



بنك الإمارات دبي الوطني
Emirates NBD

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FX Week

USD is breaking higher

Last week saw more events turn sentiment, which had been risk loving at the end of January, to being risk fearing approaching the end of this month. This culminated in a downgrade for the United Kingdom by Moody's on Friday, with the UK losing its triple AAA rating for the first time since the late 1970s. In the US the monetary policy debate turned noticeably more cautious as the Fed minutes were released, with a growing number of FOMC members seemingly in favour of scaling back asset purchases even before 'a substantial improvement in the outlook for the labour market has occurred'. China also appears to be on the brink of tightening monetary and property market policies, while in the Eurozone the divergence in economic performance between Germany and the rest became even more visible, as survey data showed the Eurozone's contraction deepening in early February. With Italian and Cyprus elections this weekend and the second US 'fiscal cliff' fast approaching in the US the USD is likely to remain the preferred currency for the time being, having enjoyed a significant bounce over the past week, and indeed throughout February.

Meeting many of our 1-month forecasts

The USD rose over the course of last week, benefiting from European weakness, as well as from signs that the Fed is becoming more restive about maintaining its open-ended monetary policy stimulus. However, the USD has been improving gradually since early February, not only during times of risk aversion, but even when the atmosphere has been more risk loving. The USD index has risen above its range in place since September, and looks to have the potential to rise further in coming weeks, may-be to as high as 85.0. Many of our 1-month forecasts included for the first time in our February Monthly Insights publication have now been met, including EUR/USD which closed last week below 1.32, and we are taking this opportunity to update them. GBP/USD is sharply lower than even our 3-month 1.54 forecast, as the markets have begun to realize that the UK authorities are comfortable with a much weaker pound, and unconcerned by the overshoot in inflation which is expected to last by the Bank of England for at least two more years. USD gains have also been significant against the CHF, CAD and AUD since the start of the year, with only the SEK and the NZD outperforming the greenback year-to-date. USD/JPY has for the moment stabilized and corrected slightly, which we had also envisaged it might.

USD breaks up out of its recent range



Source: Bloomberg, Emirates NBD Research

Bernanke testimony to be watched closely

In the coming week, Fed Chairman Bernanke's testimony to Congress will be one of the most important events, with markets looking to see if he shares concerns about the potential costs of further QE. More likely in our view he is likely to emphasize that monetary policy still needs to support the labour market, as well as reminding Congress of the need to deal with outstanding fiscal policy issues, especially in relation to upcoming 'sequestration' risks. This may temper USD gains temporarily, but markets will probably look through Bernanke's perceived 'dovishness', knowing that other Fed members are already favouring an earlier exit from QE3, or at least a tapering down of asset purchases.

Italian elections maintain EUR risks...

Financial markets will also be looking at other prominent events outside of the US, with Italian elections today and tomorrow a more immediate focus. While former PM Berlusconi is not expected to win the election, his vote may be enough to spoil an outright victory for his opponents. In particular a hung parliament and/or a coalition government without the technocratic former PM Mario Monti in it may create uncertainty about the path of reforms going forward. At a time when Eurozone economies are continuing to struggle, the temptation to slow the reform process will increase, hurting the EUR in the process.

...As Eurozone growth prospects revised lower

The European Commission downgraded its forecasts for Eurozone growth this year to -0.3%, from -0.1% previously, as well as for the European Union as a whole, while PMI activity data showed that the Eurozone economy contracted by more than expected in February. France and Italy in particular remain vulnerable, with almost flat growth seen for France this year by the Commission and a -1.0% decline in Italy. This prospect has already caused the French government to request more room for maneuver in meeting its 3.0% deficit target, but it still seems that it will need to take further austerity measures, leaving next year's growth forecasts equally vulnerable to downward revisions. Furthermore at EUR61bn LTRO2 repayments were less than expected in February highlighting that financial sector fragility has not gone away either. The markets are already looking forward to the updated ECB inflation forecasts in March which could be used as pretext for the ECB to cut the refinancing rate. Alternatively, issuing more LTROs may be considered. This backdrop should serve to keep the EUR vulnerable approaching the month-end, with EUR/USD likely to be testing levels around 1.30 soon.

