بنك الإمارات دبي الوطني
Emirates NBD

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FX Week

Conditions are aligning for further USD strength

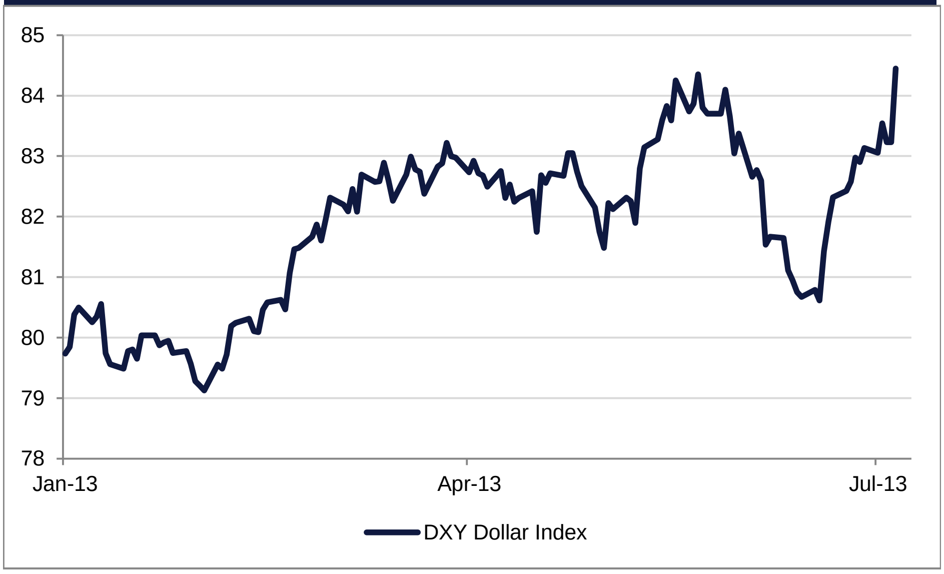
Events at the end of last week provided further support for our long-term bullish USD outlook, as strong US data benefited US yields thus giving the greenback a firm fundamental underpinning, whilst the messages from the ECB and the BOE undermined the recent resilience of the EUR and GBP. One week into H213, the stars are aligning that should propel major currency pairs towards our 3-month targets of EUR/USD1.25, USD/JPY105 and GBP/USD1.48. Indeed all of our 1-month forecasts set out in our June Monthly Insights publication have now been met, and the DXY dollar index is making new highs for the year.

US jobs data cements H213 ‘tapering’ risk

Since Fed Chairman Bernanke made his controversial comments about QE ‘tapering’ almost a fortnight ago, doubts have persisted that the US economy would not be strong enough to sustain a reduction in monetary policy stimulus, however gradual. These doubts were refuted by the June employment report, however, which showed a stronger than expected 195k gain in non-farm payrolls growth during the month, as well as back revisions which restored the monthly average for jobs growth to just over 200k so far in 2013. Admittedly, another large increase in the size of the US labour force prevented the unemployment rate from slipping from its current 7.6%, but the conditions still look favourable in our view for the unemployment rate to reach the 7.0% threshold set by the Fed to warrant an exit from QE by mid-2014.

The bond yield response, setting new cycle highs of 2.74% in 10-year terms, provides the USD with timely support, as the case for QE ‘tapering’ to begin following the September FOMC meeting would seem to have been cemented. With this occurring just as European central banks were seeking to distance themselves from the Fed’s exit strategy, instead gingerly embarking on their own version of ‘forward guidance’ in an attempt to keep policy expansionary, this provides a combination of forces that should continue to weigh on EUR/USD and GBP/USD in coming months

USD makes new highs for the year



Source: Bloomberg, Emirates NBD Research

Forward guidance European style

Both the ECB and the BOE intimated their disapproval of recent bond yield rises, with the ECB's 'forward guidance' being particularly forthright with President Draghi saying that 'the Governing Council expects the key ECB interest rates to remain at present *or lower levels* for an extended period of time. This expectation is based on the overall subdued outlook for inflation extending into the medium term, given the broad-based weakness in the real economy and subdued monetary dynamics'.

