



بنك الإمارات دبي الوطني  
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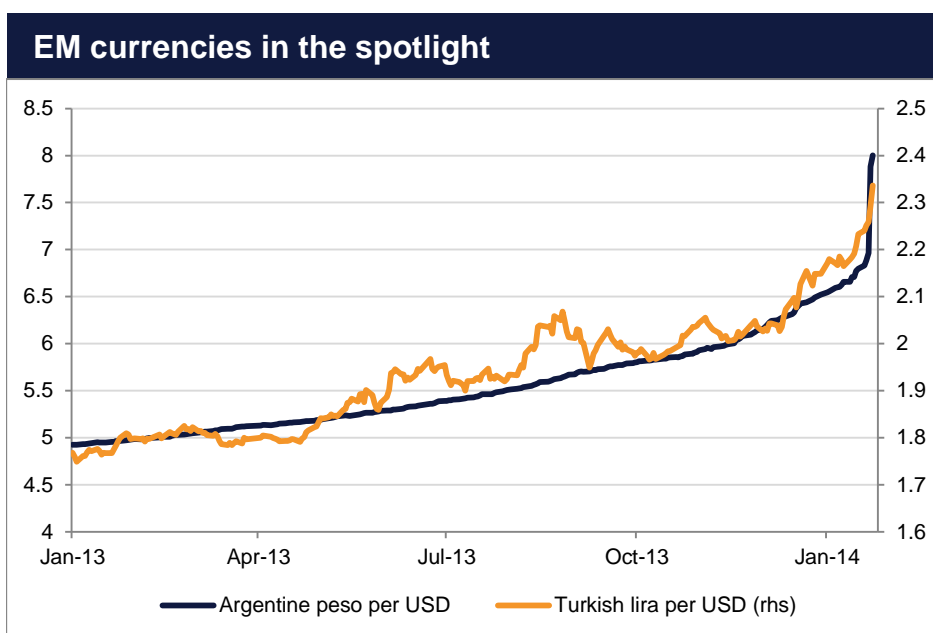
# FX Week

## Emerging markets spillover

Emerging markets moved centre-stage on Friday, causing risk aversion to boost G10 currency safe havens like the JPY and CHF at the end of the week. Argentina's decision to step back from its daily intervention to defend the Argentine peso (ARS) was the catalyst for broader pressures on emerging markets to develop. These included Turkey, with the TRY hitting another record low, and Ukraine and Thailand, where political pressures have been building for some time, and which in Ukraine's case is increasingly spilling over into violence. It also drew in South Africa (the ZAR hitting a 5-year low), India and Indonesia which have large current account deficits and which are most vulnerable to Fed tapering and the shift towards tighter global monetary conditions. In the broader context, renewed violence in Egypt as well as little headway being made in talks over Syria is likely to have further reinforced the mood of risk aversion, while signs of renewed weakness in China's economy late last week probably did not help matters either, with its PMI index moving back into contraction territory in January.

For Argentina to have triggered such a chain reaction is a little strange as it has been effectively locked out of international capital markets since it defaulted on its debt in 2002 and its currency is not freely convertible. Argentina is well known for its economic mismanagement, and shares little in common with most other EM countries, with the possible exception of Venezuela. Thus it is not specific linkages that appear to tie these pressures together, but rather the emergence of a wide range of disparate issues which have accumulated and came to a head simultaneously. Not all EM economies are vulnerable, however, with Mexico and the Philippines probably better placed due to the implementation of structural reforms. Chile is also seen quite differently to its South American neighbor as a result of its record of prudent policy-making, while in Eastern Europe, Ukraine and Hungary are the countries that stand out most negatively.

However, at the same time there are some broader questions about the macro-management of some of the bigger EM economies such as Brazil, Russia and India, which add to the overall impression of uncertainty for the overall EM asset class. China's slowdown also raises questions for a number of commodity exporters around the world who rely on its demand.



Source: Bloomberg, Emirates NBD Research

## **More Fed tapering on its way**

Although these pressures are not necessarily all related to Fed 'tapering' fears, the upcoming FOMC meeting this week is unlikely to help sentiment. The likelihood is that the Fed will look through the weakness of the US December jobs report and announce another reduction in Quantitative Easing. This could exacerbate pressure on the fragile EM economies with large current account deficits, which are dependent on capital inflows to keep their currencies stable. Thus risk aversion could continue to be seen in the early part of the week, keeping the JPY and the CHF underpinned. The USD/JPY rate is particularly vulnerable to such a reversal as short-JPY positioning has become particularly stretched in recent weeks. Inflation data in Japan will be watched closely in the coming week, as well as any reversal in recent strong inflation trends which could see the markets begin to anticipate the need for more monetary stimulus from the Bank of Japan, which in turn could return some downward pressure onto the JPY.

