



بنك الإمارات دبي الوطني  
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# FX Week

## Fate of QE in the balance

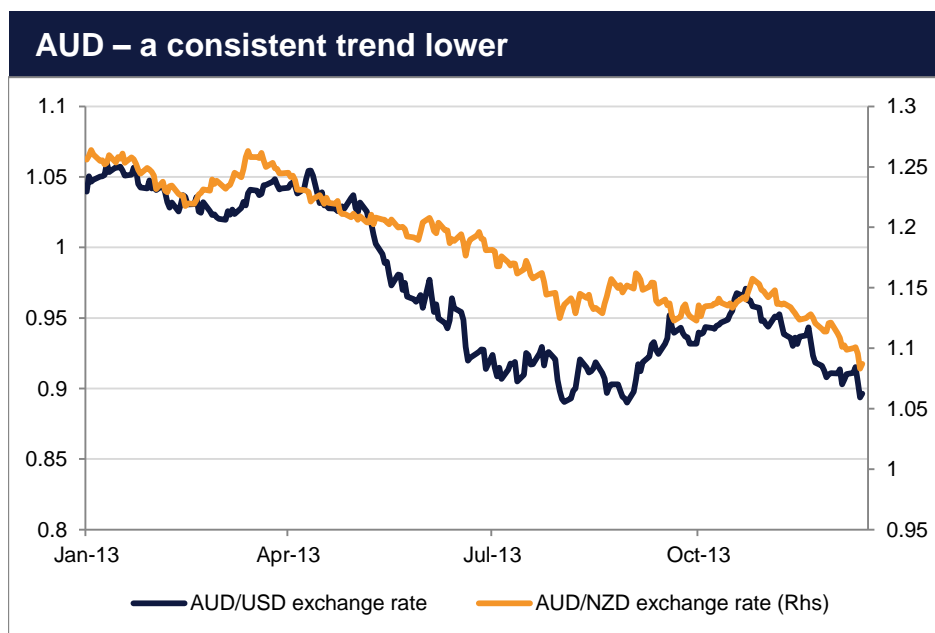
Approaching the final two weeks of the year the markets are still seeking an answer to the one unresolved issue that has dominated sentiment since the middle of it; the tapering of QE by the Fed. This issue will be the central one in FX markets in the coming days as the FOMC meets for the final time this year from Tuesday to Wednesday. Thinning liquidity will also add an element of volatility to the proceedings on top of other traditional seasonal factors.

## Fed tapering should not be a huge surprise

Having thought that economic conditions justified the beginnings of tapering back in September, subsequent data has shown that with hindsight we were probably correct with employment data being revised consistently higher over the period, growth strengthening and fiscal concerns proving overblown. While our base assumption since September has been that the Fed will begin reducing QE from January 2014, we should hardly be surprised if the Fed were to begin this process earlier. In fact it may even be desirable to have this process begun as 2013 ends rather than having it hang over markets and sentiment as 2014 gets underway.

## Complications to arise from what else the Fed might do

After all the economic data has been uniformly positive over recent weeks (employment, business surveys, retail sales), with growth forecasts for Q4 beginning to be revised higher as a result. Also the fiscal clouds hanging over early 2014 have also been lifted by the budget agreement reached last week, which have removed the prospect of a government shutdown in January and created some certainty over fiscal policy for the coming two years. The complication as far as financial markets are concerned may come from what else, if anything, the Fed may do once it finally begins to reduce the amount of assets being purchased.



Source: Bloomberg, Emirates NBD Research

The possibility remains that while tapering QE by USD10-15bn per month, the Fed will also adjust its forward guidance to effectively delay the timeline for an eventual rise in interest rates. This would serve to anchor short term interest rates, and perhaps even exert some moderation in the pace of increases in long rates. Any positive implications for the USD coming from QE tapering itself might thus be dampened slightly by the revisions to forward guidance, lowering the unemployment threshold at which hiking the Fed funds rate would be considered. Changes to growth and inflation forecasts will also be important in assessing the outlook for monetary policy over the coming two years, even after QE tapering has begun, be it in December or January.

### **USD/JPY to see the biggest reaction to any Fed move**

FX market reaction to the Fed announcements this week will also be conditioned by the monetary policy environment elsewhere. The JPY appears to be the currency most likely to be negatively affected by any QE tapering as the Bank of Japan has reiterated its intention to reach its 2.0% inflation target in 2015. BOJ Governor Kuroda made these comments in an FT interview late last week, although he stopped short of indicating that more asset purchases would be necessary to achieve this goal. However, he did acknowledge the role that a weak JPY has played in pushing inflation higher, leaving the question open as to how more inflation will be generated without further JPY weakness.