The Bank of England also provided an unusual statement to accompany its decision to leave monetary policy unchanged in July, stating that recent significant upward movement in market interest rates would weigh on the Bank's outlook for the economy and the 'implied rise in the expected future path of Bank rates was not warranted by the recent developments in the domestic economy'.

While the ECB provided an unprecedented level of guidance by its usual standards, it still remains a long way from the guidance we have become accustomed to from the US Federal Reserve, which over recent years has become quite detailed in elaborating the conditions for expecting monetary policy to change. While the Fed incorporated targets and thresholds for economic variables and for possible monetary policy actions, the ECB did not provide much in the way of detail about either the timetable envisaged or about the variables they are looking at, beyond general comments about the outlook for inflation and the state of the economy. Only when pressed did Draghi indicate that 'an extended period' means more than just six to twelve months. Over time, of course it is likely that the ECB will refine its guidance to include a greater level of detail and forms of conditionality.

From the Bank of England, Governor Carney's first statement was even less detailed, but more information is expected to be provided next month as we know that the Bank has been asked to provide a more formal form of guidance by Chancellor Osborne tied to the August Inflation Report, with future monetary policy actions likely to be linked to certain targets or thresholds for inflation, unemployment and the like.

EUR and GBP to remain heavy

September will also be a crucial month for the ECB and the Fed, as both central banks will update their economic projections in that month, which will presumably provide the opportunity for more detailed policy outcomes to be enunciated and announced. Just as the Fed is expected to embark on its QE 'tapering', the possibility is that the ECB could announce some further monetary easing. Anticipation of these events can be expected to weigh on EUR/USD over the summer, in addition to other structural issues that may also dampen the EUR over this period. There is already renewed focus on the periphery, with Greece facing a deadline Monday over whether it will receive its next tranche of bailout money from the IMF and the Troika. Portugal also faces a crucial week with political parties there set to meet together Monday to see if a revised coalition government can be formed, enough to keep the government in place and reforms on track. The week ahead will also see French and German industrial production data which may add to the pressure on the EUR if, as seems likely, production disappoints relative to expectations.

US economic news will also be in focus in the week ahead, especially the minutes of the last Fed meeting which the markets will be looking for to provide a better understanding of the 'tapering' debate at the Fed, specifically when and by how much QE can be expected to be trimmed. Fed Chairman Bernanke is also due to speak this week, and he will no doubt emphasize that 'tapering' is not 'tightening' thus attempting to calm market nerves.

USD/JPY's June losses almost recouped

In the light of recent events in the US and the Eurozone, it is easy to take one's eyes off Japan, but USD/JPY has also benefited strongly from last week's US data, and is back within range of its May 103.70 highs. The Japanese authorities will be pleased that this is being achieved without as much volatility as before, with JGB bond yields relatively steady last week despite bond yield rises elsewhere. In this environment the BOJ is unlikely to announce any new measures when it meets in the week ahead. Economic data from Japan has also been improving in recent weeks, and further signs of this continuing will also be of assistance to both the Nikkei and to USD/JPY. Markets are also beginning to focus on the upcoming Upper House elections in Japan on July 21st, with hopes of an LDP victory likely to encourage expectations that much needed structural reforms will be enacted, supplementing already powerful monetary and fiscal policy stimulus measures.

AUD still has more downside

Finally the AUD's fall from grace is showing little signs of abating and with US bond yields starting to erode the AUD's interest rate advantage it is easy to understand why. With the RBA maintaining its easing bias last week, we continue to expect it to cut interest rates in the coming quarter, and thereby undercut the AUD's support even further. Although its decline has been sharp since May, it is worth remembering that estimates of equilibrium for the AUD/USD are closer to 0.70 than 0.90 where it currently stands. Also, positioning data shows that the market has turned net short the AUD only recently, implying further downside risks, particularly as the monetary policy divergence between the US and Australia probably has years more to run.

