



بنك الإمارات دبي الوطني
Emirates NBD

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FX Week

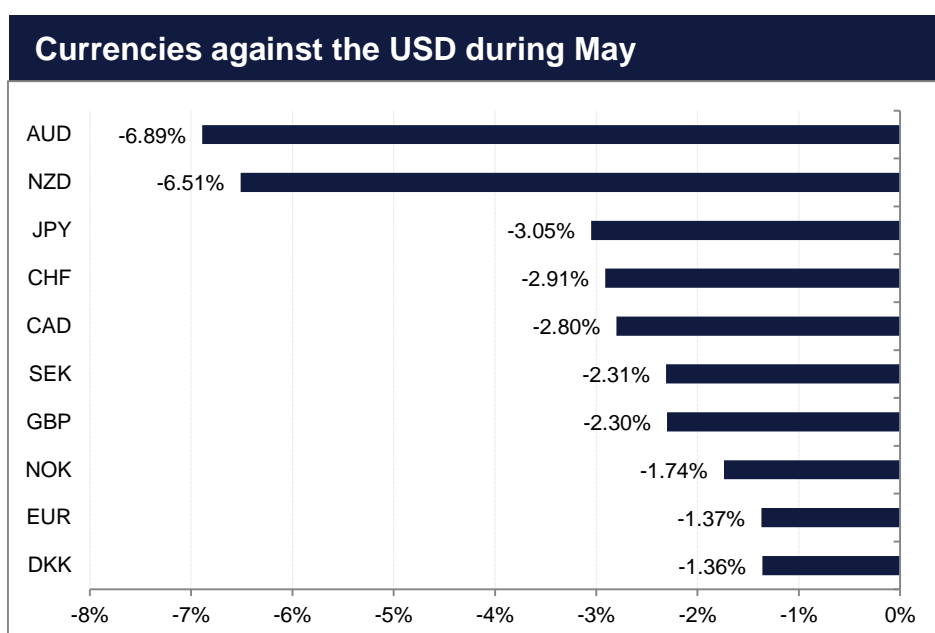
Volatile markets amidst Fed 'tapering' fears

Financial markets were volatile last week, driven by expectations about a change in Fed monetary policy. Specifically, markets are becoming fearful that the Fed could begin to 'taper', or reduce, its open-ended QE purchases of Treasury bonds and MBS assets, if not at the upcoming Fed meeting in June, then most likely later in the year. Indeed, last week we wrote that a H2 'tapering' was now firmly in play, and the price action over the last few days appears to have vindicated this view. Yields on US government debt surged on Wednesday, breaking the range that had been in place during the first half of the year, following surprising strength in US consumer confidence in April, as well as further signs of the ongoing recovery in US house prices.

This followed comments the previous week by Fed officials (including from Chairman Bernanke) suggesting that QE could begin to be eased 'in the next few meetings'. US 10-year bond yields reached as high as 2.23% on Wednesday, up from 1.61% at the start of May, while equity markets also lost ground having reached record highs only days before. Japanese equities were amongst the worst affected, falling by 13% from their 23rd May peak, with Japanese bond markets having already begun to cause jitters about whether 'Abenomics' was actually likely to succeed in righting the Japanese economy. Emerging markets, which have been amongst the principal beneficiaries of QE over the past few years, were also significant casualties, seeing their bond yields also rising sharply.

USD impact mixed and exaggerated by month-end

The currency impact was mixed for the USD, with strength against most EM and commodity currencies (especially the ZAR, MXN and HUF), but relative softness against other G4 currencies, especially the safe-havens of the JPY and the CHF. These patterns were compounded by month-end profit-taking, particularly on long USD/JPY positions, but also across other currency pairs. As the new month gets underway, we would expect some of these extreme moves to begin to stabilize, with the USD gradually beginning to reassert itself again against major currencies. This already appeared to be happening on Friday, with USD recovering some lost ground against the EUR in particular as speculation about another ECB interest rate cut surfaced.



Source: Bloomberg, Emirates NBD Research

US jobs data assumes even greater significance

In the coming week, a number of important events stand out as key determinants of where financial markets will go from here. The most important of these will be US employment data for May, along with the monthly ISM activity readings. Recent US economic data has probably not been strong enough to justify the Fed announcing any formal change in policy at its next June 18-19 meeting, when new economic projections will be released and a press conference will be held. However, a strong payrolls report might create an outside risk of more hawkish comments, with a view to a policy change later in the year, either in September or December.

