بنك الإمارات دبي الوطني
Emirates NBD

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FX Week

Fiscal stand-off to keep USD pressured

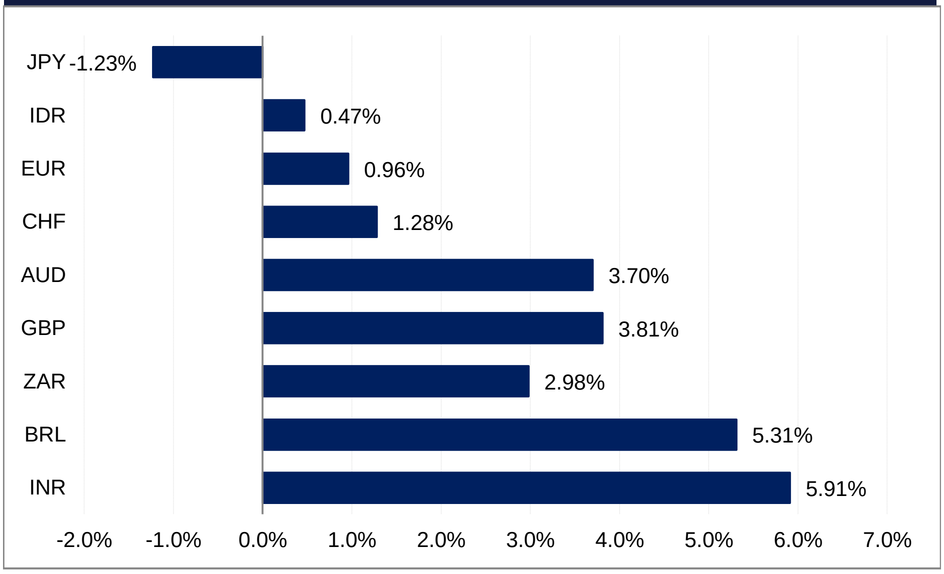
FX markets have moved on from being fixated about the Fed to being focused on fiscal policy and negotiations in Washington DC. These will come to a partial head on Tuesday October 1st, with Congress needing to pass a spending bill by then which will give the federal government authority to release the funds to pay for government spending. The Republican dominated House of Representatives passed a bill overnight that would extend current spending levels through to December 15th, but it kept contentious measures removing funding from President Obama's flagship healthcare program for at least a year. Senate Democrats have said they will reject the plan while President Obama has said he will veto it.

More negotiations will likely now go down to the wire on Monday evening, with the possibility of a government shutdown of non-essential services if agreement is not reached by then. This would entail about a third of the government's 2.1 million civilian employees stopping work, which depending on how long it lasts for could hurt consumer confidence and dampen Q4 economic growth. In reality the impact may only be felt for a relatively short period of time, as politics should dictate an agreement being reached fairly quickly after a shutdown is announced, but the uncertainty would still not be good for risk appetite. The potentially negative impact on the US economy could see US markets, including the USD, remain under pressure. One possible interesting by-product could be that economic data releases could get affected including this week's release of US September non-farm payrolls due out on Friday.

Debt ceiling deadline looms

The more important aspect, however, is the way it will affect the talks over the USD16.7 trillion debt ceiling which the Treasury has indicated will be reached on October 17th. This is an altogether much bigger issue carrying the potential for the US to default on its debt, with all the negative ramifications this would imply in terms of sovereign ratings and economic confidence. The Republicans know that the stakes are higher here, and for this reason they are likely to delay exerting maximum pressure on the White House until nearer this date. Obviously there will be memories and overtones from the last major debt ceiling wrangle in 2011, where a last minute deal was ultimately achieved, but at the price of a AAA ratings downgrade by S&P and an extended loss of confidence in the stock market and the economic recovery.

One-month currency moves against the USD (%)



Source: Bloomberg, Emirates NBD Research

The USD was not so badly affected then, but this time it could be, as so much more is dependent on a successful resolution, including Federal Reserve monetary policy.

The Fed cited the fiscal stand-off as one of the factors that led them to hold off from reducing QE earlier this month, so any resolution of these issues could clear some of the way for the Fed to begin reducing asset purchases, if not in October then by the end of the year. This would help the USD, but for the time being, with the outcome unknown the USD's fortunes remain clouded. This is one of the reasons we maintain downside risks for it over the coming month, before expecting it to gradually recover over the 3-6 month time horizon.

