بنك الإمارات دبي الوطني
Emirates NBD

# FX Week

Weekly
9 June 2013

## Volatility boosts the JPY, dampens the USD

Volatility has remained high across financial markets over the past week, depressing the USD in the process but boosting traditional safety trades such as the JPY and the CHF. However, there were signs towards the end of the week that the USD's decline might be coming to an end, or at least stabilizing.

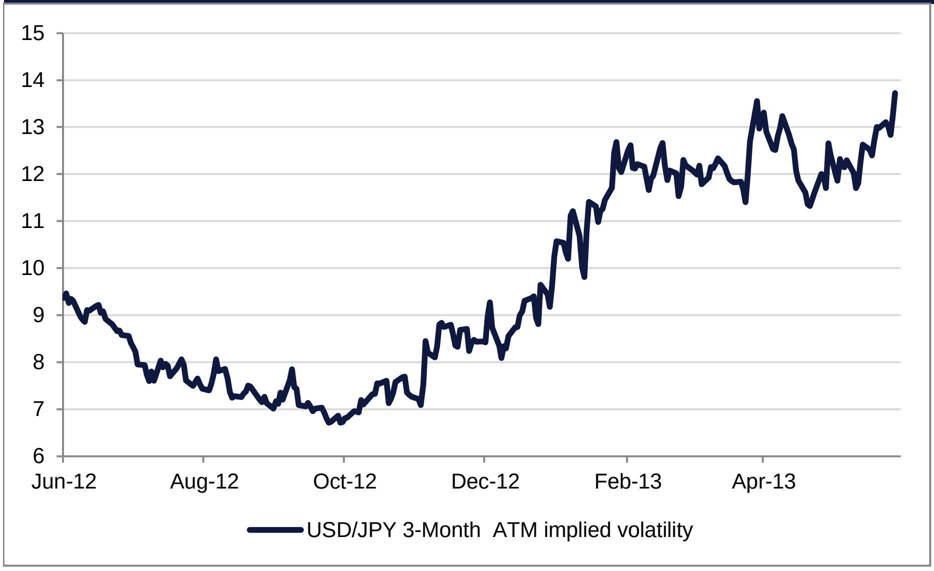
After being hurt by a weaker than expected May ISM manufacturing reading in the middle of the week, which dampened thoughts of an early 'tapering' of the Fed's Quantitative Easing, the USD recovered on Friday as optimism about the US recovery was restored with a stronger than expected non-farm payrolls reading of 175k. This enabled the USD to climb back to 97.50 versus the JPY and the EUR to fall back 1.32 from 1.3285 reached briefly earlier in the day.

## Positioning a key factor behind the USD squeeze

USD/JPY remains central to the USD's performance overall, with positioning likely to have played a significant part in its weaker tone towards the end of last week. Squaring of long USD positions against the JPY in particular was responsible for the sharp correction to 95.0 at one point (see page 6), hurt by the ongoing vulnerability of the Nikkei as well as by disappointment over the 'third arrow' policy measures of structural reforms announced by Japanese Prime Minister Abe. By the same token, going forward, positioning may also limit the USD's ability to recover quickly from this setback.

Japanese investors were also revealed as net sellers of foreign bonds for the third consecutive week. A statement by Finance minister Aso also contributed to the sell-off, by ruling out intervention to depress the JPY in the FX market. News, however, that the Japanese Government Investment Pension Fund (GIPF), which manages approximately JPY 1.2 trillion of assets, will increase the proportion of assets held overseas should return some pressure onto the JPY, especially if it is felt that other real money managers will follow its lead. The proportion of GIPF's assets held in foreign equities will be raised to 12% from 9% and those held in foreign bonds will increase to 11% from 8%.

**USD/JPY implied volatility on the rise**




*Source: Bloomberg, Emirates NBD Research*

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In the coming week the markets will want to see more action for the Bank of Japan, with its upcoming monthly meeting expected to announce a 2-year extension of its bank lending program. PM Abe is also expected to make more announcements regarding structural reforms, with some speculation that next year's planned hike in the sales tax could be postponed.