A BOJ board meeting will also be held in the coming week and certainly no change in policy can be expected at this point. Data to be released in coming days is expected to show Japanese business confidence improving in Q4, however, which should serve to show that Japanese policies are for the time being still making a difference. With USD/JPY now consolidating above our 103 one-month forecast, the risks from a Fed tapering announcement would be for it to climb quickly towards 105 by the end of the year.

### **EUR/USD may be more impervious to the Fed however**

The EUR/USD environment is different, however, as the ECB appears impervious to the evidence of weak Eurozone recovery by holding out against easing monetary policy further, seemingly reassured by the slight bounce in inflation to 0.9% in November, up from 0.7% in October. Even if the Fed embarks on tapering QE this week, EUR/USD may not fall precipitously as anticipated in the past, although the risks are probably still weighted to the downside after having failed again to break above 1.38 over the past week. Given our assumptions about Eurozone growth disappointing relative to consensus expectations next year we still believe that the ECB will have to come back with more stimulus measures eventually, and these will ultimately weigh on the EUR. However, for the moment end-year repatriation flows should keep it relatively stable, and in the event that the Fed does nothing we would not be surprised to see an end-year spike higher.

### **GBP/USD looks exhausted**

A similar logic applies to the GBP, which has again pulled back from its year highs of above 1.64 against the USD. For the moment the GBP rally looks to be exhausted but we are wary of thinking it will fall sharply from here given the improving outlook for the UK economy. Clearly, a Fed tapering decision would probably weigh on GBP/USD, but we still think the GBP should hold up well against the EUR in such an environment. The GBP would, however, benefit should the Fed remain unmoved this week. Inflation and unemployment data are amongst the domestic UK highlights, but even here the outcomes may cancel each other out, with the impact of lower unemployment offset to some extent by policy implications of a low inflation reading.

## **AUD – a consistent trend lower**

The most consistent trend of the last few weeks has been the weakness of the AUD, both against the USD as well as against the NZD which we have been highlighting. Even after better than expected employment data in November, the AUD was unable to sustain a recovery, and capitulated below 0.90 versus the USD. The number of people employed rose 21k last month, compared with expectations of a 10k increase, but October data was revised down to -0.7k. While the headline payrolls number was a welcome surprise, the underlying data was subdued, with unemployment rising to 5.8%, its highest level since 2009. Labour force participation of 64.8% was also lower than the 65.1%-65.4% range it has been in since September 2011. The RBA also appears to be ratcheting up its concerns about the strength of the AUD and with the December RBA policy meeting minutes due to be released in the coming week, more rhetoric in favour of a softer currency can be anticipated to keep sentiment negative.

## **RBI rate hike looms**

Finally this week attention will also fall on the INR and on monetary policy in India, with the RBI due to set interest rates on Wednesday, the same day as the Fed announcement. Due to the continued elevation of inflation (CPI rose to 11.2% in November) an increase in interest rates can be expected, a step that may also be necessary to afford the INR some protection in the event that the Fed does decide to pull the trigger on tapering QE.

***This is the last edition of FX Week in 2013. We would like to wish all of our readers a happy and peaceful holiday season and best wishes for the New Year!***

FX Forecasts - Major						Forwards		
	Spot 13.12	1M	3M	6M	12M	3M	6M	12M
EUR/USD	1.3742	1.34	1.31	1.27	1.20	1.3740	1.3740	1.3744
USD/JPY	103.2100	105.0	106.0	107.0	110.0	103.1485	103.0895	102.9090
USD/CHF	0.8895	0.93	0.95	0.98	1.04	0.8887	0.8879	0.8859
GBP/USD	1.6300	1.61	1.57	1.56	1.55	1.6290	1.6278	1.6253
AUD/USD	0.8964	0.90	0.89	0.88	0.85	0.8910	0.8857	0.8753
USD/CAD	1.0585	1.05	1.06	1.07	1.10	1.0609	1.0633	1.0681
EUR/GBP	0.8434	0.83	0.82	0.81	0.78	0.8438	0.8444	0.8459
EUR/JPY	141.8700	141	139	135.9	132.0	141.8690	141.8681	141.8661
EUR/CHF	1.2220	1.23	1.24	1.25	1.26	1.2208	1.2197	1.2174
EUR/NOK	8.4917	8.20	8.00	7.75	7.50	8.5192	8.5459	8.6012
EUR/SEK	9.0349	8.80	8.70	8.60	8.50	9.0487	9.0631	9.0964
NZD/USD	0.8263	0.83	0.83	0.84	0.81	0.8211	0.8150	0.8012