Risk aversion underpins the JPY

The main beneficiaries of US fiscal uncertainty would probably be safety-trade currencies like the JPY and the CHF, which were already benefiting from the situation late last week, whilst risk loving currencies like the AUD and the NZD may struggle in the first instance. Japanese markets are also waiting for the government's decision over the sales tax, which is due to be made following the release of the Q3 Tankan survey on Tuesday and which is expected to be strong. Reports suggest that the government is already leaning towards a sales tax increase from 5% to 8%, which would bring in around JPY8 trillion in revenues, but the focus is also on what measures might be announced to cushion the impact, with offsetting cuts to corporation tax or income tax also being mooted.

As we have mentioned before the impact on the JPY will be driven primarily by the perceived consequences for Bank of Japan monetary policy, whereby an offsetting monetary policy stimulus would be seen as negative for the JPY over time. As such the expected downside in USD/JPY due to US fiscal concerns is only expected to be temporary in nature as Japanese fundamentals should eventually cause USD/JPY to head higher again.

GBP also a beneficiary of USD woes

GBP may also be a near-term beneficiary of USD weakness as we highlighted in our latest Monthly Insights publication, but here too its strength may only be temporary. GBP/USD has risen back above 1.61 in recent days despite disappointing UK economic data, helped by comments from BOE Governor Carney that he does not see the need for more Quantitative Easing. However, our caution about its upside potential being limited to around 1.64 stems from our doubts about whether the UK recovery is self-sustaining. UK Q2 GDP was unrevised at 0.7% last week, but the current account deficit saw a huge downward revision in Q1 and business investment also fell sharply in Q2 by -2.7%. Measures of retail sales have also been mixed with official sales plunging by 1.0% in August but the CBI reading of sales showing an improvement in September.

A recovery of sorts certainly does appear to be underway, but whether it can be sustained without further support remains questionable in our view. In any case it seems likely to be a long time before unemployment will get any meaningful benefit, which is the standard for the Bank to begin tightening monetary policy. This week's likely focus will be on UK activity readings in the manufacturing, construction and services sectors, where the employment components in particular will be important for judging the implications (if at all) for monetary policy.

EUR upside appears more constrained

The question for the EUR is whether its gets much benefit at all from the US fiscal wrangling, for at the same time as US politicians are contributing to weakness for the greenback, Eurozone politics is also back in the spotlight, with the potential to hurt the single currency. Germany may be moving on from its elections of last weekend, with its parties seeking to form a coalition government, but in Italy the coalition government there appears to be on the verge of collapsing. With former PM Berlusconi announcing that his party's ministers will withdraw from the cabinet, it seems unlikely that the current Letta government can win a vote of confidence on Tuesday, with the likelihood that snap elections will have to be called soon after if it does not.

Italian bonds were already under pressure late last week, bucking the downward trend in yields underway elsewhere, and renewed political uncertainty in the Eurozone's third biggest economy could further derail the prospect of much needed economic and fiscal reforms being passed. For the EUR this also comes against a backdrop of mixed economic news, with data last week suggesting that growth in Q3 was probably only just being maintained, after a 0.3% recovery in Q2. The ECB meets this week against this background and is unlikely to change its downbeat tone of last month, with recent rhetoric from its officials hinting that more easing could soon be on its way. While we doubt if this will happen as early as this week, the mere talk of it, when combined with unsettling political news, could cap the EUR even as the USD remains pressured. Indeed with the GBP and the JPY both benefiting from US debt concerns by contrast, the EUR crosses could become even more vulnerable.

CHF strength, AUD vulnerability

The CHF should be another notable beneficiary of both bearish USD and bearish EUR factors, with the EUR/CHF rate at 1.2246 moving back perilously close to the 1.20 floor defended by the SNB. In the near term there would seem to be risks that this level could be tested again, but over time we would see any move down here as providing an opportunity to position for higher EUR/CHF levels. The other FX market to watch this week will be the AUD, as it will be affected by both an RBA meeting and by Chinese economic data. As mentioned before the AUD, as a risk loving currency, may not see much strength as a result of the US fiscal policy uncertainty. Improving Chinese PMI activity indicators on the other hand may provide it with at least some support, if they show that economic conditions in Australia's largest export market continue to improve. Probably more important though will be the RBA meeting, as although another rate cut is unlikely the authorities are likely to maintain a relatively dovish stance which will weigh on the AUD, both against the USD but also more probably on the crosses.