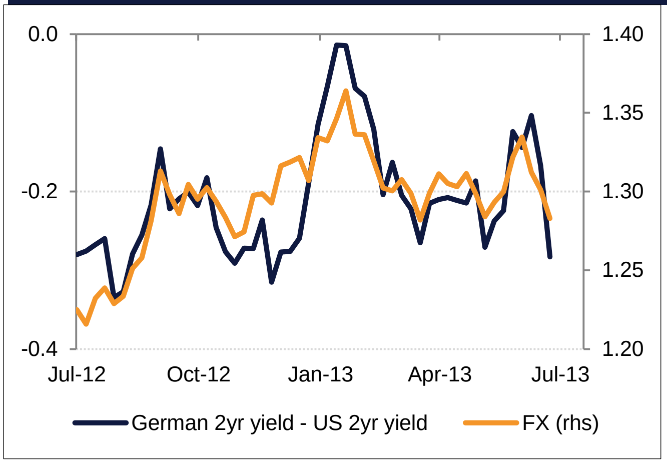
FX Forecasts - Major						Forwards		
	Spot 05.07	1M	3M	6M	12M	3M	6M	12M
EUR / USD	1.2829	1.27	1.25	1.20	1.15	1.2834	1.2843	1.2867
USD /JPY	101.20	103.0	105.0	107.0	110.0	101.15	101.06	100.76
USD / CHF	0.9640	0.98	1.00	1.04	1.08	0.9632	0.9621	0.9588
GBP / USD	1.4890	1.48	1.47	1.45	1.45	1.4881	1.4874	1.4868
AUD / USD	0.9067	0.90	0.88	0.85	0.80	0.9007	0.8951	0.8843
USD / CAD	1.0582	1.03	1.05	1.07	1.10	1.0606	1.0629	1.0673
EUR / GBP	0.8618	0.84	0.85	0.83	0.79	0.8627	0.8636	0.8656
EUR / JPY	129.82	131.0	131.0	128.4	126.5	129.82	129.82	129.82
EUR / CHF	1.2366	1.24	1.25	1.25	1.24	1.2361	1.2354	1.2336

FX Forecasts - Emerging						Forwards		
	Spot 05.07	1M	3M	6M	12M	3M	6M	12M
USD / SAR*	3.7505	3.75	3.75	3.75	3.75	3.7504	3.7510	3.7509
USD / AED*	3.6729	3.67	3.67	3.67	3.67	3.6728	3.6729	3.6724
USD / KWD	0.2865	0.282	0.285	0.282	0.28	0.2894	0.2901	0.2936
USD / OMR*	0.3850	0.38	0.38	0.38	0.38	0.3847	0.3832	0.3820
USD / BHD*	0.3770	0.376	0.376	0.376	0.376	0.3778	0.3780	0.3791
USD / QAR*	3.6415	3.64	3.64	3.64	3.64	3.6435	3.6447	3.6464
USD / INR	60.2400	56.75	55.50	55.00	53.75	60.2507	60.2603	60.2777
USD / CNY	6.1328	6.15	6.15	6.20	6.20	6.2165	6.2430	6.2955

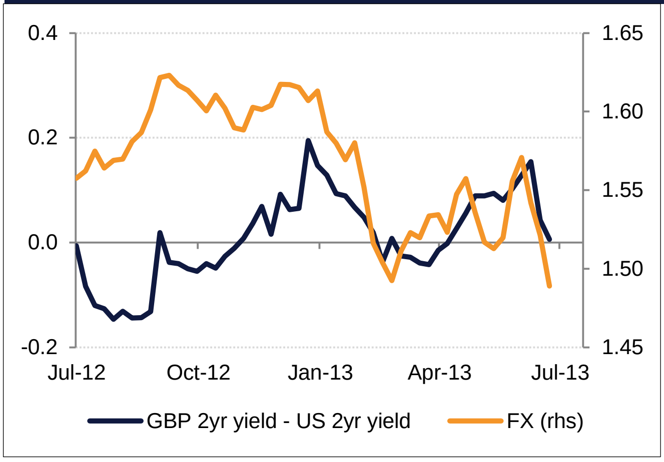
**Denotes USD peg*
Source: Bloomberg, Emirates NBD Research