More generally USD moves on Friday became largely a by-product of the latest swings in EM markets, with the USD boosted against some currencies as safe haven demand for Treasuries rose but weaker against others. The EUR for instance is also a little firmer at the USD's expense, due to the large current account surplus of the Euro area, while GBP (with a large current account deficit) has slipped back.

## **Carney trips up GBP bulls**

GBP weakness is also related to the messages from the Bank of England at the end of last week. In a week which saw UK unemployment fall to 7.1% in November, a shade above the Bank's forward guidance threshold for discussing a hike in UK rates, Governor Carney appeared to pour cold water on the importance of this threshold. With the markets beginning to discount the possibility of a hike in UK interest rates even as early as later this year, Carney suggested that the 'equilibrium' unemployment rate is lower than the Bank previously thought, seemingly downgrading its importance in policy-setting. The FT even went as far to suggest that the unemployment threshold will be scrapped altogether, causing the GBP to reverse sharply after its recent rally. Market attention will now begin to focus on the next Inflation Report on February 12<sup>th</sup> in which revisions to the forward guidance framework could be seen.

## **...As the deficiencies of 'forward guidance' are being exposed**

Having said this, the credibility of the whole forward guidance experiment does appear to be in question, with Central Bank emphasis on dual targets for unemployment and inflation beginning to be seen as untenable and confusing. This is something we have warned about in our Monthly Insights documents last summer. The Fed is just about still ahead of the game having started to reduce QE, but could quickly be wrong-footed if the US economy accelerates even more than it has been doing.

The Eurozone has a busy calendar of events this week with CPI and bank lending data likely to be among the highlights, carrying the potential to dampen some of the optimism coming from Eurozone surveys recently. IMF Head Christine Lagarde again warned this weekend about the risks of the Eurozone falling back into deflation, given the region's current inflation rate of 0.8%, and any further weakness in prices will renew pressure on the ECB to ease monetary policy further. ECB President Draghi has downplayed the possibility of deflation, and with PMI surveys starting to rise, he has some support for this view. Nonetheless, the EUR will remain vulnerable should the inflation data remain weak.

## Commodity currencies continue their decline

The AUD meanwhile is being weighed on by more rhetoric from the RBA calling for a weaker exchange rate. Only days after stronger than expected inflation (at 2.7% y/y in Q4 – its highest level in two years) caused the AUD to rally, a Reserve Bank Board Member, Heather Rideout, was quoted in the Wall Street Journal calling for a further fall in the currency saying that ‘a dollar around 0.80 would be a fair deal for everybody’, which is in line with our own forecast for the AUD this year. Previously markets had assumed that an AUD close to 0.85 would be acceptable to the RBA, following previous comments from RBA Governor Stevens, but unless these latest remarks are contradicted or qualified by the RBA then it is likely that the markets will continue to push the AUD lower.

The CAD has also been in the spotlight in recent weeks, falling sharply as the Bank of Canada has expressed concerns about Canada’s low level of inflation and highlighted the advantages that a weaker exchange rate could bring to the economy. The USD/CAD rate has moved beyond our one-month 1.10 target and briefly reached close to 1.12 last week. Canada’s inflation rate recovered from 0.9% y/y in November to 1.2% in December, which provides some reassurance for the authorities, but with an increasing emphasis on the exchange rate itself the likelihood is that the CAD will remain pressured, with our one-year forecast remaining at 1.15.

FX Forecasts - Major						Forwards		
	Spot 24.01	1M	3M	6M	12M	3M	6M	12M
EUR/USD	1.3678	1.34	1.31	1.28	1.25	1.3677	1.3678	1.3684
USD/JPY	102.3100	106.0	107.0	109.0	112.0	102.2596	102.1920	101.9750
USD/CHF	0.8945	0.92	0.95	0.98	1.04	0.8938	0.8930	0.8907
GBP/USD	1.6482	1.63	1.61	1.60	1.62	1.6471	1.6459	1.6431
AUD/USD	0.8683	0.88	0.87	0.85	0.80	0.8631	0.8581	0.8480
USD/CAD	1.1088	1.10	1.11	1.13	1.15	1.1112	1.1135	1.1177
EUR/GBP	0.8300	0.82	0.81	0.80	0.77	0.8305	0.8311	0.8329
EUR/JPY	139.9800	142	140	139	140	139.9792	139.9784	139.9760
EUR/CHF	1.2235	1.23	1.24	1.25	1.26	1.2225	1.2214	1.2188
EUR/NOK	8.4036	8.30	8.20	8.0	7.75	8.4308	8.4574	8.5113
EUR/SEK	8.8092	8.80	8.70	8.60	8.50	8.8223	8.8357	8.8672
NZD/USD	0.8214	0.82	0.83	0.83	0.82	0.8158	0.8094	0.7950