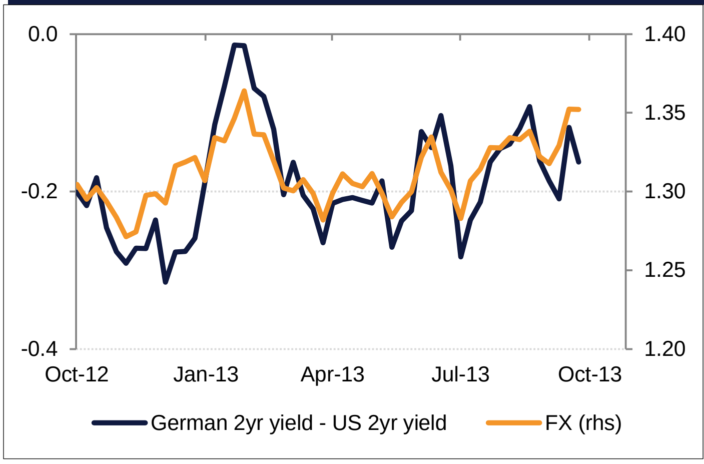
FX Forecasts - Major						Forwards		
	Spot 27.09	1M	3M	6M	12M	3M	6M	12M
EUR / USD	1.3522	1.38	1.34	1.28	1.20	1.3525	1.3528	1.3537
USD /JPY	98.24	100.0	103.0	107.0	110.0	98.18	98.12	97.92
USD / CHF	0.9059	0.90	0.93	0.98	1.04	0.9052	0.9044	0.9023
GBP / USD	1.6139	1.64	1.60	1.58	1.55	1.6128	1.6118	1.6098
AUD / USD	0.9317	0.95	0.90	0.88	0.85	0.9261	0.9209	0.9105
USD / CAD	1.0306	1.03	1.05	1.07	1.10	1.0329	1.0353	1.0401
EUR / GBP	0.8378	0.84	0.84	0.81	0.78	0.8386	0.8393	0.8408
EUR / JPY	132.86	138.0	138.0	137.0	132.0	132.86	132.86	132.86
EUR / CHF	1.2251	1.24	1.25	1.25	1.26	1.2244	1.2236	1.2216

FX Forecasts - Emerging						Forwards		
	Spot 27.09	1M	3M	6M	12M	3M	6M	12M
USD / SAR*	3.7503	3.75	3.75	3.75	3.75	3.7504	3.7509	3.7523
USD / AED*	3.6730	3.67	3.67	3.67	3.67	3.6728	3.6729	3.6730
USD / KWD	0.2832	0.282	0.285	0.282	0.28	0.2870	0.2901	0.2967
USD / OMR*	0.3850	0.38	0.38	0.38	0.38	0.3846	0.3844	0.3838
USD / BHD*	0.3770	0.376	0.376	0.376	0.376	0.3782	0.3786	0.3807
USD / QAR*	3.6406	3.64	3.64	3.64	3.64	3.6439	3.6471	3.6516
USD / INR	62.4975	64.00	62.00	59.00	57.00	62.5154	62.5290	62.5517
USD / CNY	6.1186	6.15	6.15	6.20	6.20	6.1539	6.1659	6.1974

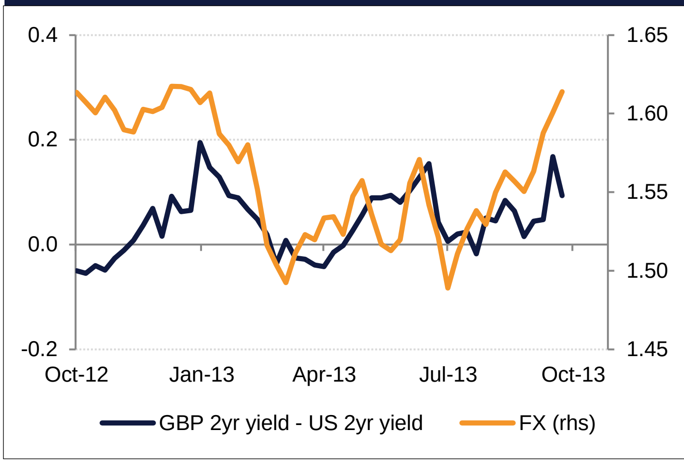
**Denotes USD peg*
Source: Bloomberg, Emirates NBD Research