GBP facing a mountain of pressure

GBP lost substantial ground last week, first in response to the Bank of England minutes which showed a sizeable minority voting for more QE. Secondly, the minutes also showed other steps were considered to revitalize growth, including buying other assets as well as Gilts, and cutting the base rate even as rates are almost zero and inflation risks were tilted higher. This all suggests an active preference on the part of the Bank for a weaker exchange rate, with attendant risks that UK Gilts would lose their safe haven standing.

The subsequent ratings downgrade to AA1 will probably cement this outcome, and led the pound to lose further ground into the close on Friday, below critical support at 1.52. We had previously considered that GBP would hold up around these levels and that it would be stronger than the EUR this year. However, faced with this mountain of pressure it is hard to argue against further GBP losses from here, and ones that will leave GBP weaker across the board, not just against the USD. Moody's cited the prospect of ongoing weak growth in the UK as the factor behind the downgrade, a prospect that is hard to argue with:

'The main driver underpinning Moody's decision to downgrade the UK's government bond rating to AA1 is the increasing clarity that, despite considerable structural economic strengths, the UK's economic growth will remain sluggish over the next few years due to the anticipated slow growth of the global economy and the drag on the UK economy,'.

Although Moody's kept the UK outlook stable, other rating agencies will probably now follow Moody's step keeping the pressure on the pound. As a result we are revising our GBP forecasts lower, allowing for a fall in GBP/USD back below 1.50 which in conjunction with our other forecasts will leave it weaker against other currencies as well (see page 4). More colour on the Bank of England's position will be gleaned from the appearances of a number of MPC members in front of the Parliamentary Treasury Committee on Tuesday. Revised Q4 GDP will also be of interest but mostly for the detail it sheds on the -0.3% q/q decline.

USD/JPY pauses

USD/JPY has steadied after its sharp rise since the turn of the year, but its pullback has been limited and is likely to be more of a pause than a reversal of its underlying trend. Markets are still awaiting the names of the new Bank of Japan governor and his deputies, which should be due in a number of days. Japanese economic data due out this week are expected to show improving industrial production and business surveys but ongoing deflation, maintaining the incentive to do more to stimulate growth.

China's tightening steps

Chinese data releases will take on more significance in view of the steps recently announced to slow the property sector in China as well as to drain liquidity from the financial system in an attempt to head-off any resumption of inflation. Such steps may have come as a surprise, but house prices rose 1.0% m/m in January, the largest rise in 2 years, and the authorities do not want the recovery to turn into another uncontrollable boom. The authorities will probably also tolerate a firmer CNY exchange rate in order to curb imported inflation, although the PBOC will probably wait to see where USD/JPY stabilizes first before encouraging any renewed USD/CNY losses. PMI data for February are due out at the end of the week, which help us to judge how much momentum the economy really has.

RBNZ warning on the 'Bird'

Implications of any Chinese tightening would probably be felt negatively by the commodity currencies of the AUD and the NZD. This may indeed be welcomed by the RBA and the RBNZ, as both central banks view their currencies as being overvalued. Of interest last week were the words of RBNZ Governor Graeme Wheeler who raised the possibility of intervention to weaken the NZD. Coming so soon after the G20 called on members to desist from weakening their exchange rates directly, the comments raised some eyebrows. However, in the context of heightened global currency competition the recourse to such rhetoric is not hugely surprising, especially from a small and relatively open economy like New Zealand which is vulnerable to volatile capital flows.