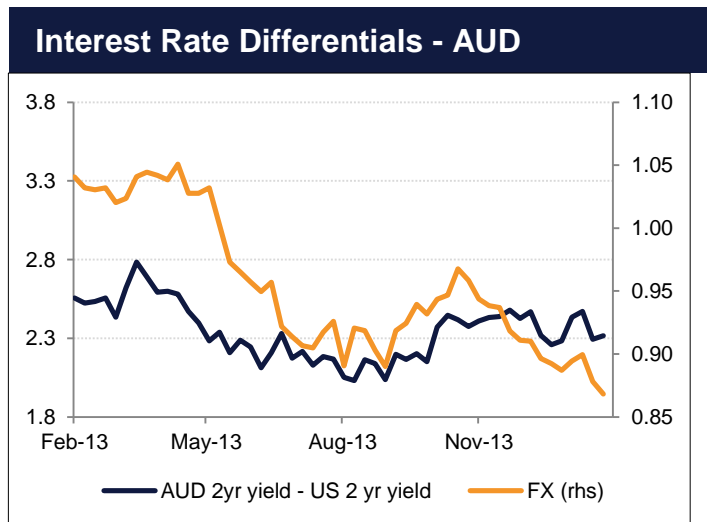
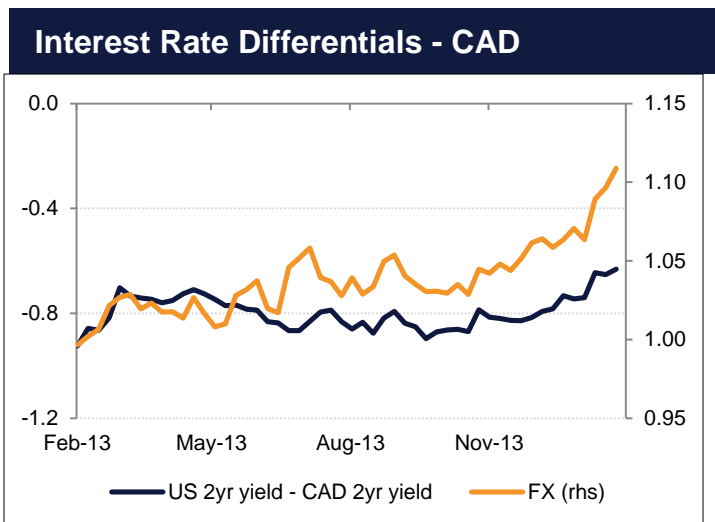
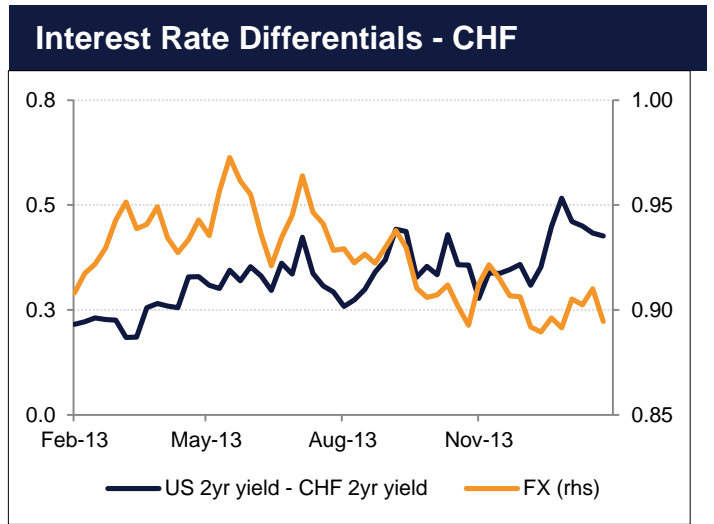
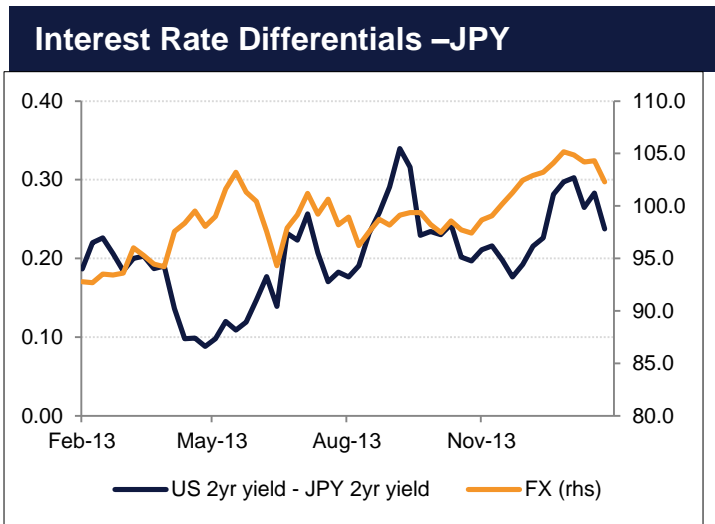
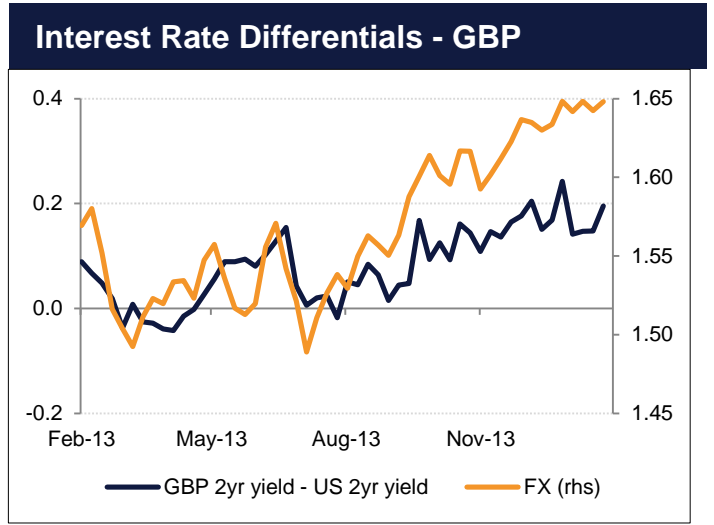
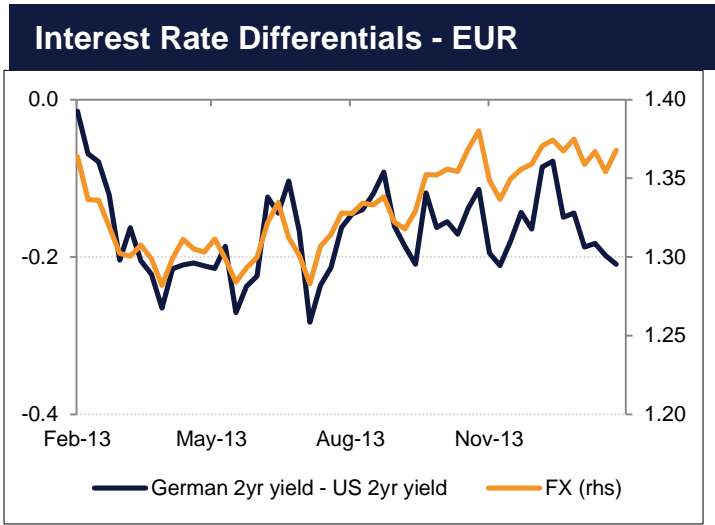
  