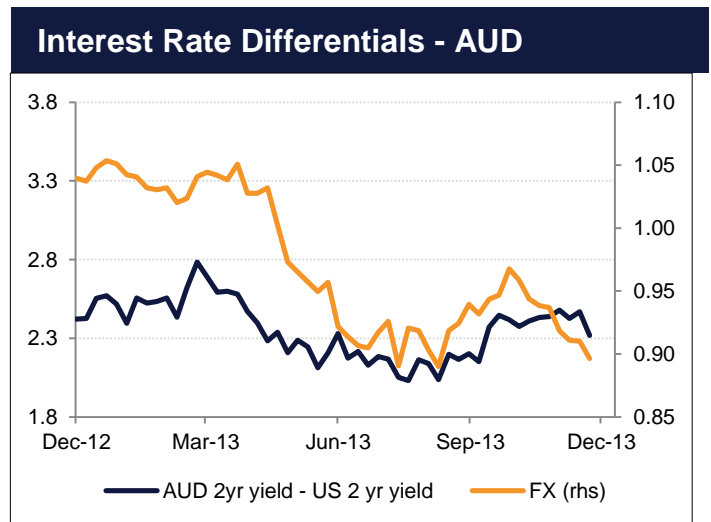
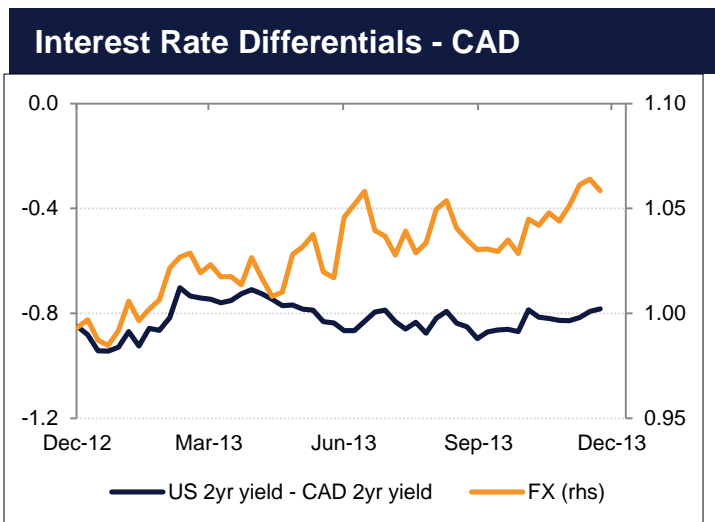
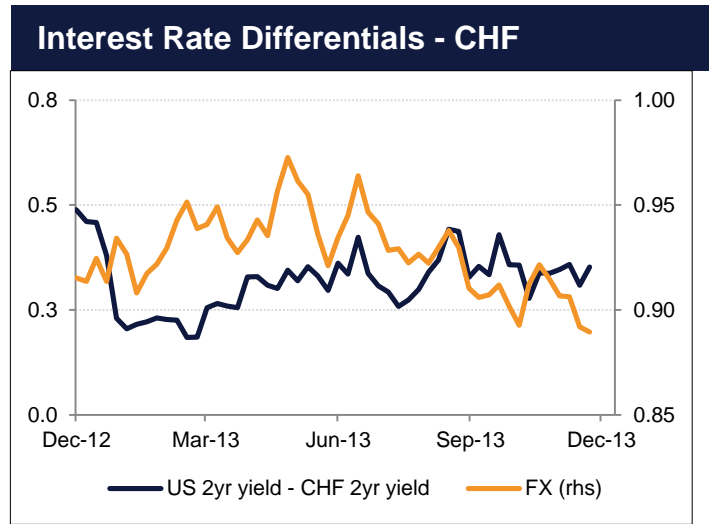
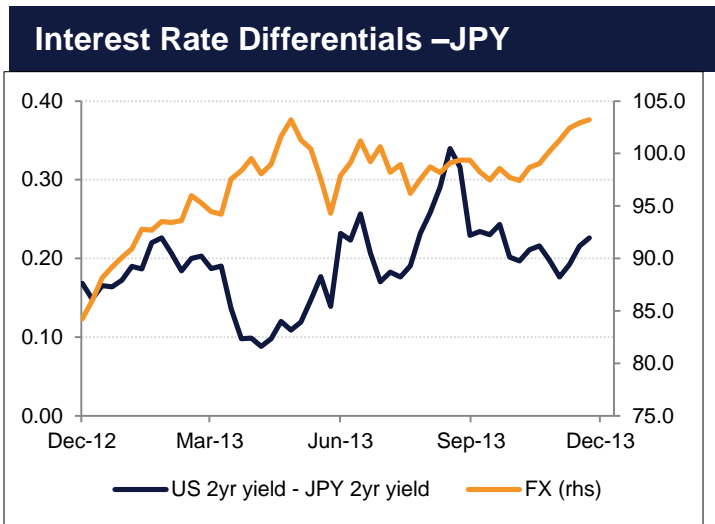
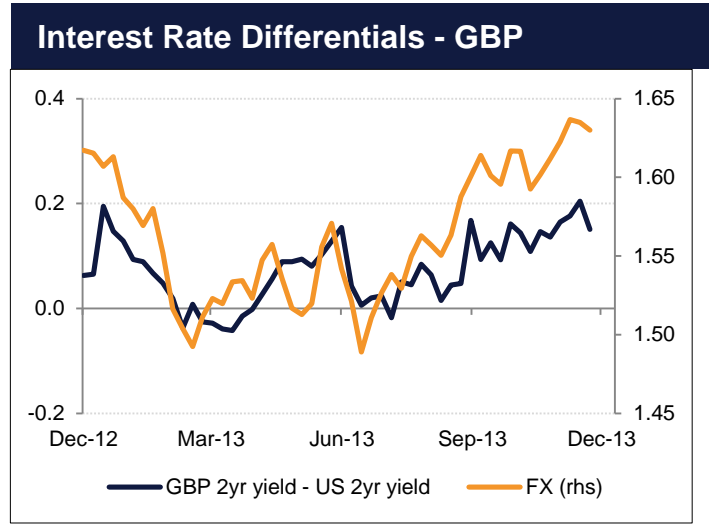
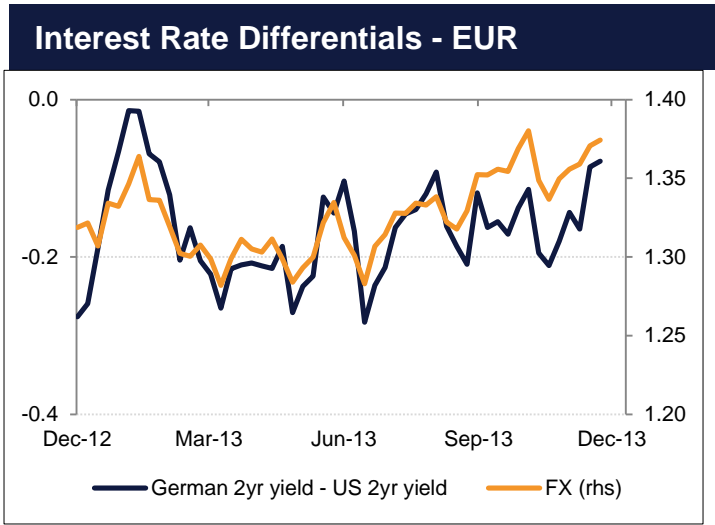
  