Consensus expectations are for May payrolls to have increased by 165k, which should be greeted broadly favorably, especially if combined with another drop in the unemployment rate. However, a rise of 200k or above, which is not out of the question, would undoubtedly provide a further twist to the markets' 'tapering' expectations. This should be bearish for bond markets but bullish for the USD. Having been in a 1.60-2.04% range this year until last week, we think that 10-year bond yields have now broken out and are beginning a new upward trend which will develop further in H213. This trend should be constructive for the USD too, which has already been on an improving trend since the beginning of the year in DXY terms

USD/JPY highly correlated to USD bull cycles

USD strength driven by firming US yields should be manifest most through the JPY. USD/JPY strength has been a central feature of most USD bull trends over the last 30 years, having a correlation of close to 0.80. Given the recent volatility in Japanese markets we would not rule out USD/JPY correcting further first before the payrolls report is released, below 100 for example. However, we would expect the overall bull trend to reassert should US yields, supported by improving US fundamentals, begin to move higher again. Relative to these factors, concerns over Japanese markets will probably dissipate especially if the BOJ is successful in holding 10-year JGB yields below 1.0%, which seems likely.

ECB policy also in focus

An ECB interest rate decision on Thursday will also be an important variable, as it always is at the beginning of any month. On Friday there were some hints from Bank of Italy Governor Visco that another interest rate cut might be being considered. This followed on from ECB Board member Asmussen saying that the central bank was having 'an open discussion' on the merits of cutting the deposit rate below zero. However, slightly better activity indicators reported over the last month, as well as firmer inflation, will probably keep the ECB on hold for the time being, even though overall activity levels are still largely consistent with the Eurozone continuing to contract again in the current quarter. Some softening in austerity timetables, also announced last week, may hold out the prospect of a stabilization and even a small recovery in 2014, but renewed efforts over structural reforms could offset these as in the short term their effects are more likely to be negative than positive. With the EUR likely having benefited from month-end seasonal buying last week, we would suspect that it could be vulnerable again with or without another rate cut. An updated set of staff projections are likely to bring downward projections to growth and inflation forecasts, and while Draghi may also provide an update on the progress of an Asset Backed Securities purchase program announced last month, its' likely impact is already being questioned by other ECB officials.

GBP – Governor King's last stand

Governor King's last MPC meeting will also be held in the coming week. GBP has been relatively sidelined in recent days, a situation that may continue until the policy outcome is known. Having resisted King's advocacy for another round of QE in recent

months it would be surprising if the Committee changed its mind at his last meeting as Governor. More likely any policy change that might be being considered will probably be announced by the new Governor Carney who takes office from next month. UK trade figures later in the week, along with the latest monthly CIPS/Markit activity indicators may present a contrasting picture of the UK's economic performance currently, with activity perking up but the trade deficit still a heavy burden. This is largely reflected in the pound's inability to break below USD1.50 recently, our 1-month target. However, an eventual break of this level does still seem likely in our view, as another round of BOE asset purchases comes into view from July.