Major Currency Pairs and Interest Rates

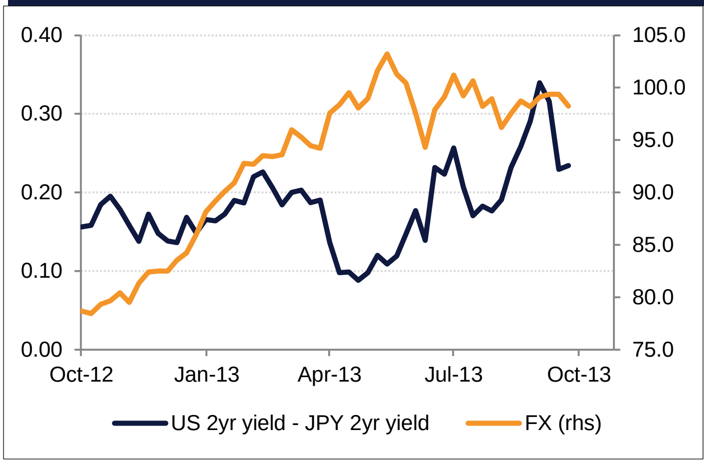
Interest Rate Differentials - EUR



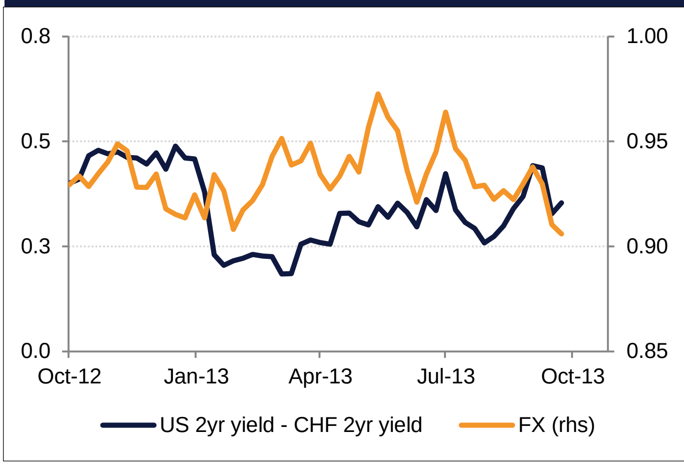
Interest Rate Differentials - GBP



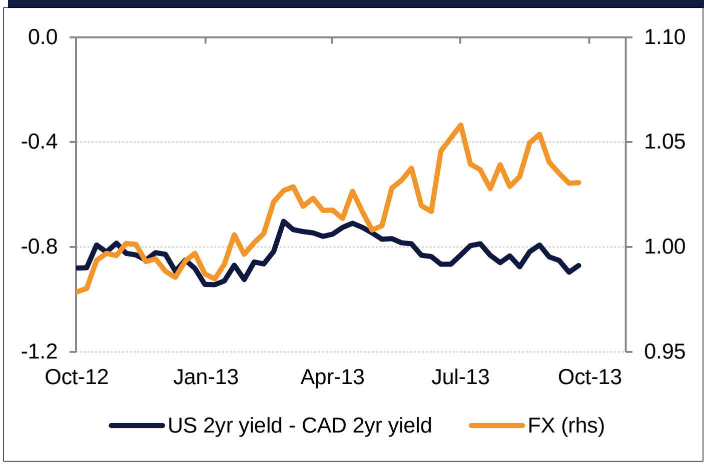
Interest Rate Differentials –JPY



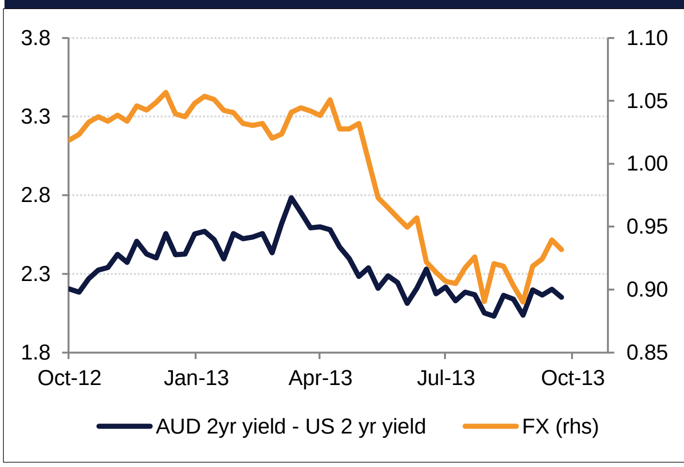
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD



