بنك الإمارات دبي الوطني
Emirates NBD

Weekly
10 November 2013

FX Week

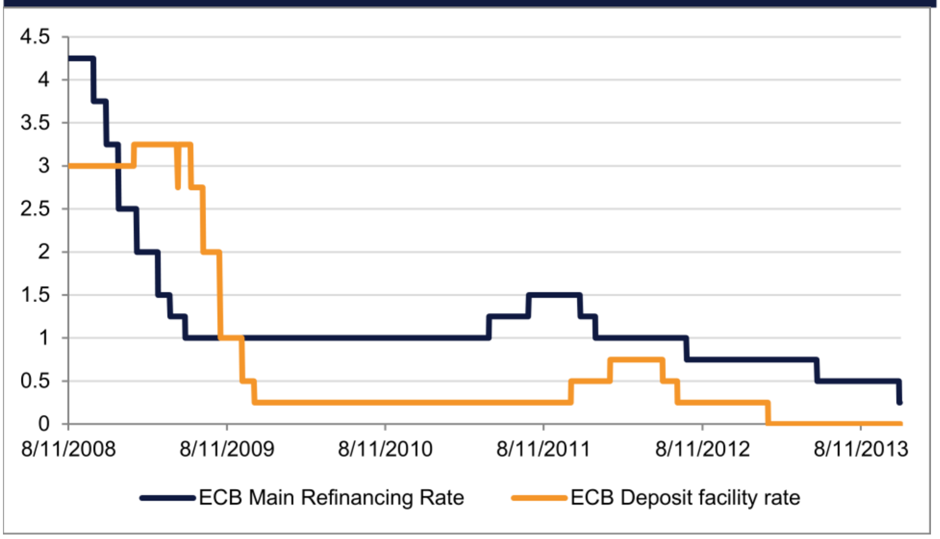
EUR plunges on ECB 'surprise'

The EUR fell sharply at the end of last week after the ECB cut key interest rates and as the US economy showed surprisingly strong momentum. The main catalyst for the EUR/USD's plunge to 1.33 on late Thursday was the decision by the ECB to cut its main refinance rate to 0.25% as we had expected it might. Most of the markets, however, were surprised by the move, and took it to mean that the ECB is becoming more concerned about deflationary risks across the Eurozone economy, with the possibility that more measures will still have to be introduced to shore up demand. ECB President Draghi acknowledged that inflation will remain low for a prolonged period, although he was at pains to point out that it was not at risk of entering a period of deflation. Although the EUR managed to recover back above 1.34, it sold-off again on Friday following the strong US October employment report, and after France's credit rating was cut by S&P to AA from AA+ on account of its poor fiscal position.

ECB policy outlook to weigh on single currency

The ECB's decision to cut the refinance rate to 0.25% was consistent with our long held forecasts and driven primarily by the drop in inflation to 0.7% in October, from 1.1% in September, and well below the ECB's rough 2.0% target. In the coming week the final estimate for October CPI will be released which will be closely watched to see if there are any revisions. Q3 Eurozone GDP will also be released which is expected to show the recovery relapse from a 0.3% growth rate in Q2 to just 0.1% in Q3. Although the ECB did not make any other significant changes, leaving the deposit rate at zero and announcing no new LTRO programs, ECB President Draghi appeared very dovish reiterating his forward guidance that key interest rates are expected to remain at current or lower levels for an extended period. He signaled that the ECB was ready to take other measures if necessary, implying that negative interest rates could still be an option. It is also worth noting that the Bundesbank appeared to oppose the cut, but the fact that its objection was overridden suggests that the majority of the ECB Council is now clearly becoming more concerned about the weakness of growth and the risks of inflation falling further. The EUR/USD exchange rate was not discussed apparently, but its weakness is unlikely to be unwelcome especially now that the risks of a Euro breakup appear to have passed. The ECB will update its staff forecasts next month and these will be looked at to determine the likelihood of any further stimulus measures. In this light the EUR is expected to continue to trade heavily in coming weeks, especially as the USD also has renewed impetus on the back of reviving 'tapering' hopes.