## US payrolls restore some USD confidence

However, with confidence also regained that the Fed will move to wind down its QE in H2 13the USD should also have a firmer base in its own right. Payrolls growth of 175k in May, while not spectacular, showed that the US economy is still steadily improving, building the case for an eventual reduction in asset purchases later this year. This is unlikely to occur as early as the June 18-19th meeting, as we mentioned last week, but could conceivably happen in September contingent on further steady improvements over the summer. Certainly the next three employment reports will be highly significant as to whether the 'tapering' begins in September or December. As we are for the moment in the September camp, we retain our 3-month 105 forecast for USD/JPY, premised largely on an assumption of Fed action around that time.

## ECB maintains an easing bias

The EUR also strengthened last week, on the back of ECB President Draghi's post-Council meeting press conference, in which he appeared less dovish than many had anticipated. Eurozone growth forecasts for 2013 were admittedly revised lower, to -0.6% (now weaker than our own -0.5% forecast), but with 2014 revised slightly higher (to 1.1%) the ECB retains its view that a recovery will begin in the second half of this year. The ECB maintained its easing bias, but appeared in no hurry to do more for the moment to spur growth, instead urging governments to continue to make more efforts over structural reforms. We expect that the ECB will cut interest rates again later in the year, which alongside a reduction of QE in the US will return pressure onto EUR/USD in H213, with our forecast for 1.25 in three-months' time remaining unchanged.

Eurozone data to be released this week includes industrial production for April which is expected to be steady, if not slightly firmer in the wake of other signs of recovering activity and momentum. Attention will also turn back to the legality of many of the rescue measures agreed to by the German government and the ECB, with the German Constitutional Court hearing evidence about the ESM, OMT, the fiscal compact, and other firefighting policy tools. Clearly if any of them were deemed unconstitutional this would be viewed very negatively by the markets. However, this seems unlikely, although the very fact that such hearings are taking place at all reminds that some in Germany remain deeply sceptical about the whole approach to backstopping peripheral economies and markets.

## GBP recovery is still vulnerable

GBP has also been a beneficiary of recent market turbulence, in part because the USD was weaker across the board, but also a reflection of gradually improving UK economic data. UK PMI readings were better than expected in May while the trade deficit narrowed in April quite sharply. However, other indicators remain patchy, with money supply and bank lending in particular still weak. It was not a surprise that the last monetary policy meeting under Governor King passed off without any change in policy, but the next Governor Mark Carney will still inherit some challenging issues when he takes office from July. In this context this week's labour market and industrial production data will be of interest, as the new leadership at the Bank is being charged with creating 'forward guidance' for monetary policy to support the government's broader objectives for the economy, as well as meeting the 2.0% inflation target. As such, a still sluggish labour market could be seen as increasing the pressure on the Bank to take more initiatives to promote growth, raising speculation about the need for more QE.

## AUD weakness bucks the broad USD move

The AUD remained the most conspicuous loser in major FX markets over the last week, falling further even as the USD was under pressure to be down -0.77% against it. Its situation will not be helped by the news this weekend that China's economy continues to slow, with industrial production, fixed asset investment, money supply and inflation all worse than expected in May. In particular export and import data was much weaker in May at 1.0% y/y and -0.3% y/y respectively. China's financial markets will be closed on Monday but international markets will likely react negatively to such news, keeping risk appetite and by extension the AUD under pressure. Vulnerability from this international dimension will only add to that coming domestically, with Australian growth data, retail sales and the trade balance all disappointing recently and adding to pressure for a further interest rate cut at the next RBA meeting in July.

## INR weakness a concern for the authorities

The INR continued to remain under pressure this past week, losing -1.0% the USD. The weakness was mainly on account of domestic factors as concerns remained over economic growth and the current account deficit. For example, gold imports for the month of May was 162 tonnes, more than double the average monthly import, forcing the government to increase the import duty on gold from 6% to 8%. The fact that the INR weakened despite overall weakness in the USD (DXY dollar index losing -2.0% over the week as a while), will be a matter of concern and could well force the RBI to adopt a more hawkish stance when it meets later this month. We will be revising our INR forecasts when we publish our Monthly Insights later this week.

