بنك الإمارات دبي الوطني
Emirates NBD

Weekly
12 January 2014

FX Week

Emirates NBD was the best forecaster of USD/JPY, USD/CAD and AUD/USD in 2013 according to the latest Q4 Bloomberg FX survey.

USD gives back early 2014 gains

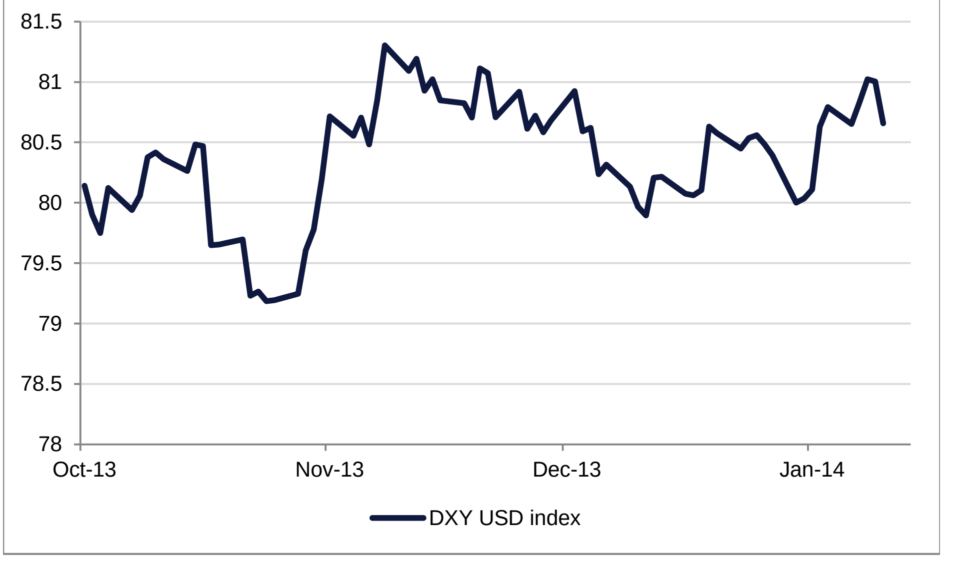
After starting 2014 strongly the USD gave back some of its gains following the weaker than expected December US jobs report. Non-farm payrolls showed a rise of just 74k during the month, less than half what was expected and the lowest since 2011. Admittedly the unemployment rate fell to 6.7% from 7.0% but this was because of another reduction in the participation rate - an expression of subdued confidence on the part of the working population. However, the weak payrolls figures were depressed by poor weather and are eventually likely to either be revised or prove to be only a temporary slowdown.

But Fed tapering should restore its strength

Consequently the Fed seems unlikely to slow the pace of QE tapering when it meets later this month (January 28-29th) especially as other US data releases have remained quite firm. Fed officials have already indicated that they are not inclined to react to one month's payroll number, with even the dovish St Louis Fed President Bullard predicting that the Fed will keep tapering. The minutes of the December FOMC talked about a 'measured' pace of tapering so we would expect that the Fed will still follow the USD10bn reduction of asset purchases announced in December with another USD10bn later this month, which should help to restore the USD's early year strength.

The coming week sees US retail sales and industrial production data for December reported and these are also likely to show some of the impact from the bad weather, which could easily carry over into January as well given the icy conditions being experienced recently. However, for these reasons near-term soft US economic data may well be looked through by the markets with investors increasingly looking for direction from factors elsewhere.

USD gives back early 2014 gains as jobs data disappoint



Source: Bloomberg, Emirates NBD Research

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ECB strengthens its ‘dovish’ guidance

Indeed the interruption to the USD’s uptrend came as the signals for the EUR and GBP were also becoming less favorable. These may actually have helped to contain the USD’s sell-off on Friday, especially against the EUR. Following the dip in Eurozone core inflation to a new cycle and historical low of 0.7% in December the ECB reinforced its forward guidance when it met last week, with President Draghi ‘firmly reiterating’ that the ECB ‘expects to keep the key ECB interest rates at present or lower levels for an extended period of time’.