ECB delivers blow to the Euro



Source: Bloomberg, Emirates NBD Research

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USD benefits from US labour market upswing

The US labour market appears to have shrugged off the government shutdown in October with 204k jobs added during the month and with substantial upward revisions to previous data (60k over the preceding two months). Although the unemployment rate rose a little to 7.3% this was where the impact of the government shutdown was most felt, and for this reason it is likely to be temporary. Indeed with two of the last three months seeing jobs growth in excess of 200k, this is exactly the momentum that is needed to see a consistent reduction in the unemployment rate going forward.

Turn of year QE tapering back on the table

The data has rightly caused the market to reassess its assumptions that the US economy was slowing as the fiscal deadlock on Washington DC approached. Other data points recently have provided a similar message to the jobs report, with the ISM activity indices improving in October and with Q3 GDP growth surprising positively at 2.8% (seasonally adjusted annualized rate). As a result, expectations that 'tapering' would not begin until at least March of next year look to have been made too hastily, with a growing consensus again building around the possibility of the first move occurring around the turn of the year, probably in January, and with December no longer out of the question. In this respect the November payrolls report in early December will now be an even more crucial.

The message from key Fed policymakers will also be of increasing importance. In particular Fed Chair nominee Janet Yellen's appearance in front of the Senate Banking Committee on Thursday of this week will take on special significance as she is presumed to be in favour of delaying the onset of QE tapering. From the Fed's perspective the rise in bond yields over last week from 2.60% to just short of 2.75% may cause some anxiety, as tightening financial conditions were one on the reasons it held off from tapering in September when yields were elevated at around 3.0%. This concern was subsequently dropped in its statement in October when bond yields were closer to 2.50%. Managing market expectations may become less important however, if the economy begins to produce a more consistent improvement in its performance

One-month targets met

There has also been some conjecture that the Fed could combine a start to tapering with a refinement of its forward guidance over interest rate increases, lowering the unemployment rate threshold at which rate increases could begin, from 6.5% currently to 6.0% or even 5.5%. These are all questions that the market will be looking for clarification about, but for the time being the push up in yields is likely to keep the USD underpinned, with further gains likely as yields move closer to 3.0% again. Our one-month EUR/USD and GBP/USD forecasts of 1.34 and 1.60 have both been exceeded in the past few days, and our USD/JPY forecast of 100 is coming back into view. We have updated our one-month forecasts accordingly, and over the 3-month time horizon we still have forecasts of 1.31, 1.57 and 103 for these currency pairs respectively.

GBP strength still best played through the crosses

We continue to see the crosses as the best way to play GBP strength, following on from positive macroeconomic data in the UK in recent weeks. This data has not prevented the pound from easing back against the USD, but it has caused it to outperform the EUR and most recently the JPY as well. The coming week will see the Bank of England Quarterly Inflation Report released which is expected to include a downward revision to the Bank's unemployment rate forecast. September unemployment data and October retail sales data will also both be watched closely. The distinctions the Bank makes about the unemployment rate will be important, for even though it may reduce the speed with which unemployment could fall it will also likely reinforce its message that a 7.0% threshold is not an automatic trigger for higher interest rates. Thus the Bank is likely to continue to refute market assumptions that a hike in interest rates could come towards the end of next year, which may help to keep GBP vulnerable against the USD.

USD/JPY regaining momentum

USD/JPY finally appears to be on the verge of recapturing the summer highs of around 100, being a primary beneficiary of the improving sentiment towards the US economy. The JPY will continue to be sensitive to signs of QE tapering in the US because the BOJ is simultaneously doing the opposite being engaged in massive QE expansion, with USD/JPY the ideal vehicle to express these opposing monetary policy trends. Japanese Q3 GDP data will be watched closely in the coming week as well, with a 0.5% expansion expected to be seen. In annualized terms a 2.0% growth this would represent a fall back from the 3.8% Q2 growth rate, but it would still be broadly positive and encouraging for Japanese investors to continue being comfortable buying overseas assets, pushing the JPY down in the process.