Major Currency Pairs and Interest Rates

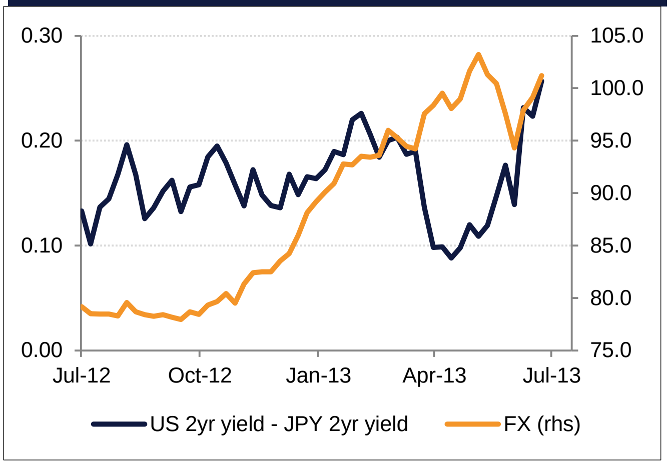
Interest Rate Differentials - EUR



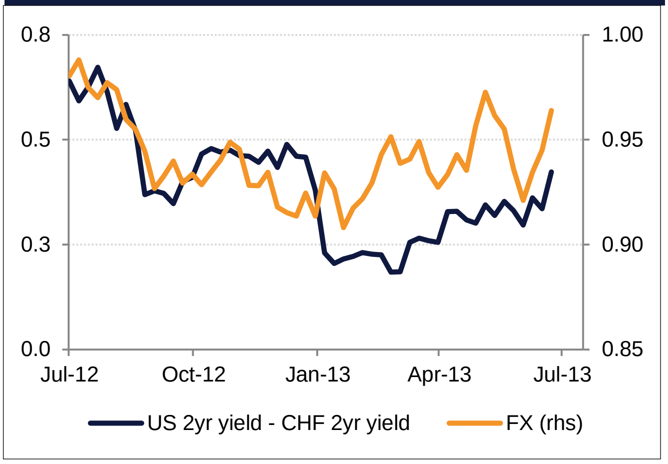
Interest Rate Differentials - GBP



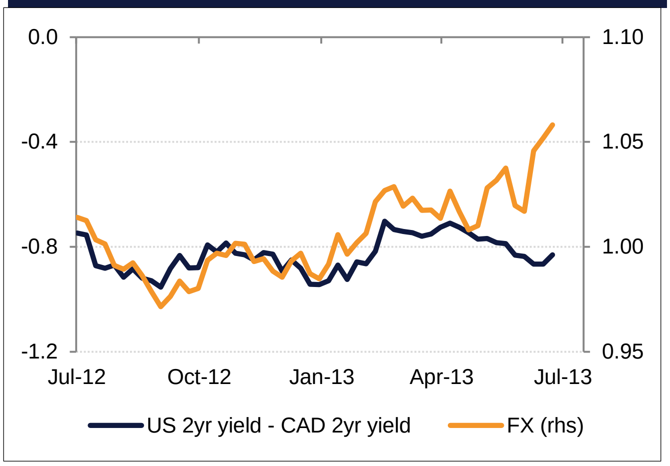
Interest Rate Differentials –JPY



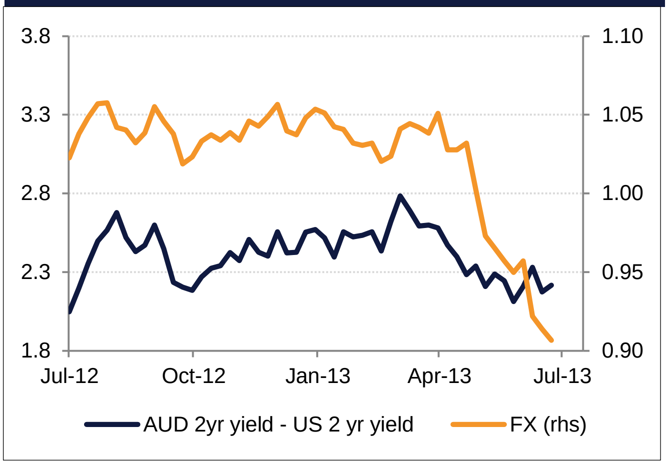
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD



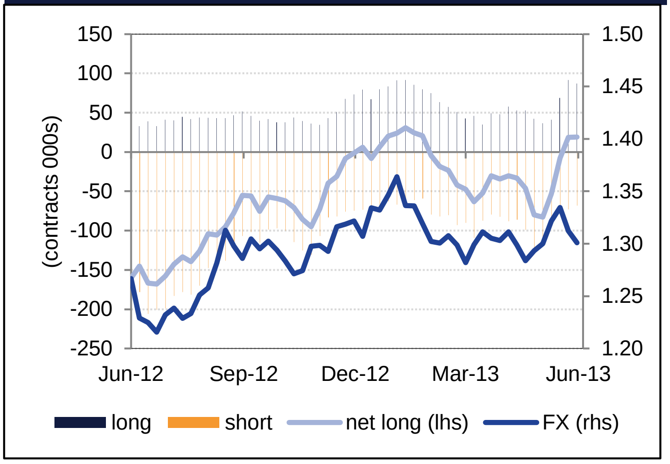
Interest Rate Differentials - AUD



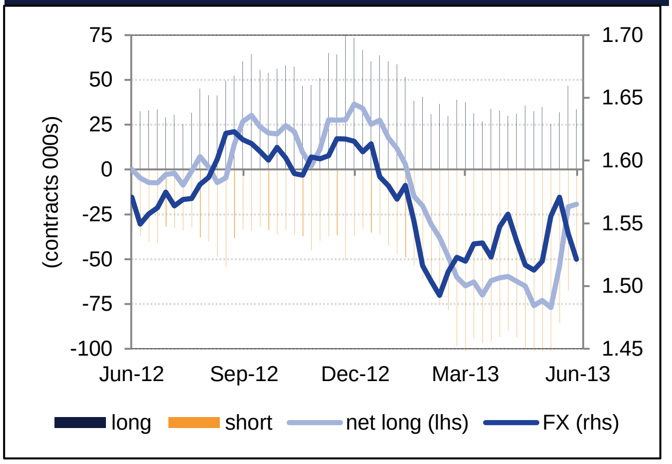
Source: Bloomberg, Emirates NBD Research