Furthermore Draghi also strengthened his language regarding the instruments at the ECB’s disposal, saying that the ECB was prepared to use all policy tools ‘permitted by the Treaty’ to take further ‘decisive action’ if needed. While expressing doubt as to whether inflation would actually fall much further, Draghi effectively covered himself for such an eventuality. The markets began to interpret this commitment as a veiled reference to the possibility of asset purchases by the ECB, or Quantitative Easing, something that so far the ECB has been resistant to do so that it is not seen as financing government borrowing.

EUR/USD risks still to the downside

Opening the door to this possibility should in the near term serve to cap EUR gains, but in the medium-long term recourse to such measures would see it begin to lose ground. Our one-month EUR/USD forecast remains at 1.34 on the assumption that the FOMC will announce another reduction in QE in late January while the trends in Eurozone money and credit are likely to remain anemic thus maintaining the potential for more decisive ECB steps. Further out we still anticipate the EUR falling below 1.30 over the 6-month time horizon as the ECB has to come to the table with more stimulus measures, although we have raised our 12-month forecast to 1.25, from 1.20 previously.

USD/JPY unwinds strong holiday gains

USD/JPY was the main casualty of the US jobs data, as it had previously been the main beneficiary of signs of US tapering over the holiday season, reaching as high as 105.44 and above our former 3-month target. As 2014 gets underway attention will remain on US monetary policy, but Japanese monetary policy and fundamentals will also assume more significance in H114. In particular, policymakers will be closely watching spending patterns prior to the consumption tax increase due on April 1st. The Bank of Japan is targeting an inflation rate of 2.0% in early 2015 and progress has already been made thanks to the 20% decline of the JPY since massive QE was announced last April, with core inflation already reaching 1.2% in November.

However, signs that consumption could stall ahead of the tax hike may spur the need for more monetary policy stimulus, as weak demand could prevent the pick-up in inflation already seen from being sustained. The current account balance for November will be released in the coming week, which is likely to show a second successive monthly deficit as imports are likely to have risen ahead of the tax increase. Japan’s move into deficit could be a double-edged sword for the JPY, however. On the one hand it would normally be construed as negative for traditional balance of payments reasons, but with implications also for consumption, growth and policy the outcome may be more complex

GBP/USD recaptures 1.65 but momentum to slow

Markets are also awaiting an expected tweaking in the Bank of England’s forward guidance, to lower the unemployment threshold at which a rate hike would be considered. The GBP benefited from the lack of action at the January MPC meeting, and with the US data disappointing a day later GBP/USD has recovered back to 1.65. Next week’s BOE monetary minutes and the unemployment data will be the next main focus in regard to these issues, but before then inflation and sales data in the coming week may deflect sentiment slightly from thoughts of a monetary tightening, with inflation expected to be on the BOE’s target but with sales over December expected to have been slow. Accordingly, upward momentum in GBP may again soon begin to run out of steam.

AUD and CAD struggle in face of easing bias

The AUD has also recovered from early year lows, but we still see it having downside risks estimating another 10% decline against the USD over the course of the year to 0.80. The biggest driver for the AUD will be the relative stance of monetary policy of the RBA, which will veer towards being dovish, especially when compared to the US Fed and also compared to its main regional competitor the RBNZ which is biased to tighten. We would not rule out another cut in interest rates by the RBA this year, as it sees the AUD as still being overvalued, a view that we would broadly share, seeing long-term equilibrium somewhere between 0.70-0.80.

The CAD is also struggling at the start of the year, with its weakness accelerating in the wake of Canada’s December employment data which fell by 45.9k, with the unemployment rate rising to 7.2% from 6.9%. Other data points since the start of the year have also been disappointing, with the Ivey activity PMI falling back into contraction territory in December and with inflation continuing to undershoot the 2.0% target, standing currently at 0.9%. USD/CAD has already almost reached the 1.10 level we had penciled in for it in 2014, causing us to lift our forecast to 1.15 against the backdrop of the Bank of Canada also mulling the need to cut interest rates from their current 1.0% level.