Indian budget the next test for the INR

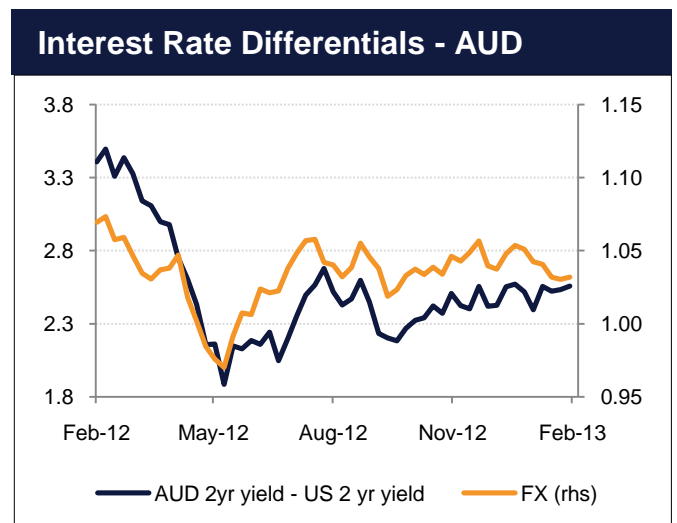
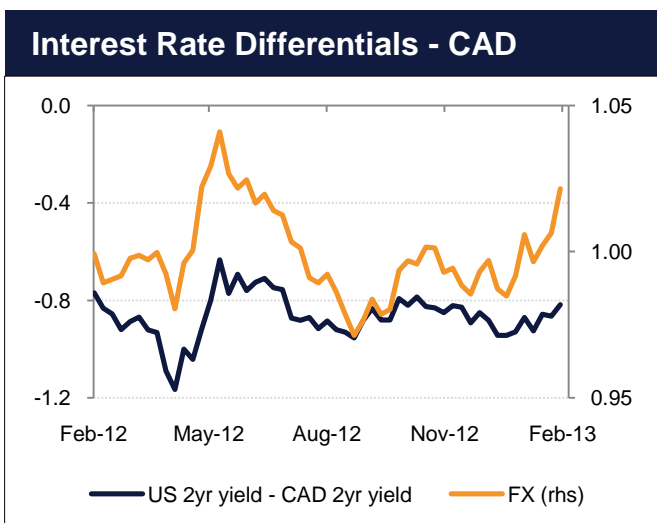
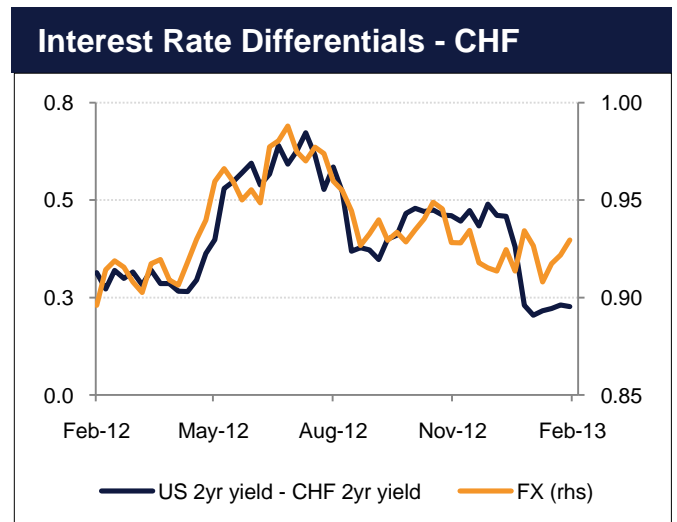
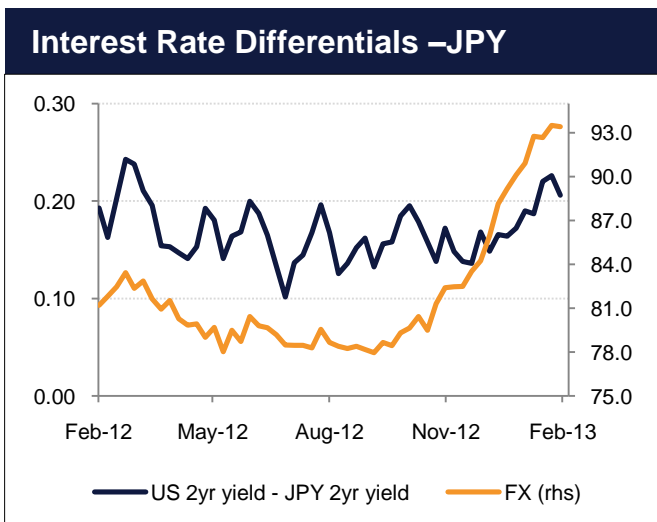
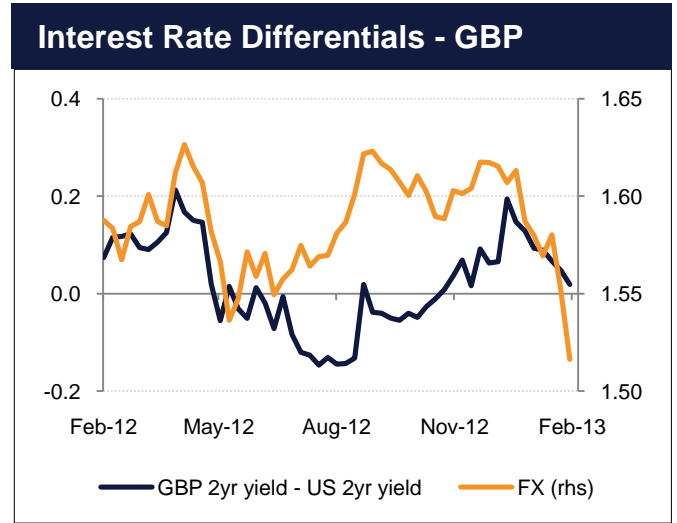
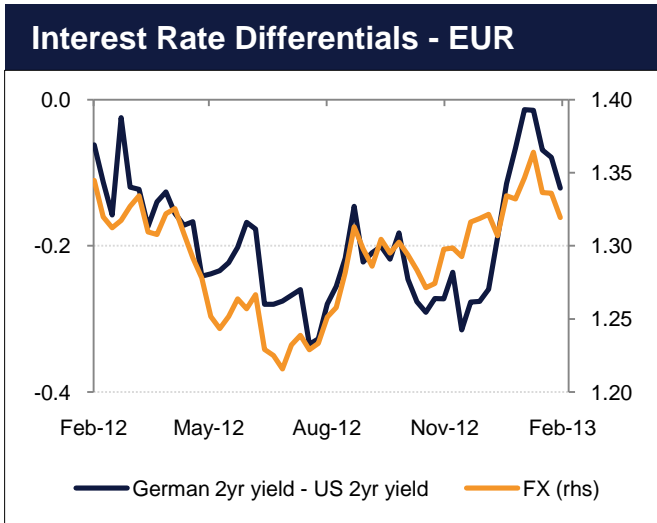
Finally, the INR has risen 1.5% year-to-date, starting the year on a strong footing following steps taken by the Indian government to manage its 'twin' deficits. However, it has lost some momentum recently falling -0.7% over the last month on account of resurgent USD strength. The next catalyst for the INR should be the Indian budget announcement later this week. In all likelihood, it is going to be the most austere budget in recent years as the focus of the government remains on managing its fiscal and current account deficit and reviving inward investment flows.