AUD succumbs to stronger USD, more dovish RBA

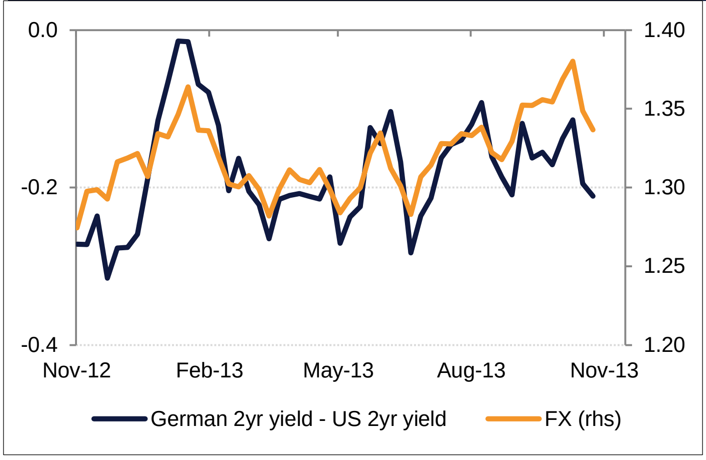
Finally, having stubbornly gripping around 0.95 over the last fortnight the AUD also succumbed to the stronger USD on Friday, falling back to 0.9380 at the close. The AUD's resilience was surprising as the RBA has consistently warned recently that the AUD can be expected to weaken saying in its latest monetary statement that it is 'still uncomfortably high'. The RBA also said that it had not ruled out another cut in policy rates from their current 2.5% whilst downgrading its growth forecasts to 2.3% for next year and 2.5-3.5% in 2015. With the October employment report disappointing, with only 1k jobs added, the unemployment rate remained elevated at 5.7% and is also a cause for concern. Now that the AUD has begun to slip back, it may not be too long before it is again testing the low 0.90's.

	FX Forecasts - Major					Forwards		
	Spot 8.11	1M	3M	6M	12M	3M	6M	12M
EUR / USD	1.3367	1.32	1.31	1.27	1.20	1.3369	1.3372	1.3381
USD /JPY	99.05	100.0	103.0	107.0	110.0	98.99	98.93	98.74
USD / CHF	0.9215	0.93	0.95	0.98	1.04	0.9208	0.9200	0.9178
GBP / USD	1.6003	1.59	1.57	1.56	1.55	1.5992	1.5979	1.5953
AUD / USD	0.9385	0.92	0.90	0.88	0.85	0.9328	0.9273	0.9157
USD / CAD	1.0479	1.05	1.06	1.07	1.10	1.0503	1.0527	1.0578
EUR / GBP	0.8345	0.83	0.83	0.81	0.78	0.8352	0.8360	0.8379
EUR / JPY	132.42	132	134.9	135.9	132.0	132.42	132.42	132.42
EUR / CHF	1.2315	1.23	1.24	1.25	1.26	1.2308	1.2299	1.2278
	FX Forecasts - Emerging					**Forwards**		
	Spot 8.11	**1M**	**3M**	**6M**	**12M**	**3M**	**6M**	**12M**
USD / SAR*	3.7505	3.75	3.75	3.75	3.75	3.7507	3.7510	3.7519
USD / AED*	3.6730	3.67	3.67	3.67	3.67	3.6725	3.6724	3.6725
USD / KWD	0.2833	0.282	0.285	0.282	0.28	0.2898	0.2929	0.3003
USD / OMR*	0.3850	0.38	0.38	0.38	0.38	0.3847	0.3844	0.3840
USD / BHD*	0.3770	0.376	0.376	0.376	0.376	0.3792	0.3818	0.3852
USD / QAR*	3.6408	3.64	3.64	3.64	3.64	3.6451	3.6483	3.6562
USD / INR	62.4750	62.00	61.00	59.00	57.00	62.4923	62.5065	62.5309
USD / CNY	6.0908	6.15	6.15	6.20	6.20	458.0908	501.3108	638.0908

