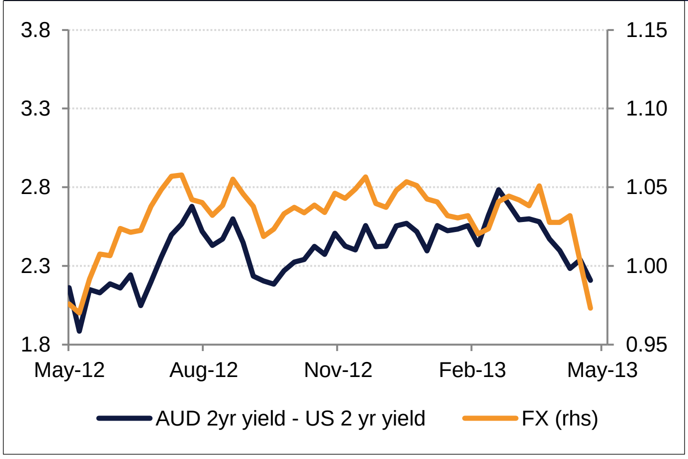
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD



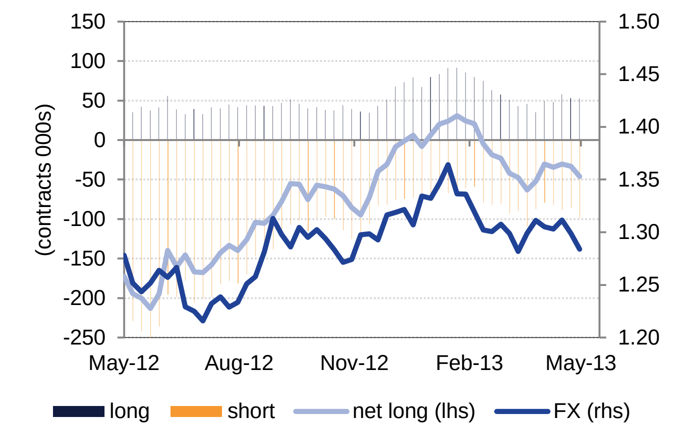
Interest Rate Differentials - AUD



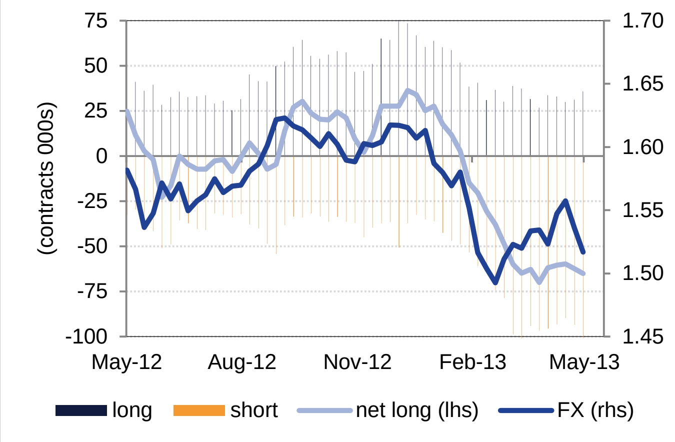
Source: Bloomberg, Emirates NBD Research