FX Forecasts - Major						Forwards		
	Spot 22.02	1M	3M	6M	12M	3M	6M	12M
EUR / USD	1.3194	1.30	1.25	1.20	1.15	1.3203	1.3213	1.3233
USD / JPY	93.42	94.0	95.0	97.0	100.0	93.36	93.28	93.04
USD / CHF	0.9295	0.94	0.96	1.02	1.08	0.9285	0.9274	0.9247
GBP / USD	1.5163	1.50	1.47	1.42	1.45	1.5156	1.5150	1.5142
AUD / USD	1.0320	1.01	0.97	0.94	0.90	1.0250	1.0184	1.0052
USD / CAD	1.0215	1.03	1.05	1.07	1.10	1.0235	1.0255	1.0297
EUR / GBP	0.8699	0.87	0.85	0.85	0.79	0.8709	0.8719	0.8736
EUR / JPY	123.22	122.2	119.0	116.0	115.0	123.22	123.22	123.22
EUR / CHF	1.2263	1.22	1.20	1.22	1.25	1.2259	1.2253	1.2236
FX Forecasts - Emerging						Forwards		
	Spot 22.02	1M	3M	6M	12M	3M	6M	12M
USD / SAR*	3.7502	3.75	3.75	3.75	3.75	3.7504	3.7509	3.7519
USD / AED*	3.6730	3.67	3.67	3.67	3.67	3.6729	3.6731	3.6732
USD / KWD	0.2829	0.282	0.285	0.282	0.28	0.2835	0.2837	0.2845
USD / OMR*	0.3850	0.38	0.38	0.38	0.38	0.3842	0.3835	0.3827
USD / BHD*	0.3770	0.376	0.376	0.376	0.376	0.3771	0.3778	0.3783
USD / QAR*	3.6409	3.64	3.64	3.64	3.64	3.6430	3.6442	3.6480
USD / INR	54.1850	53.25	53.00	52.00	51.00	54.1951	54.2034	54.2193
USD / CNY	6.2389	6.23	6.22	6.20	6.25	6.2955	6.3050	6.3238