Major Currency Positions*

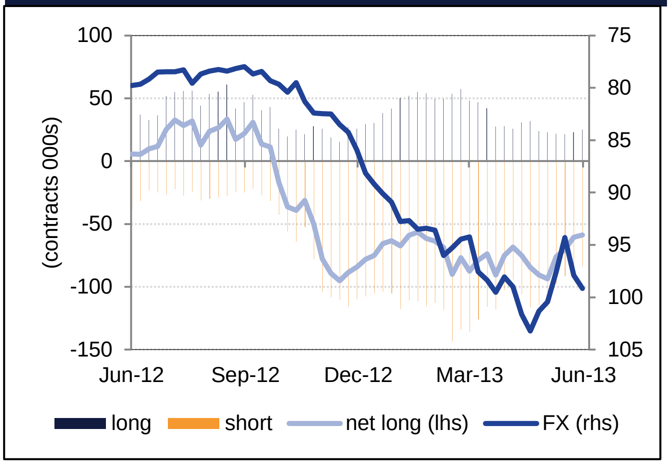
CFTC – Speculative Positions - EUR



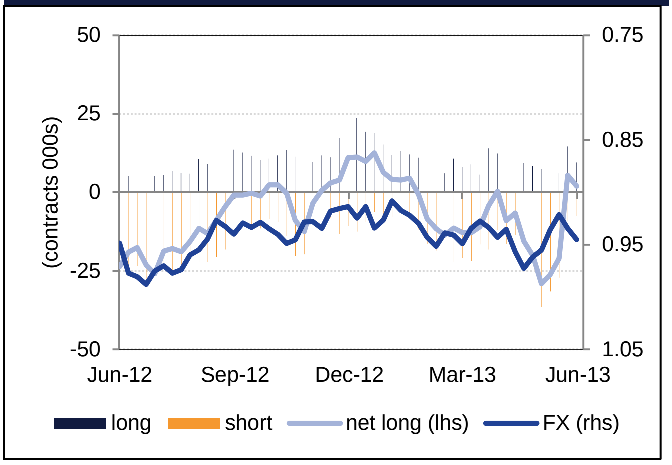
CFTC – Speculative Positions - GBP



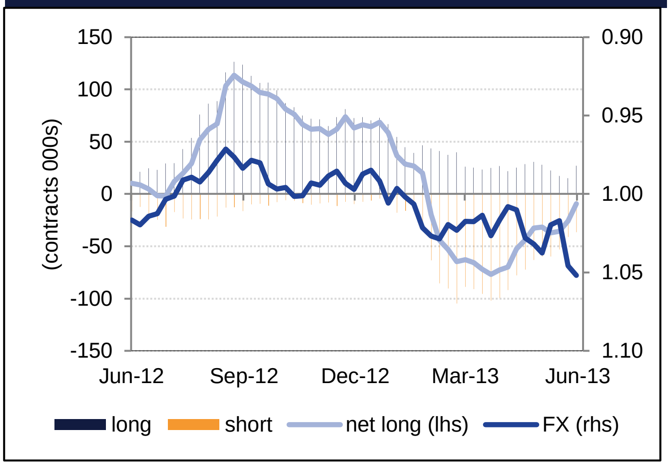
CFTC – Speculative Positions - JPY



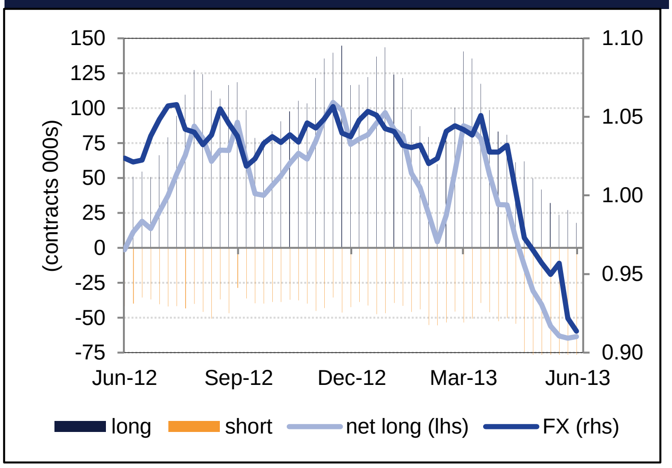
CFTC – Speculative Positions - CHF



CFTC – Speculative Positions - CAD



CFTC – Speculative Positions - AUD



Source: Bloomberg, Emirates NBD Research
**Data as of 25th June, 2013*

Economic Calendar

Date	Country	Event
8-July	Japan	Trade Balance
	Switzerland	Unemployment Rate
	Germany	Trade Balance
	France	Bank of France Business Sentiment
	Switzerland	Industrial Production
	Germany	Industrial Production
9-July	China	CPI
	Switzerland	Retail Sales
	UK	Industrial Production
	UK	Trade Balance
	Canada	Housing Starts
10-July	Japan	Tertiary Industry Index
	Germany	CPI
	France	Industrial Production
	Italy	Industrial Production
	US	MBA Mortgage Applications
	US	Fed Meeting Minutes
	Brazil	SELIC Target
	Egypt	CPI
	China	Trade Balance
11-July	Australia	Unemployment Rate
	France	CPI
	Brazil	Retail Sales
	US	Initial Jobless Claims
	US	Monthly Budget Statement
	Japan	Bank of Japan Monetary Policy Statement
12-July	Japan	Industrial Production
	Italy	CPI
	Eurozone	Industrial Production
	US	U of Michigan Confidence
	India	CPI

Source: Bloomberg

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