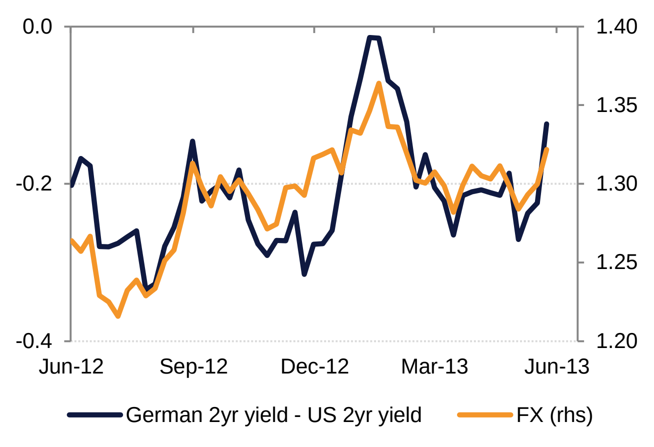
| FX Forecasts - Major | | | | | | Forwards | | |
|---|---|---|---|---|---|---|---|---|
| | Spot 07.06 | 1M | 3M | 6M | 12M | 3M | 6M | 12M |
| EUR / USD | 1.3218 | 1.27 | 1.25 | 1.20 | 1.15 | 1.3225 | 1.3232 | 1.3249 |
| USD /JPY | 97.56 | 103.0 | 105.0 | 107.0 | 110.0 | 97.51 | 97.44 | 97.21 |
| USD / CHF | 0.9360 | 0.98 | 1.00 | 1.04 | 1.08 | 0.9351 | 0.9341 | 0.9314 |
| GBP / USD | 1.5558 | 1.50 | 1.48 | 1.45 | 1.45 | 1.5549 | 1.5541 | 1.5530 |
| AUD / USD | 0.9497 | 0.98 | 0.97 | 0.94 | 0.90 | 0.9436 | 0.9380 | 0.9275 |
| USD / CAD | 1.0197 | 1.03 | 1.05 | 1.07 | 1.10 | 1.0220 | 1.0243 | 1.0288 |
| EUR / GBP | 0.8497 | 0.85 | 0.84 | 0.83 | 0.79 | 0.8506 | 0.8515 | 0.8532 |
| EUR / JPY | 128.96 | 131.0 | 131.0 | 128.4 | 126.5 | 128.96 | 128.96 | 128.96 |
| EUR / CHF | 1.2373 | 1.24 | 1.25 | 1.25 | 1.24 | 1.2367 | 1.2360 | 1.2341 |

| FX Forecasts - Emerging | | | | | | Forwards | | |
|---|---|---|---|---|---|---|---|---|
| | Spot 07.06 | 1M | 3M | 6M | 12M | 3M | 6M | 12M |
| USD / SAR* | 3.7503 | 3.75 | 3.75 | 3.75 | 3.75 | 3.7503 | 3.7508 | 3.7512 |
| USD / AED* | 3.6729 | 3.67 | 3.67 | 3.67 | 3.67 | 3.6728 | 3.6731 | 3.6726 |
| USD / KWD | 0.2843 | 0.282 | 0.285 | 0.282 | 0.28 | 0.2856 | 0.2861 | 0.2877 |
| USD / OMR* | 0.3851 | 0.38 | 0.38 | 0.38 | 0.38 | 0.3849 | 0.3847 | 0.3843 |
| USD / BHD* | 0.3770 | 0.376 | 0.376 | 0.376 | 0.376 | 0.3776 | 0.3779 | 0.3785 |
| USD / QAR* | 3.6405 | 3.64 | 3.64 | 3.64 | 3.64 | 3.6419 | 3.6433 | 3.6463 |
| USD / INR | 57.0650 | 53.50 | 53.00 | 52.00 | 51.00 | 57.0750 | 57.0833 | 57.0992 |
| USD / CNY | 6.1332 | 6.23 | 6.22 | 6.20 | 6.25 | 6.1935 | 6.2130 | 6.2615 |

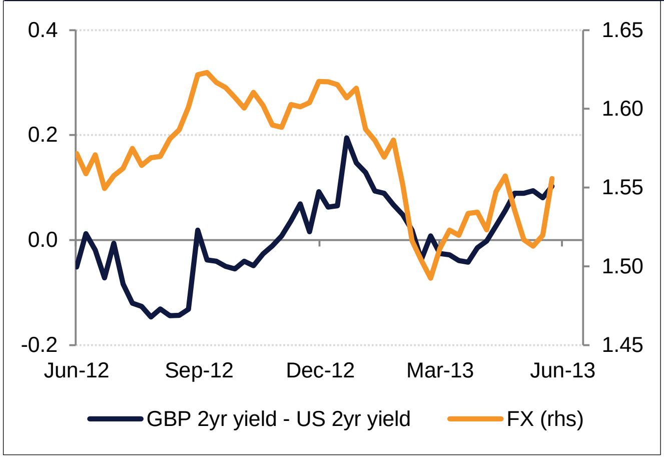
**Denotes USD peg*
*Source: Bloomberg, Emirates NBD Research*