*Denotes USD peg

Source: Bloomberg, Emirates NBD Research

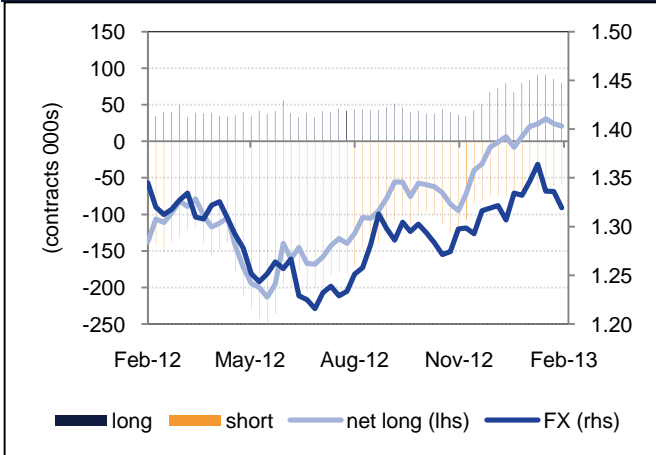
Major Currency Pairs and Interest Rates



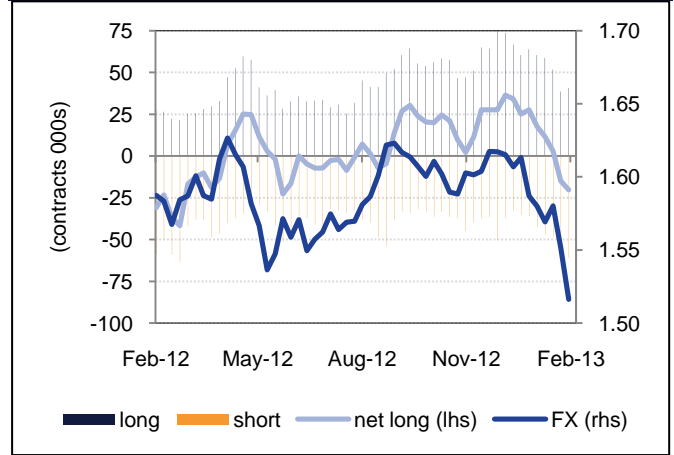
Source: Bloomberg, Emirates NBD Research