FX Forecasts - Emerging						Forwards		
	Spot 24.01	1M	3M	6M	12M	3M	6M	12M
USD/SAR*	3.7504	3.75	3.75	3.75	3.75	3.7504	3.7511	3.7520
USD/AED*	3.6730	3.67	3.67	3.67	3.67	3.6720	3.6713	3.6705
USD/KWD	0.2826	0.282	0.285	0.282	0.28	0.2899	0.2933	0.3036
USD/OMR*	0.3850	0.38	0.38	0.38	0.38	0.3842	0.3830	0.3818
USD/BHD*	0.3770	0.376	0.376	0.376	0.376	0.3781	0.3797	0.3824
USD/QAR*	3.6413	3.64	3.64	3.64	3.64	3.6428	3.6451	3.6484
USD/EGP	6.9618	6.89	6.89	6.89	6.89	7.1636	7.4032	7.9758
USD/INR	62.6850	62.00	61.00	59.00	57.00	62.6979	62.7115	62.7365
USD/CNY	6.0484	6.10	6.15	6.20	6.20	6.5784	-	-

Source: Bloomberg, Emirates NBD Research

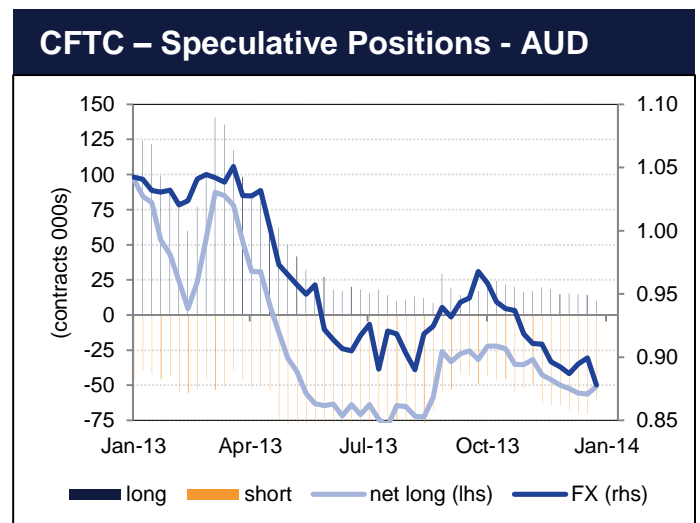
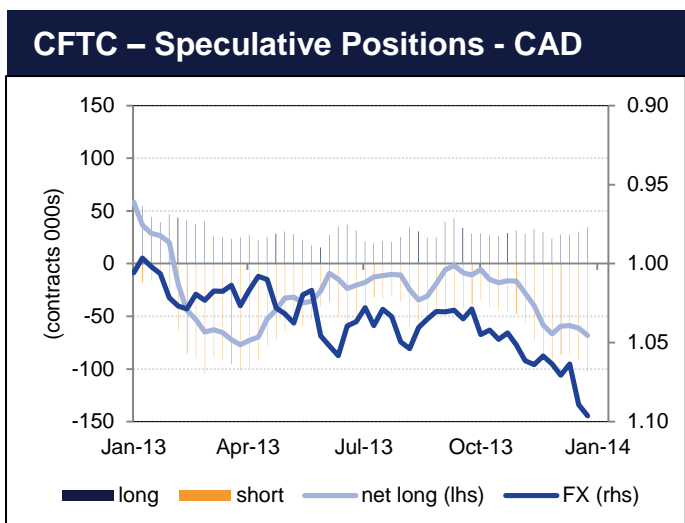
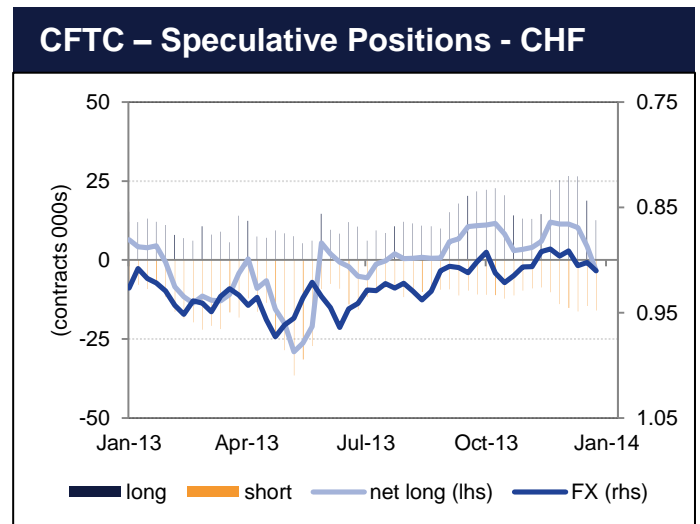
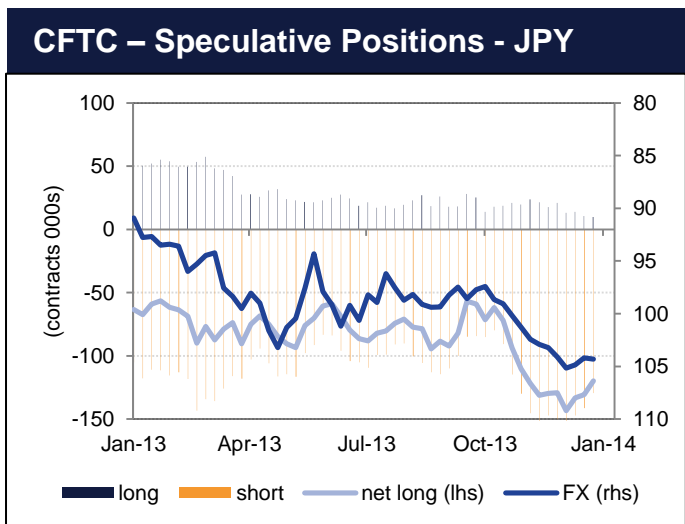
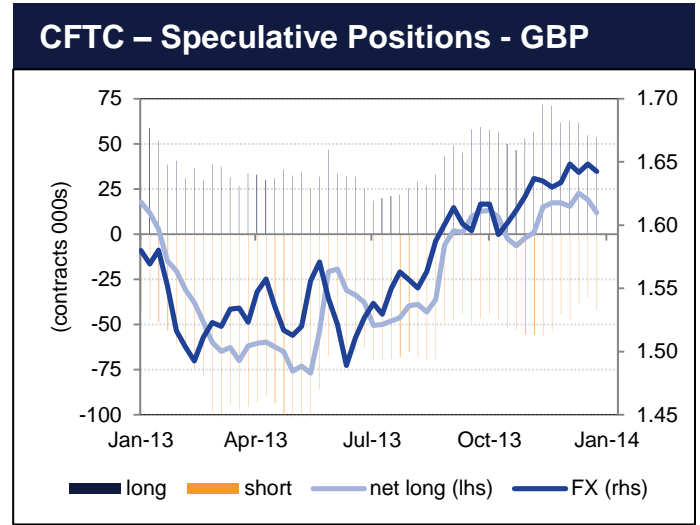
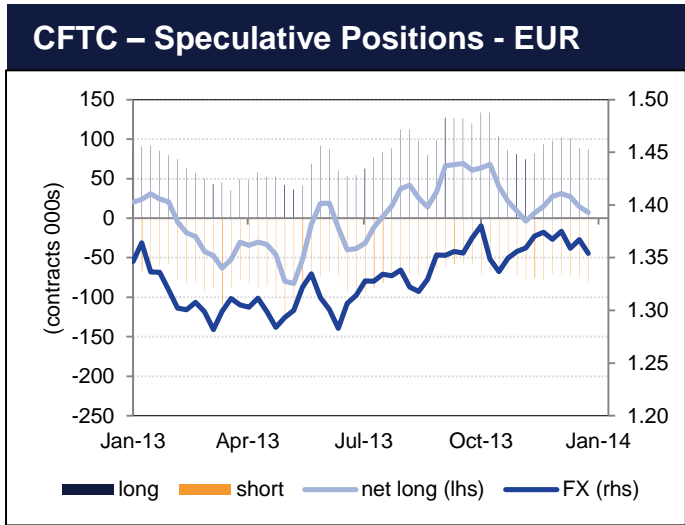
\*Denotes USD peg

