Emirates NBD

FX Week

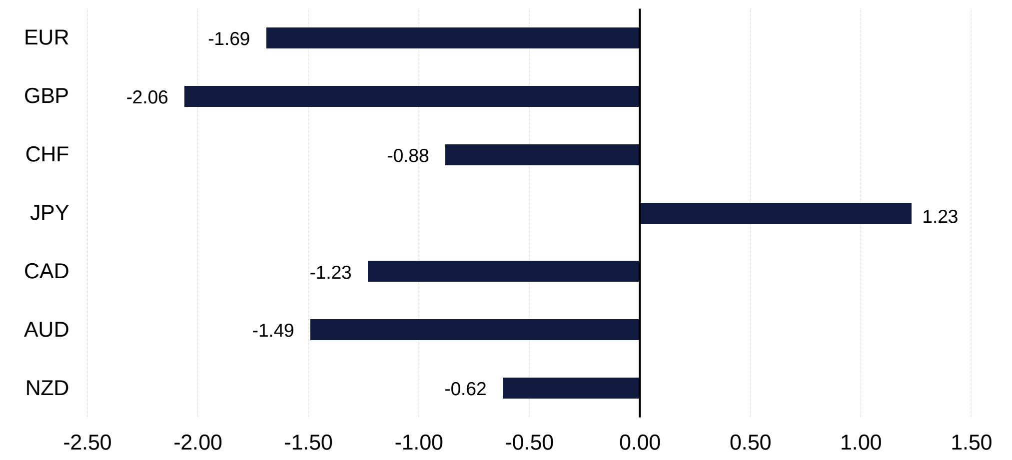
Markets end week in better shape

Markets ended last week in better shape than they spent much of it, but the possibility of more turmoil has not gone away with both fundamental and technical forces likely to continue exerting pressure. In particular, the passage of a US budget bill through Congress at the end of last week is only likely to reinforce the bullish bias to bond yields, given the impact it will have in boosting the fiscal deficit. This may in turn extend the concern about equities even though corporate earnings appear relatively healthy. The dollar may be stronger for now as investors have pared short positions, but this cannot be counted on to last especially if the Fed begins to look behind the curve when it comes to inflation. As such the January CPI data in the coming week will be the main event risk, with the possibility of a firmer core rate keeping sentiment uncertain.

Weekly
11 February 2018

The passage of the USD300bn two-year budget deal through Congress at the end of last week not only averted another government shutdown, but it has added significantly to upside growth and inflation risks in the coming year. The stimulus is worth approximately 0.5% of GDP, on top of the tax cuts already passed at the end of last year, making it likely that growth could exceed 2.5% in 2018. The Fed has been cautious about the volatility seen in the markets, downplaying it and signaling that monetary policy tightening will only proceed gradually. Of course the markets are aware of the Fed's record when it comes to back-stopping stocks, but in this instance with global growth more secure we doubt if the current market instability will delay a rise in interest rates in March.

Weekly currency movement vs USD (%)



Source: Bloomberg, Emirates NBD Research

US CPI key the release in coming week

New Fed Chair Powell will have an opportunity to address these issues near the end of the month when he will testify to Congress. However, events may already be running ahead of him if inflation data in the coming week confirms that price pressures are finally resurfacing. Such an outcome is likely to keep bond yields headed higher, which may mean that equities will have to endure more volatility than a 'healthy correction' might seem to imply. The same probably applies to the dollar, with its recent gains likely to be short-lived if the markets begin to sense that bond market induced equity weakness could extend.

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Dollar gains for a second week

The Dollar index rose for a second week, gaining 1.30% to close at 90.44. Of note is that these gains have taken the index back above the baseline that had held since September 2016, indicating that a reversal may be on the cards. While the price remains above this baseline, we expect a test of 91.70 to be the next likely direction. At this level which sits at the 23.6% one year Fibonacci retracement and 50 day moving average (91.69), we expect the index to counter stronger selling pressures. On the downside, a break below the one year low of 88.438 could lead to more significant declines towards 85.