FX Forecasts - Major						Forwards		
	Spot 10.01	1M	3M	6M	12M	3M	6M	12M
EUR/USD	1.3670	1.34	1.31	1.28	1.25	1.3669	1.3669	1.3673
USD/JPY	104.18	106.0	107.0	109.0	112.0	104.1349	104.0805	103.8901
USD/CHF	0.9024	0.92	0.95	0.98	1.04	0.9018	0.9011	0.8991
GBP/USD	1.6483	1.63	1.61	1.60	1.62	1.6472	1.6459	1.6431
AUD/USD	0.8995	0.88	0.87	0.85	0.80	0.8942	0.8888	0.8779
USD/CAD	1.0892	1.10	1.11	1.13	1.15	1.0916	1.0938	1.0981
EUR/GBP	0.8294	0.82	0.81	0.80	0.77	0.8299	0.8305	0.8322
EUR/JPY	142.3900	142	140	139	140	142.3893	142.3885	142.3864
EUR/CHF	1.2336	1.23	1.24	1.25	1.26	1.2327	1.2317	1.2294
EUR/NOK	8.3985	8.30	8.20	8.0	7.75	8.4259	8.4520	8.5056
EUR/SEK	8.8645	8.80	8.70	8.60	8.50	8.8776	8.8903	8.9211
NZD/USD	0.8303	0.82	0.83	0.83	0.82	0.8248	0.8184	0.8041

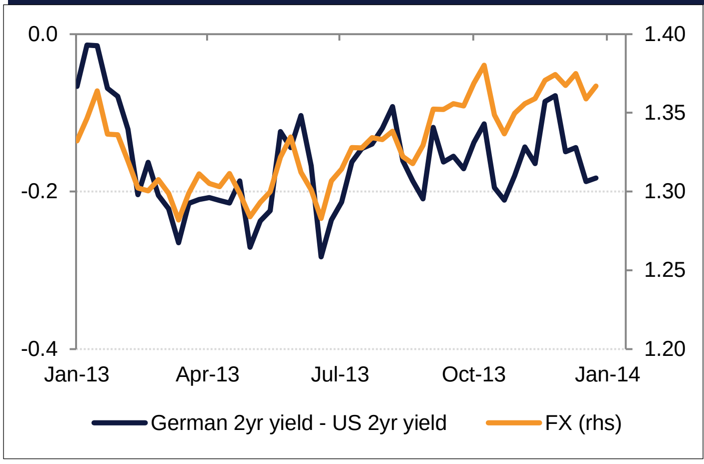
FX Forecasts - Emerging						Forwards		
	Spot 10.01	1M	3M	6M	12M	3M	6M	12M
USD/SAR*	3.7504	3.75	3.75	3.75	3.75	3.7505	3.7509	3.7519
USD/AED*	3.6730	3.67	3.67	3.67	3.67	3.6723	3.6721	3.6714
USD/KWD	0.2830	0.282	0.285	0.282	0.28	0.2899	0.2925	0.3031
USD/OMR*	0.3850	0.38	0.38	0.38	0.38	0.3842	0.3838	0.3823
USD/BHD*	0.3770	0.376	0.376	0.376	0.376	0.3782	0.3792	0.3825
USD/QAR*	3.6408	3.64	3.64	3.64	3.64	3.6439	3.6463	3.6527
USD/EGP	6.9612	6.89	6.89	6.89	6.89	7.2339	7.5439	8.1744
USD/INR	61.9050	62.00	61.00	59.00	57.00	61.9166	61.9293	61.9533
USD/CNY	6.0521	6.10	6.15	6.20	6.20	-	-	-