AUD – May's weakest link

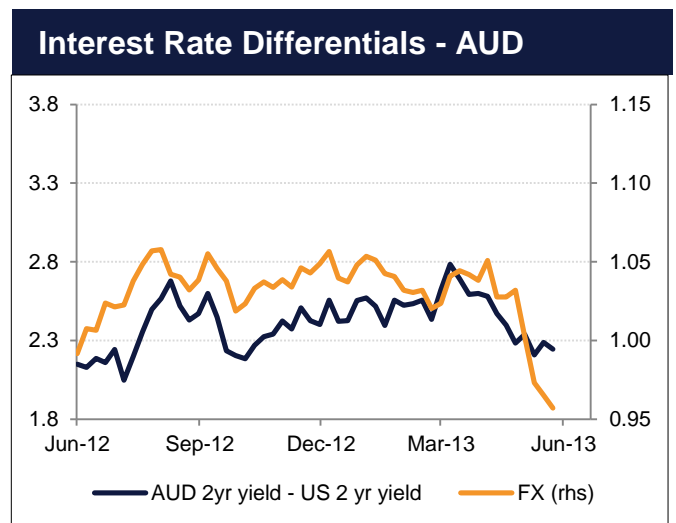
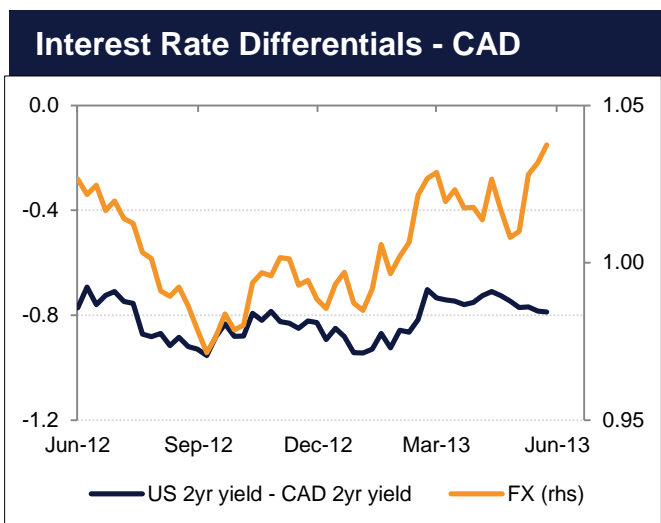
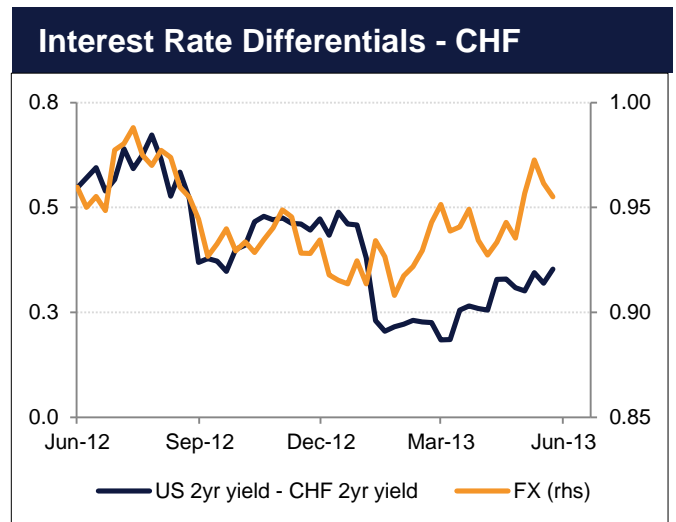
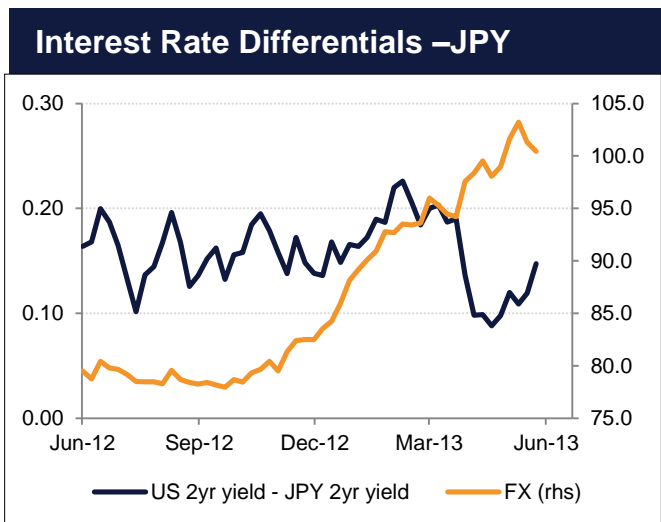
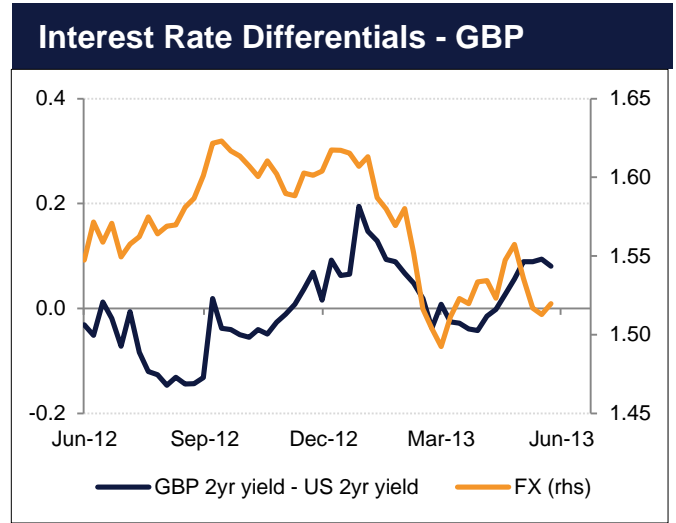
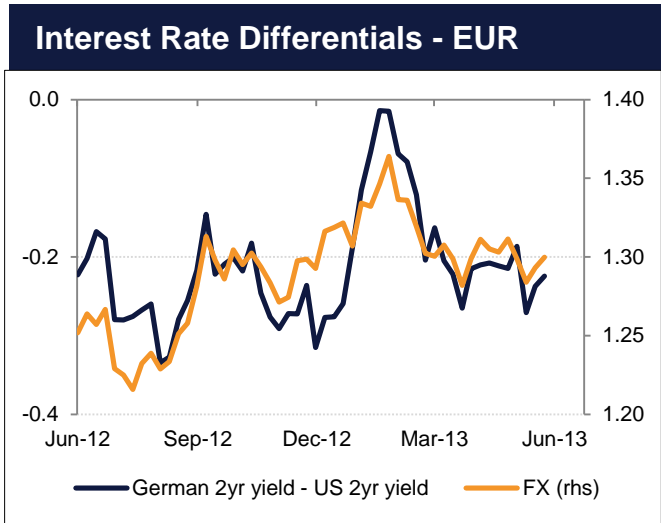
The AUD will also be in focus from a policy perspective with an interest rate announcement from the RBA due on Tuesday followed by the publication of the Q1 GDP report on Wednesday. The AUD has been barely able to correct at all during its May plunge, having fallen from 1.0380 on the 1st May to 0.9570 currently, making it the weakest G10 currency over the whole month falling by -6.9%. Growth is expected to moderate in Q1 as the investment boom in the mining sector has eased, and while another rate cut is not expected this week, we would still expect rates to fall to 2.50% before the end of the year, keeping pressure on the AUD. The NZD has also been under acute pressure as the RBNZ governor Wheeler has recently acknowledged the problems of managing an overvalued currency, having even intervened over the last few weeks to depress it. The NZD predicament is complicated, however, by a booming housing market, which might mean that the RBNZ may eventually have to raise interest rates, from their current 2.50%, whilst also fighting to dampen NZD demand. Such contrasting monetary policy risks between the RBA and the RBNZ leave the AUD as more vulnerable than the NZD, although the slide in the AUD/NZD cross since March is already largely a reflection of these issues.