Dollar Index climbs back above 90

Source: Bloomberg

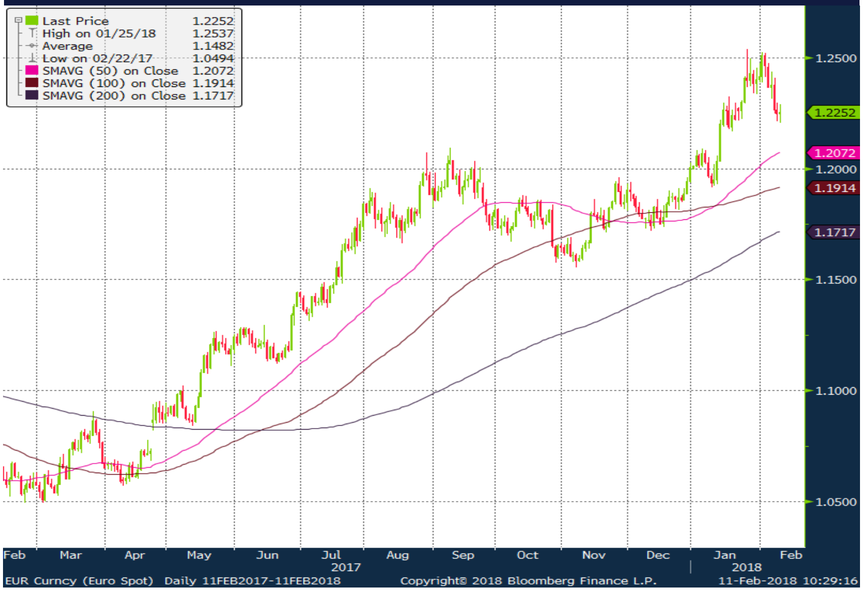
German political parties come to an agreement

The Euro's relapse will be largely welcome to the ECB, and may encourage its hawks that policy normalization should be on the agenda this year. The March ECB meeting is likely to be a pivotal one in which policymakers will seek to articulate a more reliable timeline for QE to be phased out. However, it will also coincide with election risks in Italy at the start of that month, with the possibility of a confusing picture emerging out the new election process, with right wing parties likely to be in the ascendency. German political parties have finally reached an agreement over the formation of a new government, with the opposition SPD taking five cabinet positions, compared to eight for the CDU. Of these five the SPD have control of the Finance Ministry and the Foreign Ministry, both very important portfolios. Conditional on SPD members approving the coalition in a postal ballot this outcome will play in to greater government spending and a more integrationist EU policy. Accordingly there will be upside risks to German growth and inflation this year, especially after German unions reached a landmark pay deal of 4.3% with employers last week, signaling the end of wage restraint. This will also strengthen the arm of the Bundesbank on the ECB Council when it comes to making the case for QE to end. As such EURUSD's current softness may not last for long, although we retain our 1.22 forecast for the end of Q1.

EURUSD finally retreats after seven weeks of gains

EURUSD retreated 1.69% last week, to close at 1.2252 and record the first decline in 8 weeks. However analysis of the candle charts reveal different likely outcomes based on the timeframe. Looking at Friday's daily candle chart shows a long legged doji, indicating that the bearish momentum could be running out of steam and we could see a reversal of losses in the week ahead. In addition, the daily candle chart shows that the uptrend that has been in effect since April 2017 remains intact. In contradiction to this, analysis of the weekly candle chart shows a very bearish close indicating that further losses may lie ahead. With these mixed signals in mind and the 14-day Relative Strength Indicator (RSI) remaining near neutral (50.22), it would not surprise us to see EURUSD trading in a range of 1.2150-1.2300 over the week ahead. In order to break this range, a catalyst would likely be needed in the form of an economic data surprise or political development.

EURUSD remains in daily uptrend



Source: Bloomberg

BOE upgrades growth assessment…

GBP was also caught up in the squaring of short dollar positions, even as the Bank of England turned more hawkish. While leaving interest rates unanimously unchanged the BOE upgraded its assessment for UK economic growth while acknowledging that productivity has been poor. The net result was an unexpected increase in hawkish guidance, as the Bank indicated it is less inclined to tolerate inflation above the 2-year target over the next three years, moving the prospect of a May rate hike on to the stage. Governor Carney remarked 'that it will probably be necessary to raise interest rates ….. somewhat earlier and to a somewhat greater extent than we had thought in November'. The upshot appears to be that there could be two rate hikes this year, one in May and another towards the end of the year.