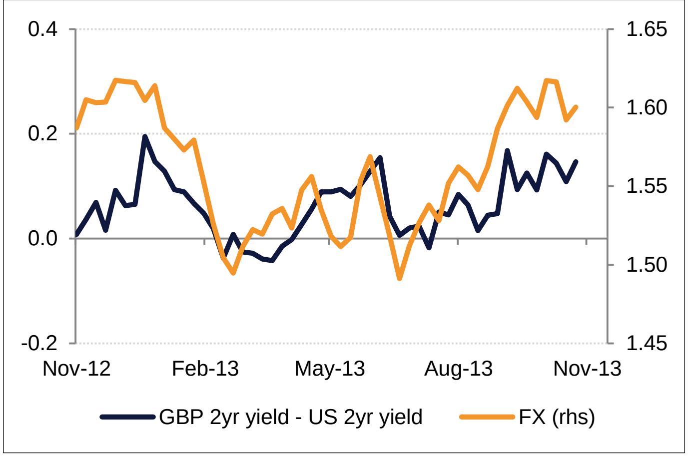
**Denotes USD peg*
Source: Bloomberg, Emirates NBD Research

Major Currency Pairs and Interest Rates

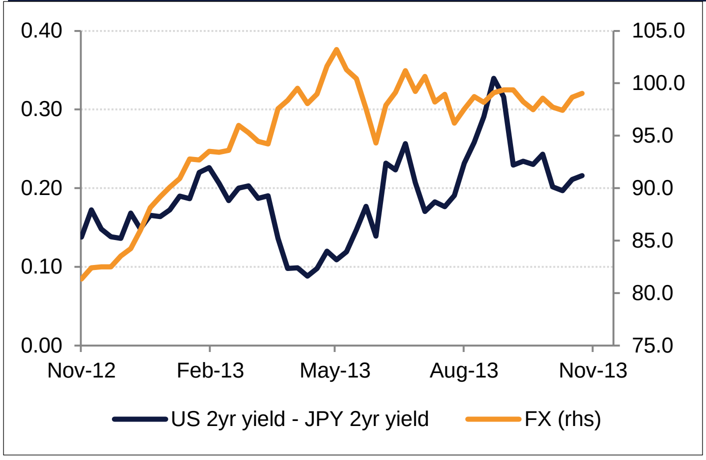
Interest Rate Differentials - EUR



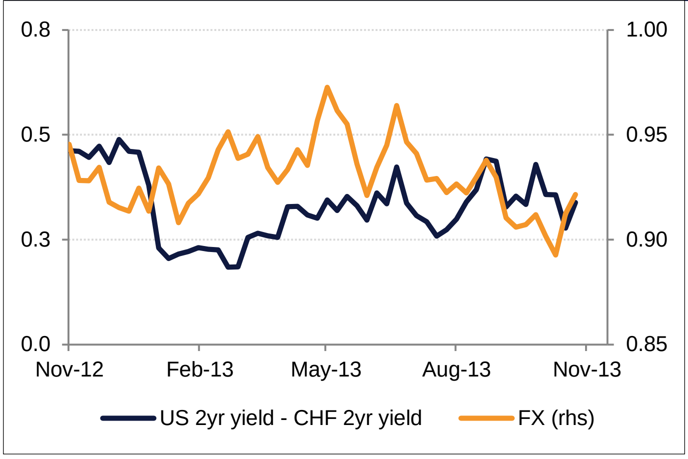
Interest Rate Differentials - GBP