## Major Currency Pairs and Interest Rates

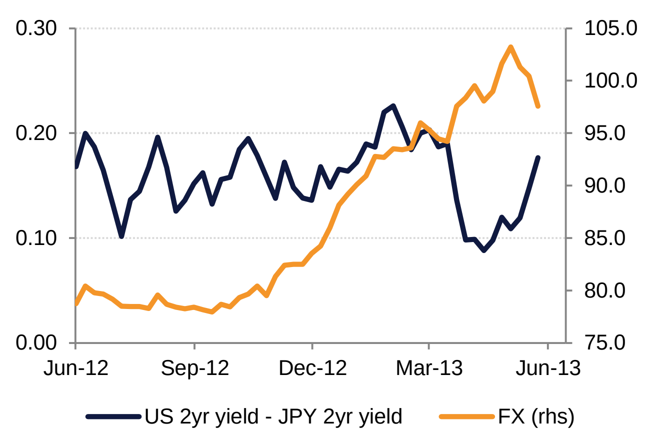
### Interest Rate Differentials - EUR



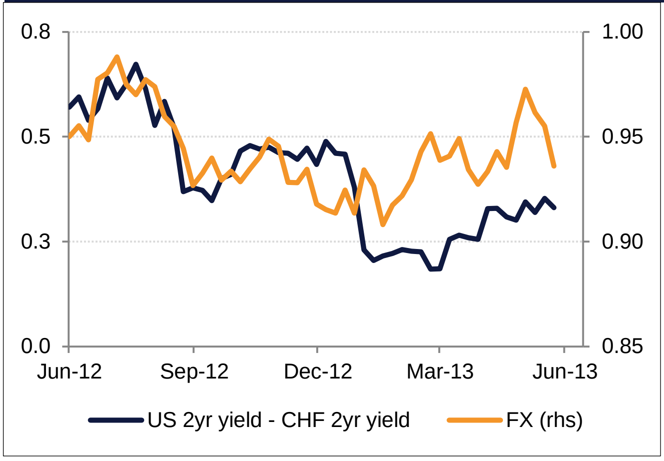

### Interest Rate Differentials - GBP



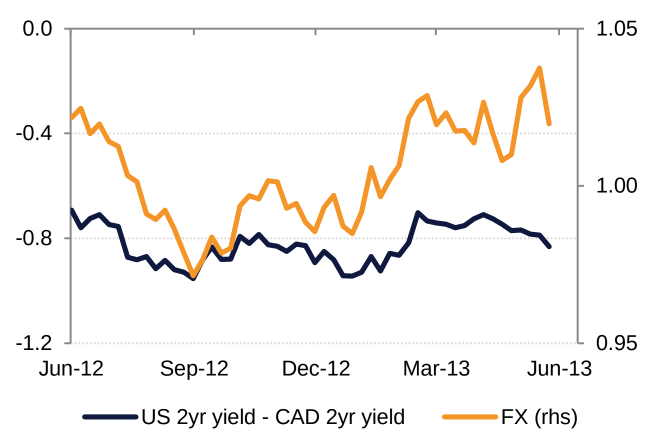

### Interest Rate Differentials –JPY



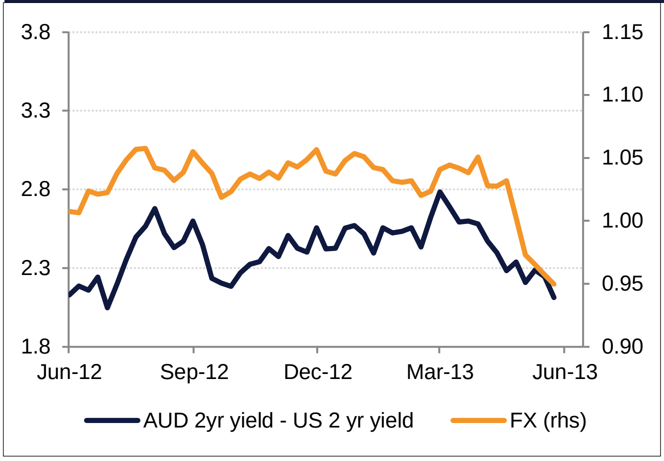

### Interest Rate Differentials - CHF




### Interest Rate Differentials - CAD



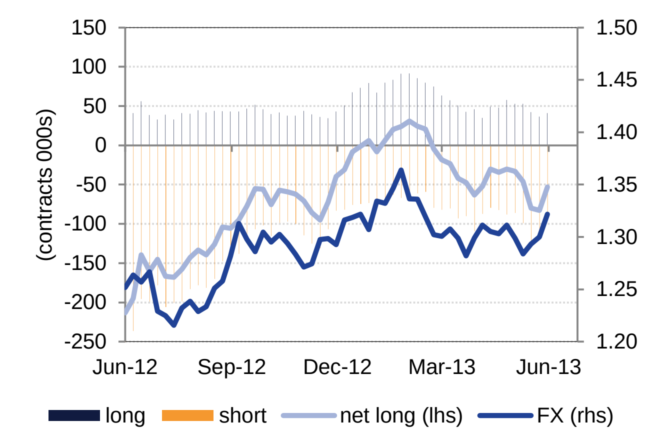

### Interest Rate Differentials - AUD



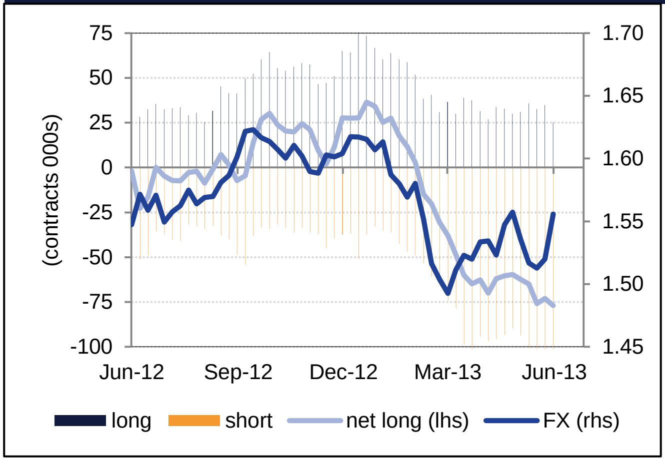

*Source: Bloomberg, Emirates NBD Research*

## Major Currency Positions

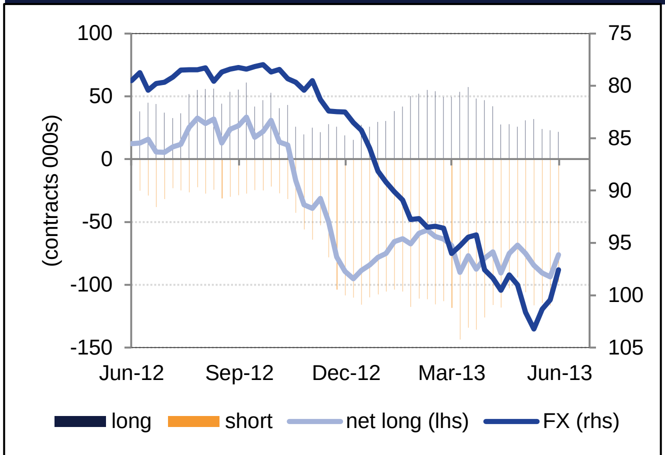
### CFTC – Speculative Positions - EUR



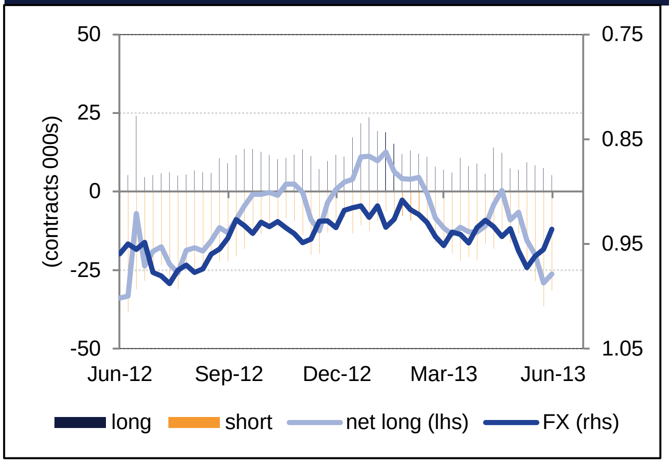