Source: Bloomberg, Emirates NBD Research

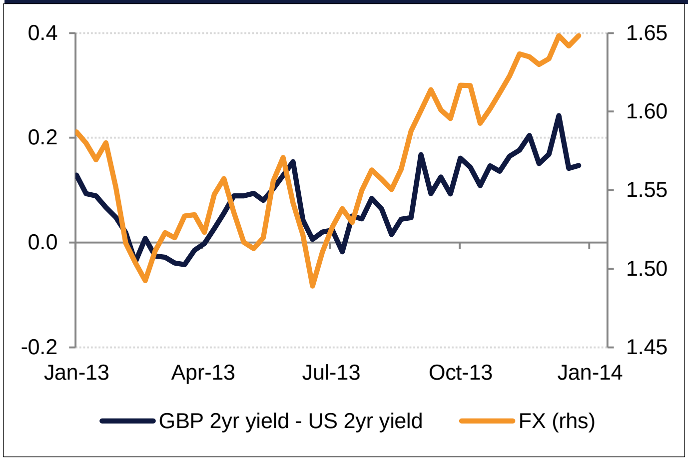
**Denotes USD peg*

Major Currency Pairs and Interest Rates

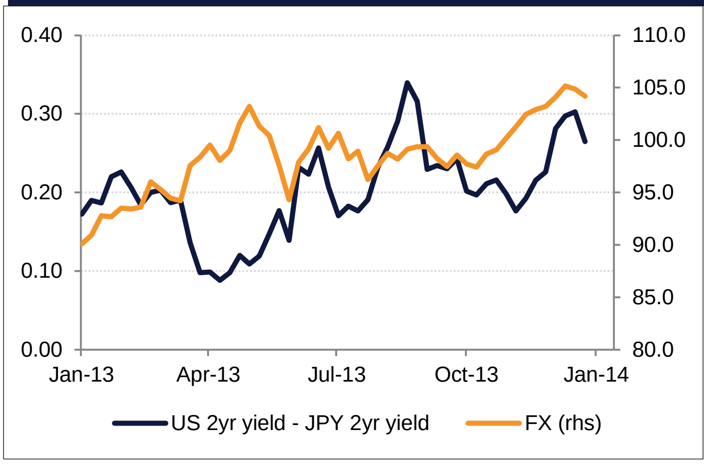
Interest Rate Differentials - EUR



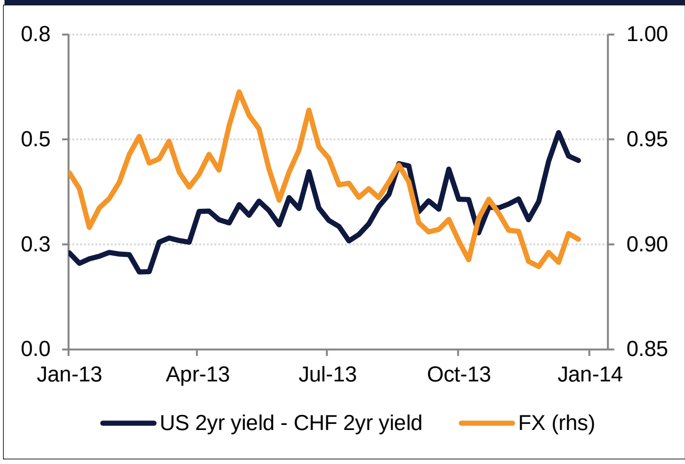
Interest Rate Differentials - GBP



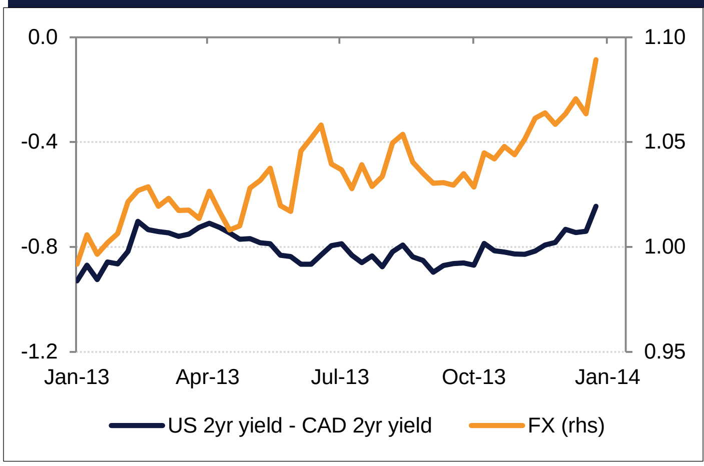
Interest Rate Differentials –JPY



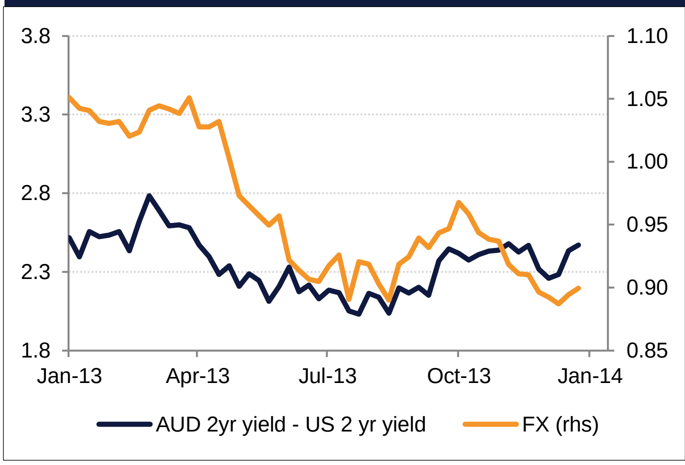
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD



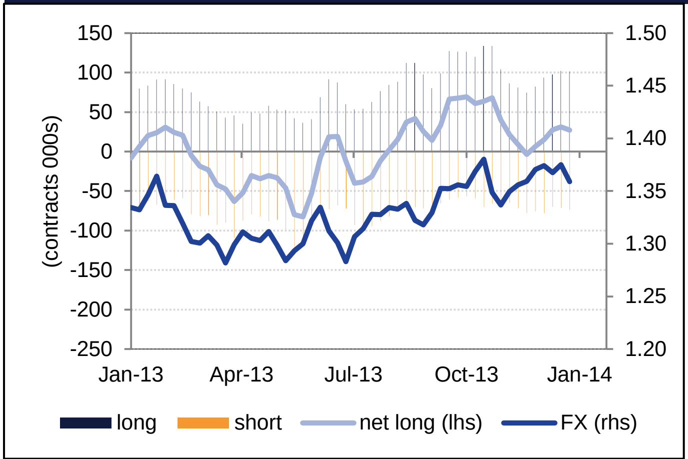
Interest Rate Differentials - AUD



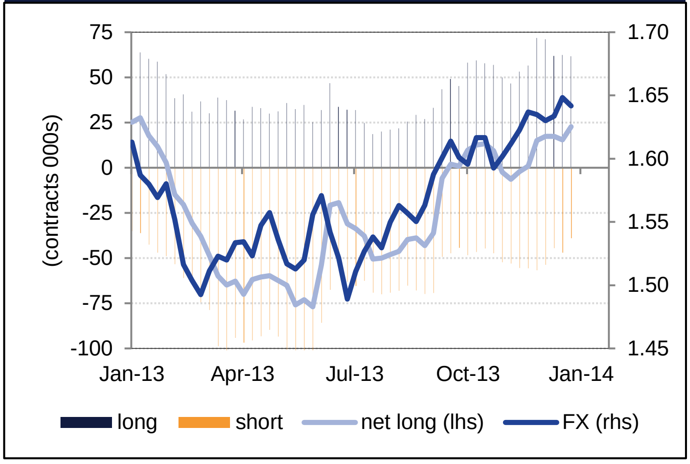
Source: Bloomberg, Emirates NBD Research