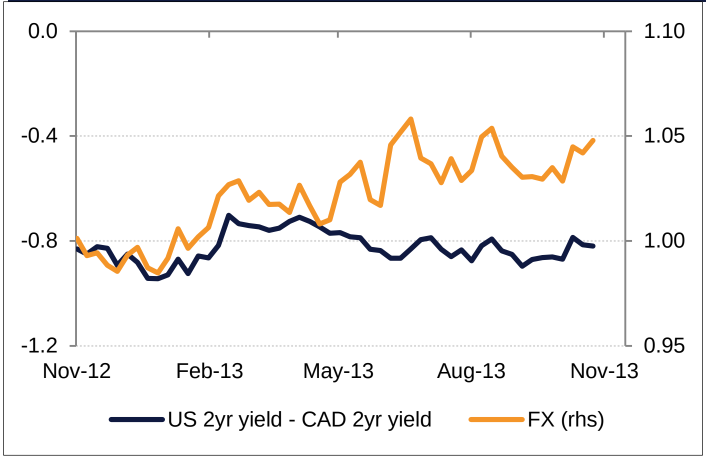
Interest Rate Differentials –JPY



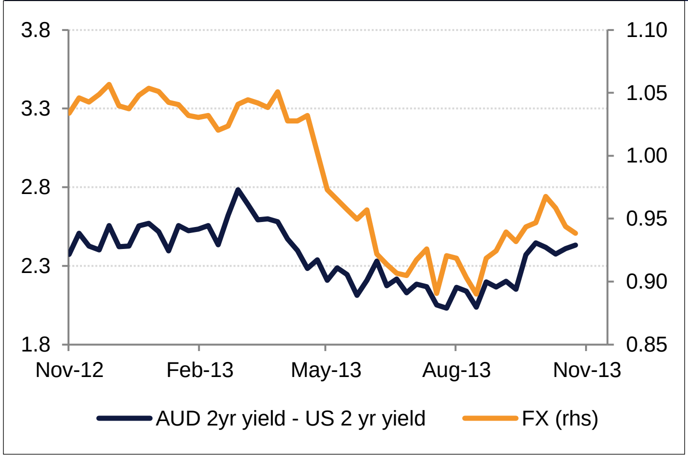
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD



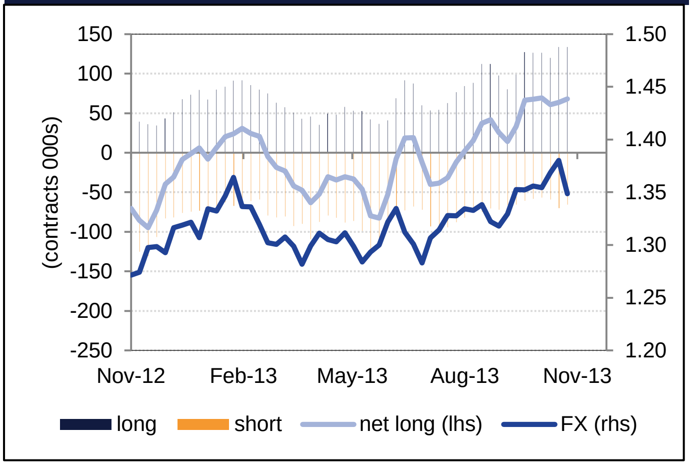
Interest Rate Differentials - AUD



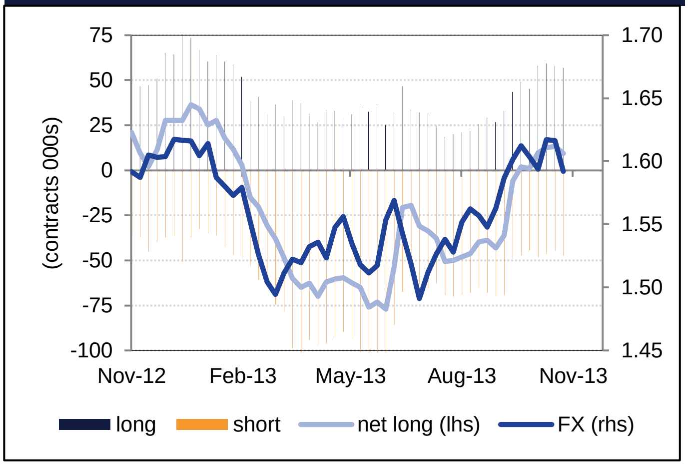
Source: Bloomberg, Emirates NBD Research