FX Forecasts - Emerging						Forwards		
	Spot 6.12	1M	3M	6M	12M	3M	6M	12M
USD/SAR*	3.7503	3.75	3.75	3.75	3.75	3.7501	3.7501	3.7499
USD/AED*	3.6730	3.67	3.67	3.67	3.67	3.6724	3.6723	3.6715
USD/KWD	0.2827	0.282	0.285	0.282	0.28	0.2906	0.2945	0.3038
USD/OMR*	0.3850	0.38	0.38	0.38	0.38	0.3845	0.3835	0.3819
USD/BHD*	0.3770	0.376	0.376	0.376	0.376	0.3783	0.3799	0.3832
USD/QAR*	3.6414	3.64	3.64	3.64	3.64	3.6446	3.6476	3.6525
USD/EGP	6.8890	6.89	6.89	6.89	6.89	7.1591	7.4222	7.9523
USD/INR	62.1250	62.00	61.00	59.00	57.00	62.1388	62.1529	62.1783
USD/CNY	6.0717	6.10	6.15	6.20	6.20	441.0817	473.5817	616.0817

Source: Bloomberg, Emirates NBD Research

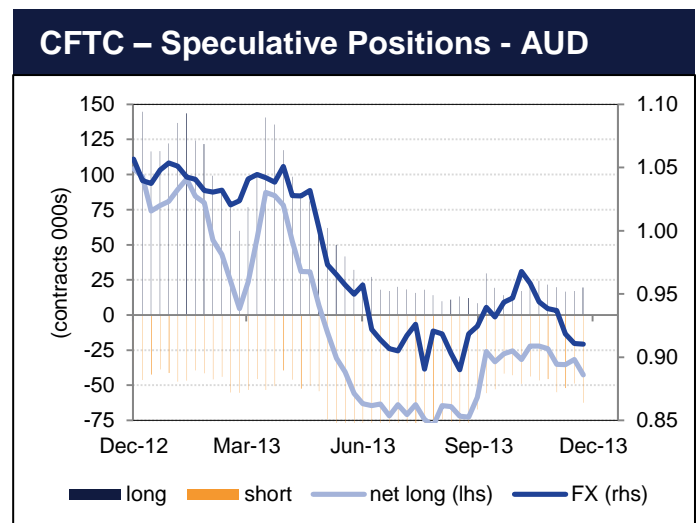
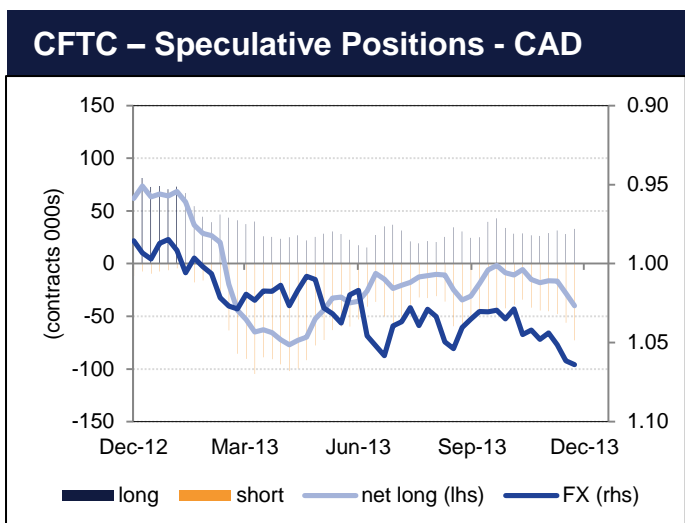
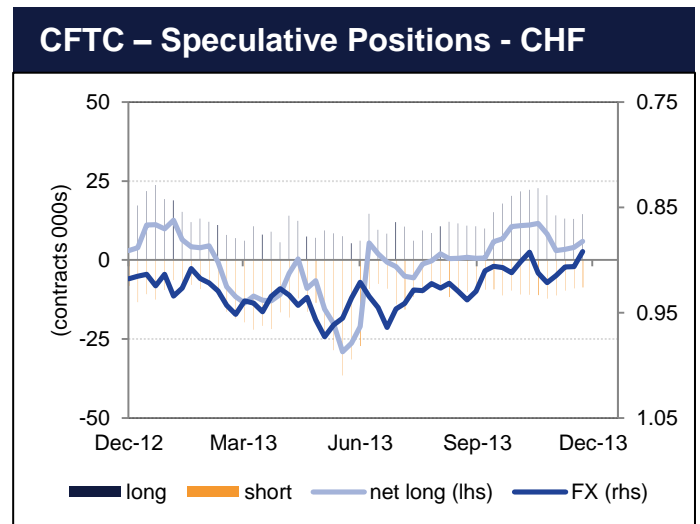
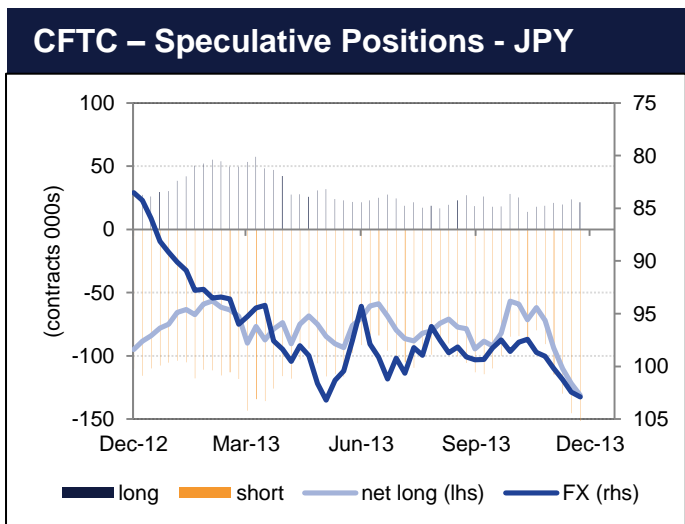
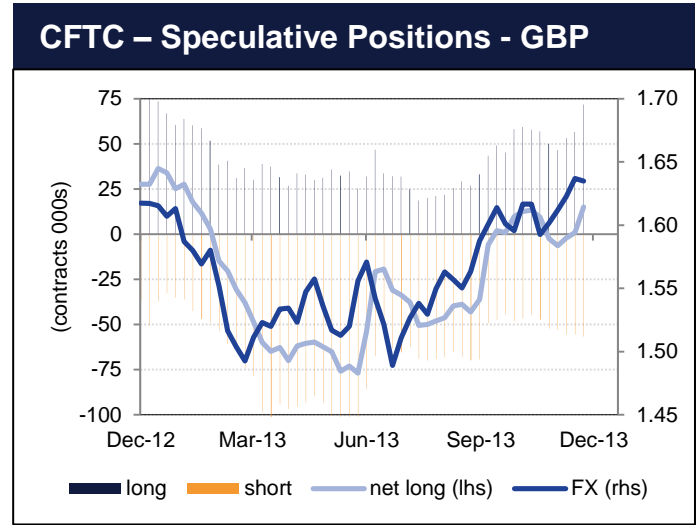
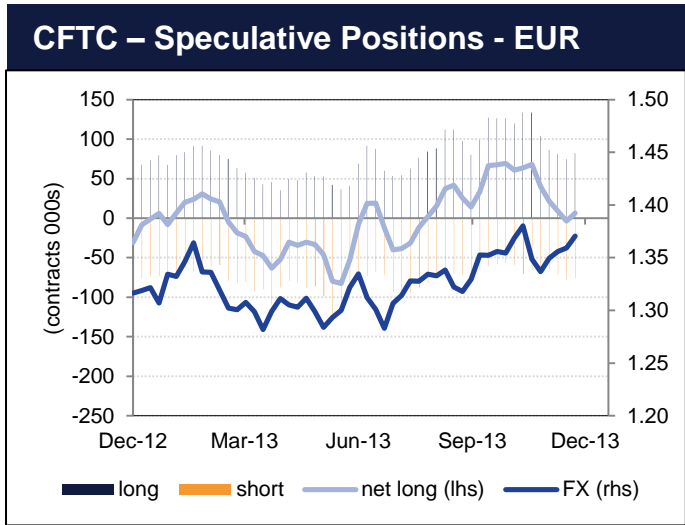
\*Denotes USD peg