### CFTC – Speculative Positions - GBP



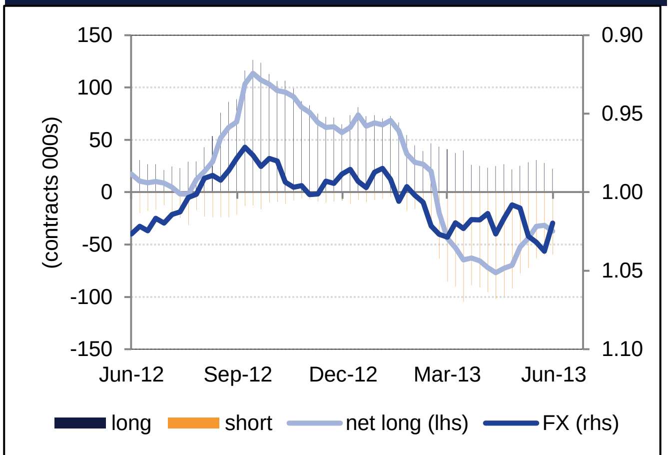

### CFTC – Speculative Positions - JPY



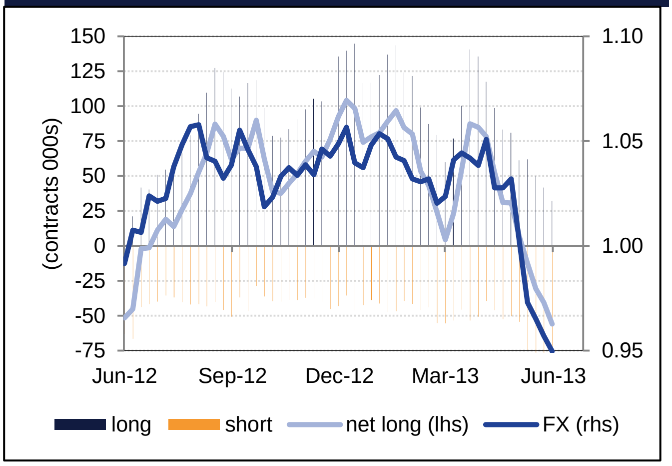

### CFTC – Speculative Positions - CHF




### CFTC – Speculative Positions - CAD




### CFTC – Speculative Positions - AUD




*Source: Bloomberg, Emirates NBD Research*

## Economic Calendar

| Date | Country | Event |
|---|---|---|
| 10-June | Japan | GDP |
| | Japan | Trade Balance |
| | Japan | Consumer Confidence |
| | Switzerland | Unemployment Rate |
| | France | Industrial Production |
| | Switzerland | Retail Sales |
| | Italy | Industrial Production |
| | Italy | GDP |
| | Canada | Housing Starts |
| | Brazil | Trade Balance |
| | Russia | Refinancing Rate |
| | Egypt | CPI |
| 11-June | UK | RICS House Price Balance |
| | UK | Industrial Production |
| | Japan | BoJ Target Rate |
| 12-June | France | Non-Farm Payrolls |
| | India | Industrial Production |
| | Germany | CPI |
| | France | CPI |
| | Italy | CPI |
| | UK | ILO Unemployment Rate |
| | Eurozone | Industrial Production |
| | US | MBA Mortgage Applications |
| | India | CPI |
| 13-June | Australia | Unemployment Rate |
| | Eurozone | ECB Publishes Monthly Report |
| | Brazil | Retail Sales |
| | US | Advance Retail Sales |
| | US | Initial Jobless Claims |
| 14-June | India | Wholesale Price Index |
| | Eurozone | CPI |
| | Canada | Manufacturing Sales |
| | US | Producer Price Index |
| | US | Industrial Production |
| | US | U. of Michigan Confidence |

*Source: Bloomberg*

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