Major Currency Positions

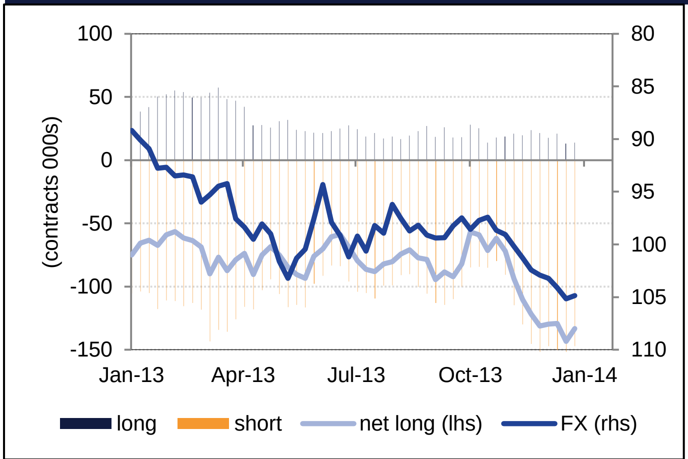
CFTC – Speculative Positions - EUR



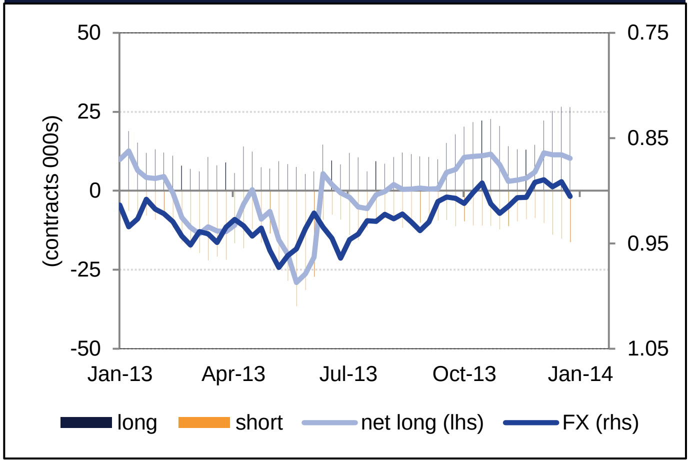
CFTC – Speculative Positions - GBP



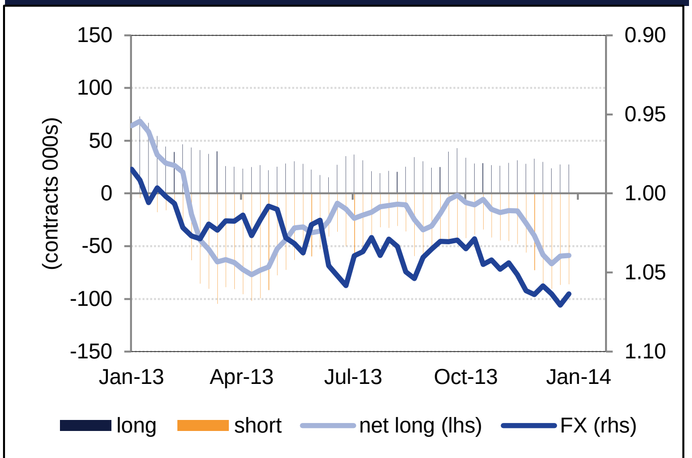
CFTC – Speculative Positions - JPY



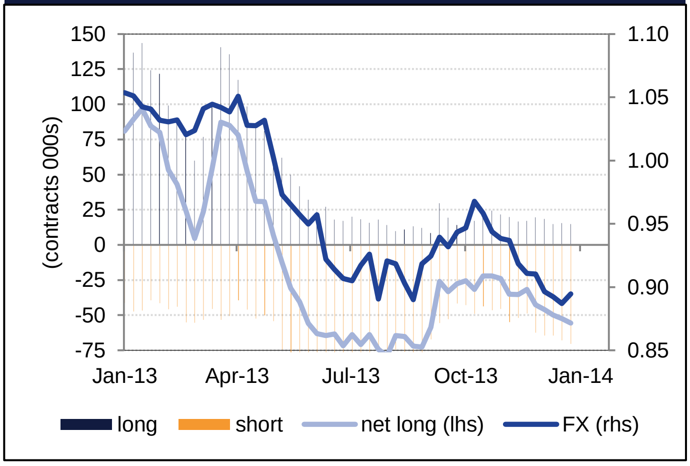
CFTC – Speculative Positions - CHF



CFTC – Speculative Positions - CAD



CFTC – Speculative Positions - AUD



Source: Bloomberg, Emirates NBD Research

Economic Calendar

Date	Country	Event
13-Jan	Italy	Industrial Production
	India	CPI
14-Jan	France	CPI
	Italy	CPI
	UK	CPI
	UK	Retail Price Index
	Eurozone	Industrial Production
	US	Retail Sales
15-Jan	India	WPI
	Germany	GDP
	Switzerland	Retail Sales
	Eurozone	Trade Balance
	US	MBA Mortgage Applications
	Russia	CPI
	US	Empire Manufacturing
	Canada	Existing Home Sales
	US	Fed Reserve releases Beige Book
	Brazil	Selic Rate
16-Jan	Japan	Tertiary Industry Index
	UK	RICS House Price Balance
	Australia	Unemployment Rate
	Germany	CPI
	Italy	Trade Balance
	Eurozone	CPI
	Brazil	Retail Sales
	US	CPI
	US	Initial Jobless Claims
	US	NAHB Housing Market Index
	Egypt	Rate decision
17-Jan	Japan	Consumer Confidence Index
	UK	Retail Sales
	US	Housing Starts
	US	Industrial Production
	US	U of Michigan Confidence

Source: Bloomberg

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