Major Currency Positions

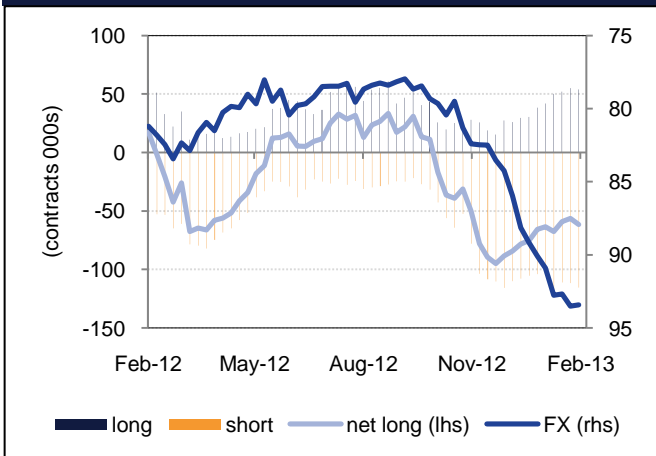
CFTC – Speculative Positions - EUR



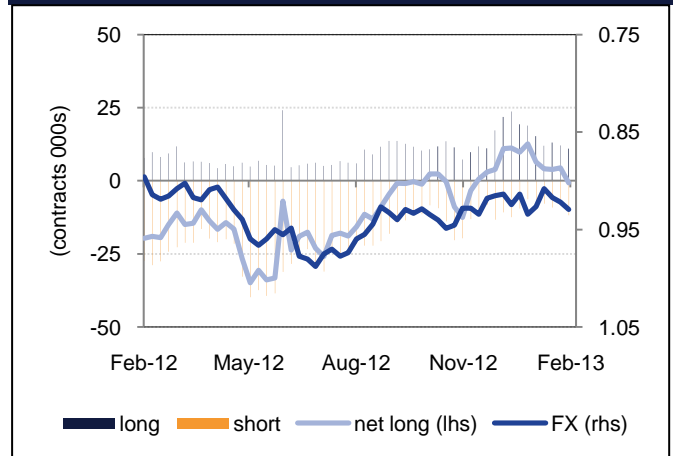
CFTC – Speculative Positions - GBP



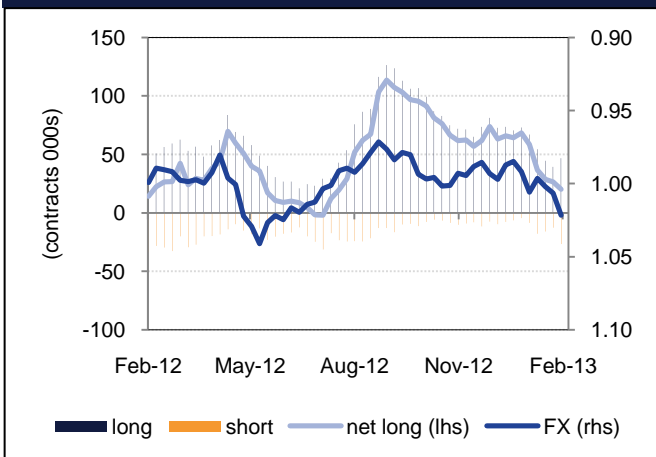
CFTC – Speculative Positions - JPY



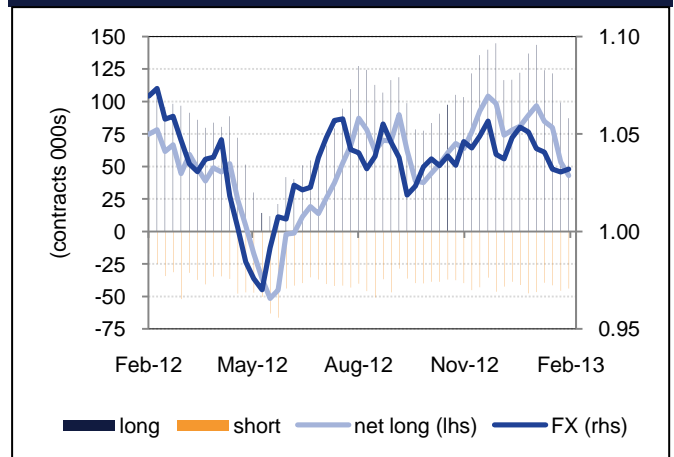
CFTC – Speculative Positions - CHF



CFTC – Speculative Positions - CAD



CFTC – Speculative Positions - AUD



Source: Bloomberg, Emirates NBD Research

Economic Calendar

Date	Country	Event
25-Feb	China	HSBC Flash Manufacturing PMI
	US	Chicago Fed Nat Activity Index
	US	Dallas Fed Manufacturing Activity
26-Feb	UK	Nationwide House Prices
	UK	CBI Reported Sales
	Brazil	Unemployment Rate
	US	S&P/Case Shiller Home Price
	US	Richmond Fed Mfg Index
	US	Consumer Confidence
	US	New Home Sales
	US	Consumer Confidence
27-Feb	Japan	Retail Trade
	Germany	GfK Consumer Confidence
	Italy	Business Confidence
	UK	GDP
	Eurozone	Business Climate
	US	MBA Mortgage Applications
	US	Durable Good Order
	US	Durable Good Order
	US	Durable Good Order
	US	Durable Good Order
28-Feb	Japan	Industrial Production
	UK	GfK Consumer Confidence Survey
	India	GDP
	Switzerland	GDP
	Germany	CPI
	Germany	Unemployment Rate
	Eurozone	CPI
	Switzerland	CPI
	US	GDP
	US	Core PCE
	US	Initial Jobless Claims
	US	Chicago Purchasing Manager
	US	Kansas City Fed Mfg Activity
	India	Budget
	India	Budget
1-March	Japan	Jobless Rate
	Japan	CPI
	China	Manufacturing PMI
	Switzerland	PMI Manufacturing

1-March	Italy	PMI Manufacturing
	France	PMI Manufacturing
	Germany	PMI Manufacturing
	Eurozone	PMI Manufacturing
	Italy	Unemployment Rate
	UK	PMI Manufacturing
	Italy	CPI
	Brazil	GDP
	Canada	GDP
	US	PCE Core
	US	U of Michigan Confidence
	US	ISM Manufacturing

Source: Bloomberg

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