Major Currency Positions*

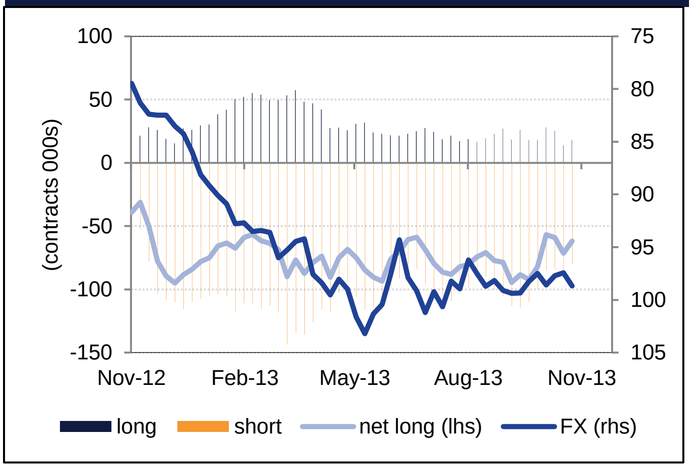
CFTC – Speculative Positions - EUR



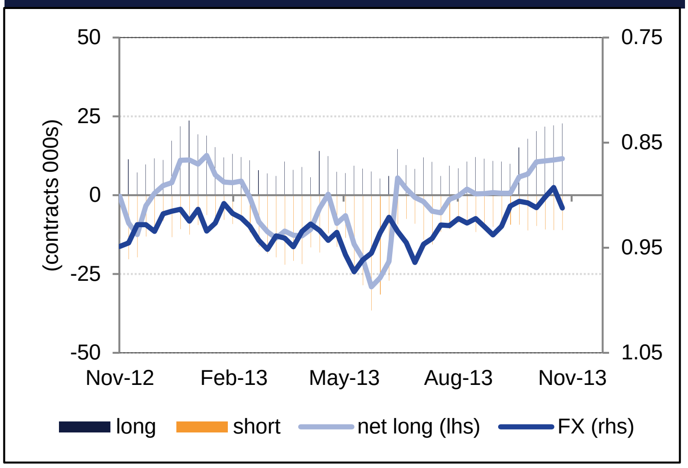
CFTC – Speculative Positions - GBP



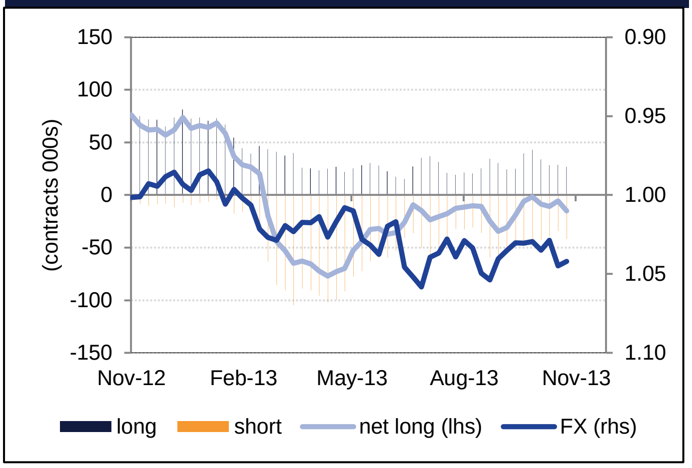
CFTC – Speculative Positions - JPY



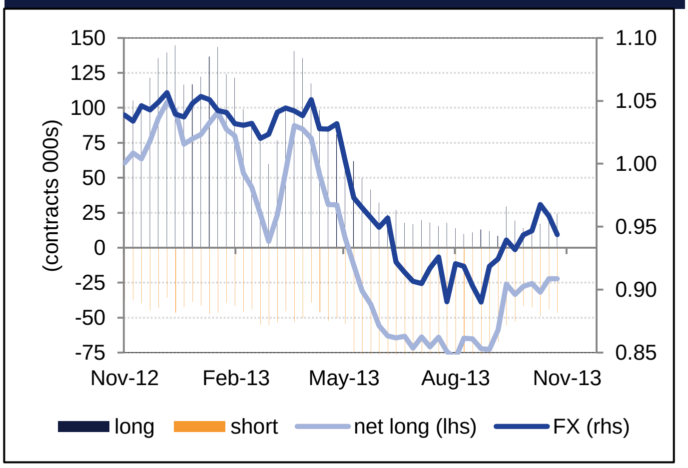
CFTC – Speculative Positions - CHF



CFTC – Speculative Positions - CAD



CFTC – Speculative Positions - AUD



Source: Bloomberg, Emirates NBD Research
**Data as of 1 November , 2013*

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