FX Forecasts - Major						Forwards		
	Spot 31.05	1M	3M	6M	12M	3M	6M	12M
EUR / USD	1.2999	1.27	1.25	1.20	1.15	1.3006	1.3015	1.3039
USD / JPY	100.45	103.0	105.0	107.0	110.0	100.40	100.34	100.11
USD / CHF	0.9551	0.98	1.00	1.04	1.08	0.9542	0.9531	0.9504
GBP / USD	1.5198	1.50	1.48	1.45	1.45	1.5189	1.5182	1.5173
AUD / USD	0.9571	0.98	0.97	0.94	0.90	0.9509	0.9453	0.9344
USD / CAD	1.0375	1.03	1.05	1.07	1.10	1.0398	1.0420	1.0466
EUR / GBP	0.8552	0.85	0.84	0.83	0.79	0.8561	0.8571	0.8592
EUR / JPY	130.64	131.0	131.0	128.4	126.5	130.64	130.64	130.64
EUR / CHF	1.2414	1.24	1.25	1.25	1.24	1.2409	1.2404	1.2391
FX Forecasts - Emerging						Forwards		
	Spot 31.05	1M	3M	6M	12M	3M	6M	12M
USD / SAR*	3.7506	3.75	3.75	3.75	3.75	3.7503	3.7501	3.7494
USD / AED*	3.6730	3.67	3.67	3.67	3.67	3.6728	3.6727	3.6726
USD / KWD	0.2859	0.282	0.285	0.282	0.28	0.2870	0.2873	0.2884
USD / OMR*	0.3850	0.38	0.38	0.38	0.38	0.3848	0.3846	0.3843
USD / BHD*	0.3770	0.376	0.376	0.376	0.376	0.3775	0.3779	0.3785
USD / QAR*	3.6414	3.64	3.64	3.64	3.64	3.6433	3.6450	3.6486
USD / INR	56.5050	53.50	53.00	52.00	51.00	56.5149	56.5236	56.5395
USD / CNY	6.1345	6.23	6.22	6.20	6.25	6.1980	6.2185	6.1830