## Major Currency Pairs and Interest Rates



Source: Bloomberg, Emirates NBD Research

## Major Currency Positions\*



Source: Bloomberg, Emirates NBD Research  
 \*Data as of 6 November, 2013

## Economic Calendar

Date	Country	Event	
16-Dec	Japan	Tankan Survey	
	India	Wholesale Price Index	
	France	PMI Manufacturing / Services	
	Germany	PMI Manufacturing / Services	
	Eurozone	PMI Manufacturing / Services / Composite	
	Italy	Trade Balance	
	US	Empire Manufacturing	
	Canada	Existing Home Sales	
	US	Industrial Production	
	17-Dec	Russia	Industrial Production
		Australia	RBA Policy Meeting – December Minutes
		UK	CPI
UK		Retail Price Index	
Germany		ZEW Survey	
Eurozone		CPI	
UK		CBI Trends	
US		CPI	
US		NAHB Housing Market Index	
18-Dec		Japan	Trade Balance
	India	RBI Rate Decision	
	Germany	IFO Business Climate	
	UK	Bank of England Minutes	
	UK	ILO Unemployment Rate	
	US	MBA Mortgage Applications	
	US	Housing Starts	
	US	FOMC Rate Decision	
	19-Dec	Japan	All Industry Activity Index
		Switzerland	Trade Balance
UK		Retail Sales	
Brazil		Unemployment Rate	
US		Initial Jobless Claims	
US		Existing Home Sales	
Russia		Unemployment Rate	
UK		GfK Consumer Confidence	
20-Dec	UK	Public Finances	

20-Dec	UK	Gdp
	Italy	Retail Sales
	Canada	CPI
	US	GDP
	US	Personal Consumption
	US	Core PCE
	Canada	Retail Sales

Source: Bloomberg



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