## Major Currency Pairs and Interest Rates



Source: Bloomberg, Emirates NBD Research

## Major Currency Positions



Source: Bloomberg, Emirates NBD Research

## Economic Calendar

Date	Country	Event	
27-Jan	Japan	Trade Balance	
	Germany	IFO Business Climate	
	US	New Home Sales	
28-Jan	US	Dallas Fed Mfg Activity	
	Australia	NAB Business Confidence	
	India	RBI Rate Decision	
	UK	GDP	
	US	Durable Goods Order	
	US	S&P/ CaseShiller Home Price Index	
	US	Consumer Confidence	
	US	Richmond Fed Mfg Index	
	29-Jan	Germany	GfK Consumer Confidence
		Italy	Business Confidence
US		MBA Mortgage Applications	
Russia		CPI	
US		FOMC Rate Decision	
30-Jan	Japan	Retail Sales	
	China	HSBC/Markit Mfg PMI	
	Germany	CPI	
	Germany	Unemployment Rate	
	UK	Money Supply	
	Eurozone	Consumer Confidence	
	US	GDP	
	US	Personal Consumption	
	US	Core PCE	
	US	Initial Jobless Claims	
	31-Jan	Japan	Jobless Rate
Japan		CPI	
Japan		Industrial Production	
UK		GfK Consumer Confidence	
Germany		Retail Sales	
Eurozone		Unemployment Rate	
Eurozone		CPI	
Canada		GDP	
US		PCE Deflator	

31-Jan	US	U. of Michigan Confidence
	Russia	GDP

Source: Bloomberg



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