*Denotes USD peg

Source: Bloomberg, Emirates NBD Research

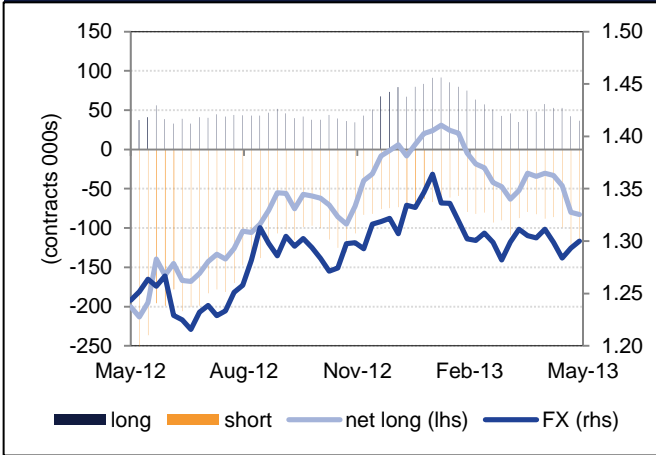
Major Currency Pairs and Interest Rates



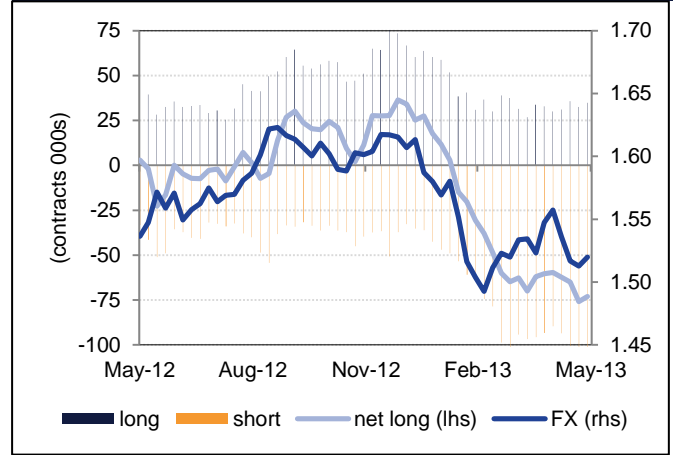
Source: Bloomberg, Emirates NBD Research