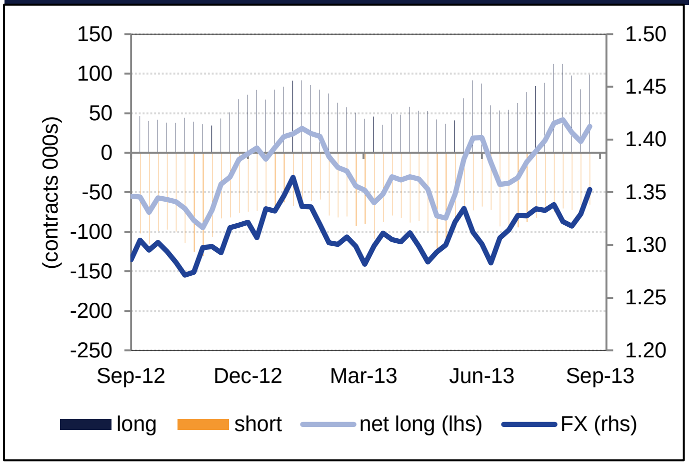
Interest Rate Differentials - AUD



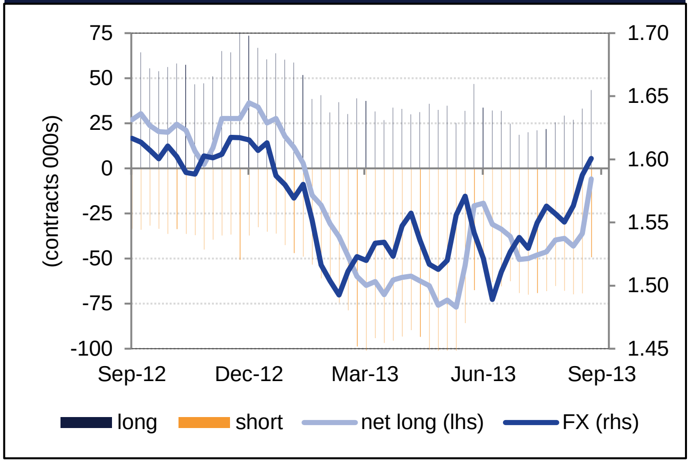
Source: Bloomberg, Emirates NBD Research