Major Currency Positions

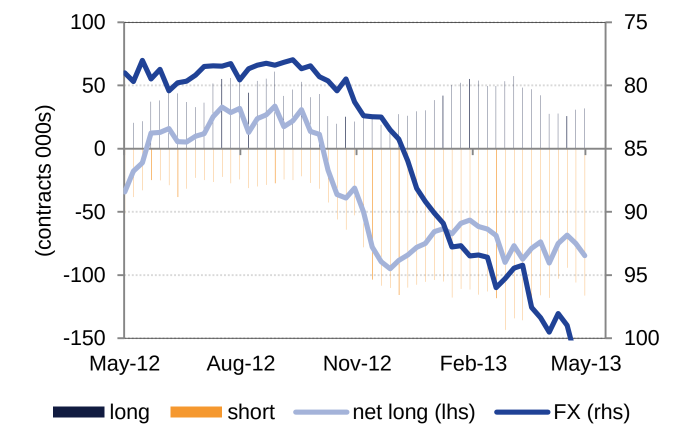
CFTC – Speculative Positions - EUR



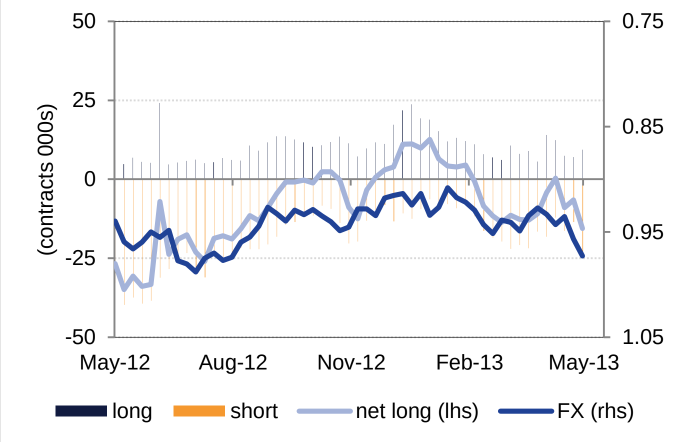
CFTC – Speculative Positions - GBP



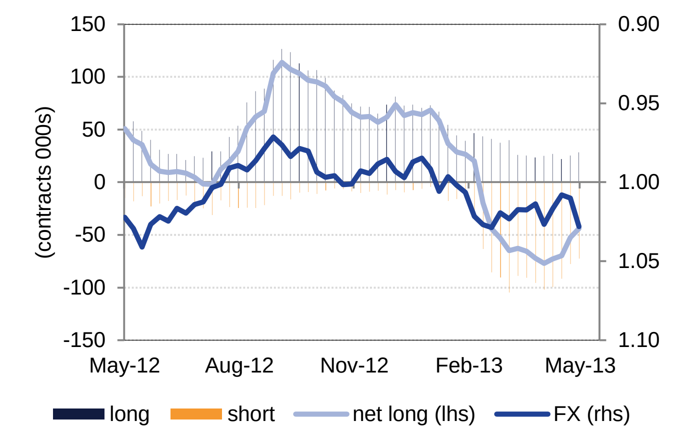
CFTC – Speculative Positions - JPY



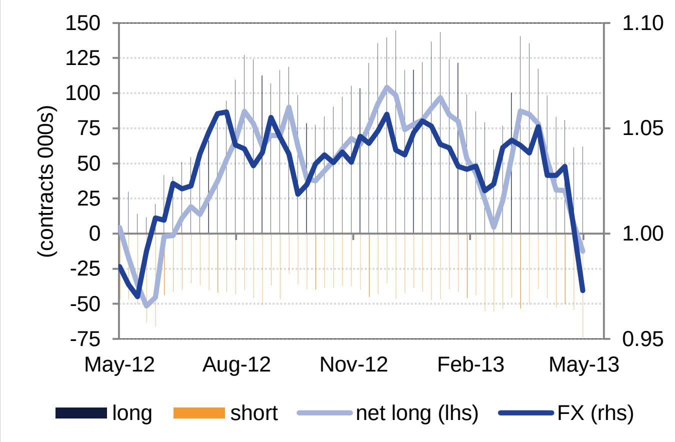
CFTC – Speculative Positions - CHF



CFTC – Speculative Positions - CAD



CFTC – Speculative Positions - AUD



Source: Bloomberg, Emirates NBD Research

Economic Calendar

Date	Country	Event
20-May	US	Chicago Fed Nat Activity Index
	Brazil	Trade Balance
21-May	Australia	RBA Policy Meeting – May Minutes
	Japan	All Industry Activity Index
	UK	CPI
	UK	Retail Price Index
22-May	UK	Bank of England Minutes
	UK	Public Finances
	UK	CBI Trends
	US	MBA Mortgage Applications
	Canada	Retail Sales
	US	Existing Home Sales
	US	Fed Minutes
	Japan	BoJ Target Rate
23-May	China	HSBC Flash Manufacturing PMI
	France	PMI Manufacturing / Services
	Germany	PMI Manufacturing / Services
	Eurozone	PMI Manufacturing / Services
	Italy	Retail Sales
	UK	Retail Sales
	UK	GDP
	Brazil	Unemployment Rate
	US	Initial Jobless Claims
	US	House Price Index
	Eurozone	Consumer Confidence
	US	New Home Sales
24-May	Germany	GDP
	Germany	GfK Consumer Confidence Survey
	Germany	IFO Business Climate
	Italy	Consumer Confidence
	US	Durable Goods Order

Source: Bloomberg

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