Major Currency Positions

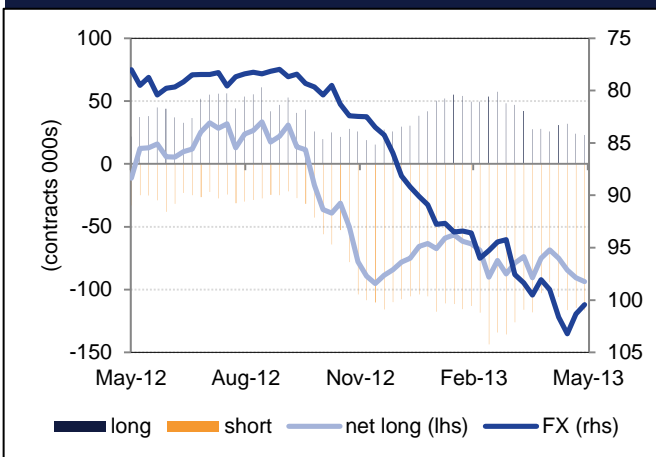
CFTC – Speculative Positions - EUR



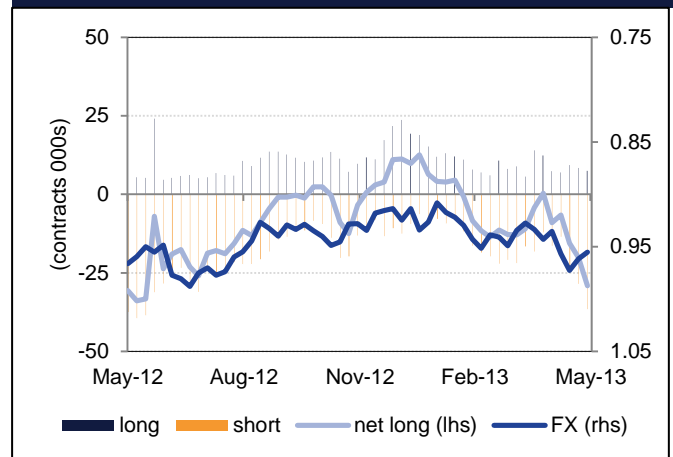
CFTC – Speculative Positions - GBP



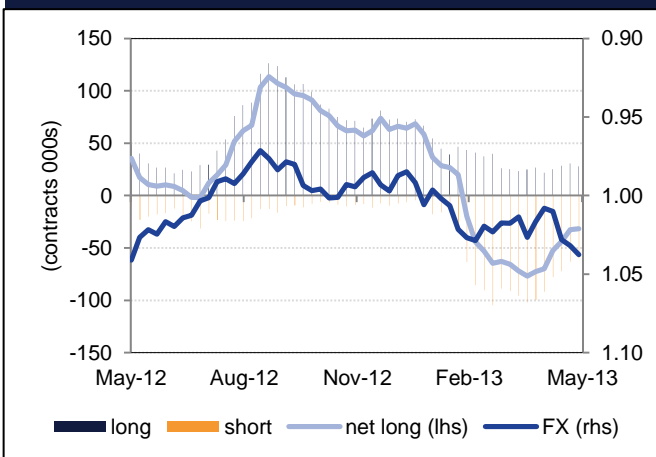
CFTC – Speculative Positions - JPY



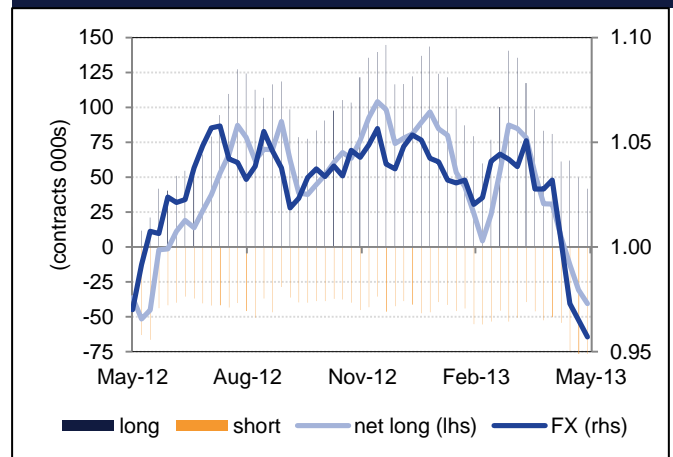
CFTC – Speculative Positions - CHF



CFTC – Speculative Positions - CAD



CFTC – Speculative Positions - AUD



Source: Bloomberg, Emirates NBD Research

Economic Calendar

Date	Country	Event
3-June	China	Non-manufacturing Sales
	Australia	Retail Sales
	China	HSBC Manufacturing PMI
	Switzerland	PMI Manufacturing
	Italy	PMI Manufacturing
	France	PMI Manufacturing
	Germany	PMI Manufacturing
	Eurozone	PMI Manufacturing
	UK	PMI Manufacturing
	Brazil	PMI Manufacturing
	US	ISM Manufacturing
	Brazil	Trade Balance
	4-June	Australia
Brazil		Industrial Production
US		Trade Balance
5-June	Russia	CPI
	Australia	GDP
	Italy	PMI Services
	France	PMI Services
	Germany	PMI Services
	Eurozone	PMI Services
	UK	PMI Services
	Eurozone	GDP
	Eurozone	Retail Sales
	US	MBA Mortgage Applications
	US	ADP Employment Change
	US	Factory Orders
	US	ISM Non-Mfg Composite
US	Federal Reserve Beige Book	
6-June	Australia	Trade Balance
	France	Unemployment Rate
	Switzerland	CPI
	UK	BoE announces Rates
	Eurozone	ECB announces Rates
US	Initial Jobless Claims	

7-June	Germany	Trade Balance
	France	Trade Balance
	Germany	Industrial Production
	Canada	Unemployment Rate
	US	Change in non-farm payrolls
8-June	China	Trade Balance

Source: Bloomberg

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