Major Currency Positions*

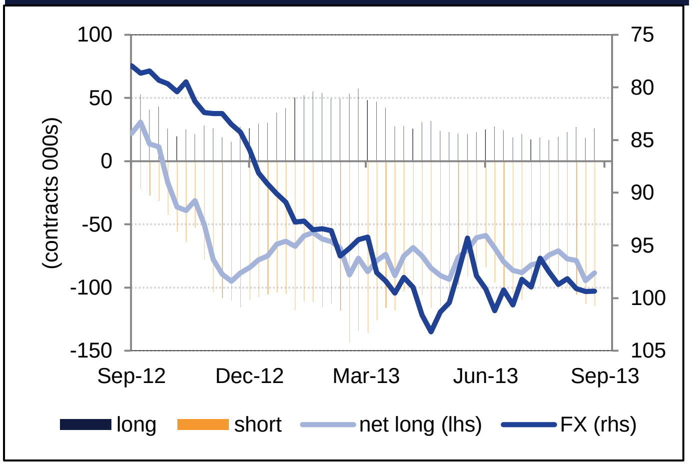
CFTC – Speculative Positions - EUR



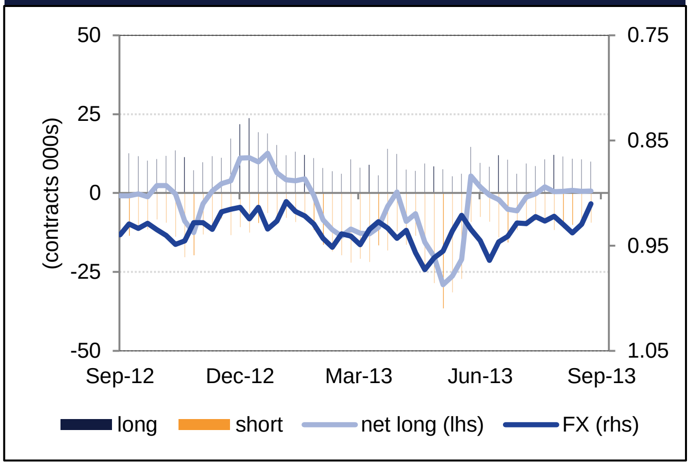
CFTC – Speculative Positions - GBP



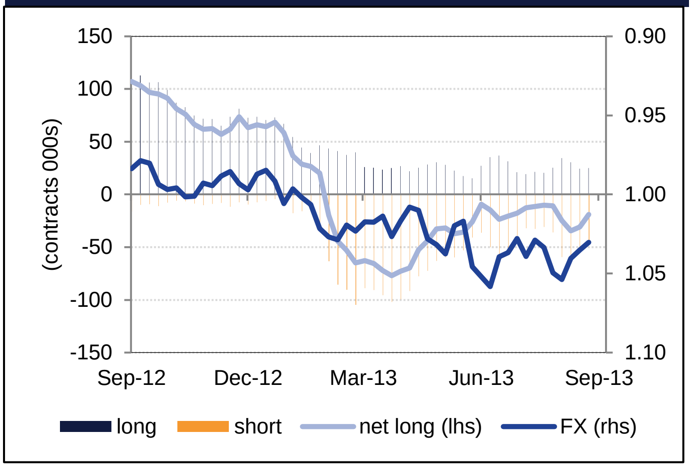
CFTC – Speculative Positions - JPY



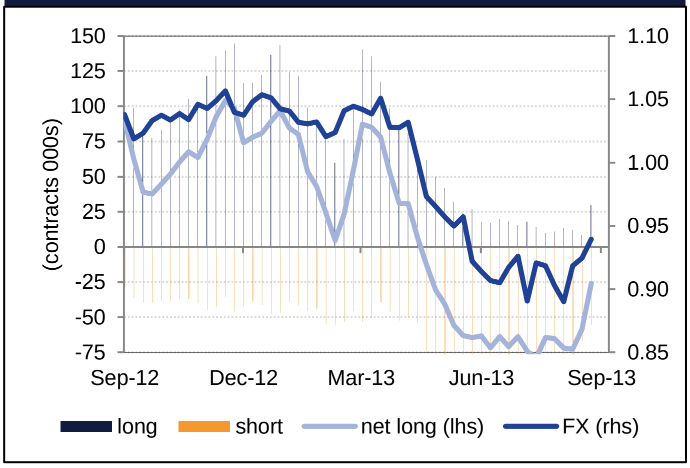
CFTC – Speculative Positions - CHF



CFTC – Speculative Positions - CAD



CFTC – Speculative Positions - AUD



Source: Bloomberg, Emirates NBD Research
**Data as of 13th September, 2013*

Economic Calendar

Date	Country	Event
30-Sept	Japan	Industrial Production
	Japan	Retail Trade
	China	HSBC/Markit Manufacturing PMI
	UK	Mortgage Approvals
	UK	Money Supply
	Italy	CPI
	Eurozone	CPI
	Canada	GDP
	US	Dallas Fed Manufacturing Activity
1-Oct	Japan	Jobless Rate
	Japan	Tankan Survey
	China	Manufacturing PMI
	Australia	Retail Sales
	Australia	RBA Cash Rate Target
	Switzerland	PMI Manufacturing
	Italy	PMI Manufacturing
	France	PMI Manufacturing
	Germany	Unemployment Rate
	Germany	PMI Manufacturing
	UK	PMI Manufacturing
	Eurozone	Unemployment Rate
	Brazil	PMI Manufacturing
	US	ISM Manufacturing
	Russia	GDP
2-Oct	Australia	Trade Balance
	US	MBA Mortgage Applications
	Eurozone	ECB announces Rates
	Russia	CPI
	Brazil	Industrial Production
	US	ADP Employment Change
3-Oct	China	Non-Manufacturing PMI
	Italy	PMI Services
	France	PMI Services
	Germany	PMI Services
	Eurozone	PMI Composite

3-Oct	UK	PMI Services
	Eurozone	Retail Sales
	US	Initial Jobless Claims
	Brazil	PMI Services
	US	Factory Orders
	US	ISM Non-Mfg Composite
4-Oct	US	Change in non-farm Payrolls
	US	Unemployment Rate
	Japan	BoJ Target Rate

Source: Bloomberg

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