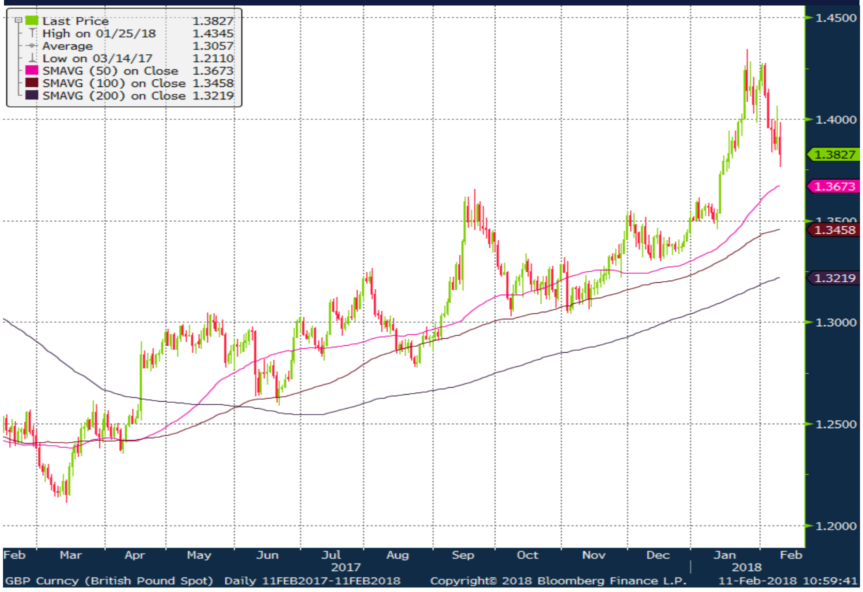
…despite ongoing Brexit concerns

However, Brexit-related concerns complicated the reaction of the pound, with the EU's Brexit negotiator Michel Barnier, saying that a transition deal is 'not a given,' and signaling that border checks on the Irish border may be 'unavoidable'. This prompted a sell-off in sterling which more than reversed the gains seen following the BoE's announcement. The UK data calendar this week includes the release of January inflation data (Tuesday), along with retail sales figures for the same month (Friday), with inflation expected to remain at 3.0%, 1 percentage point about the Bank's target.

GBPUSD falls but finds support at 76.4% retracement

GBPUSD posted a 2.06% loss, closing the week at 1.3827 after finding support at the 76.4% one year Fibonacci retracement of 1.3818, a former resistance level which has held since breached on 17 January 2018. Over the week ahead we expect additional tests of this support level. A break of this level will likely lead to further losses with the next level of support likely to be near the 50 day moving average of 1.3673. With the 14 day RSI showing a bearish direction and currently sitting at 46.79, the risks of this outcome are more significant. In addition, the 26 base of the daily Ichimoku cloud (1.3902) has been broken and the price remains below this level, risks remain to the downside.

GBPUSD to decline further?



Source: Bloomberg

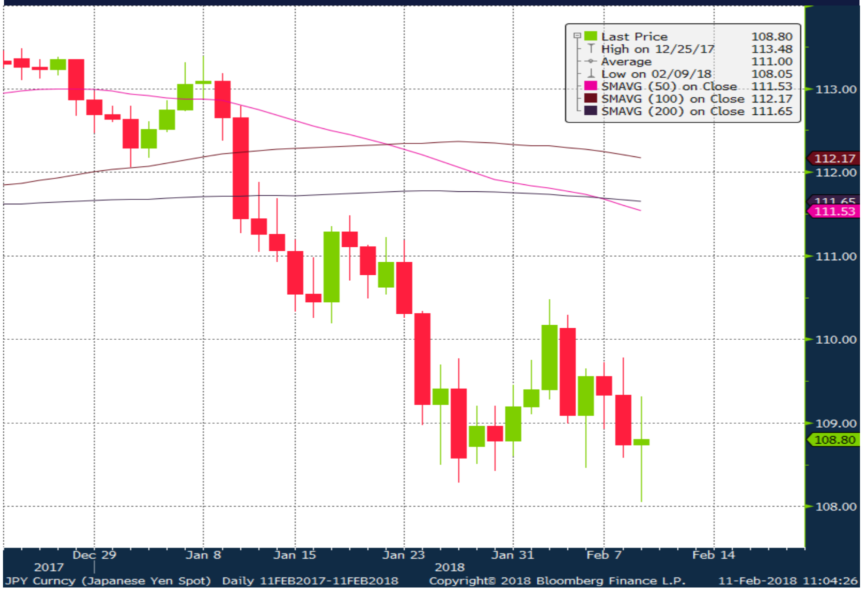
Asian economic calendar light due to holidays

The Asian calendar is a light one this week due to holidays, with Japanese markets closed Monday for National Foundation Day, while China begins Lunar New Year festivities on Thursday which run through to next Wednesday. Preliminary Japanese Q4 GDP growth is seen slowing to a 0.2% q/q pace from 0.6% previously.

USDJPY erases the gains of previous week

USDJPY fell 1.24% last week, to reach 108.81, having hit new 2018 lows of 108.05 during the Friday session. While the main driver for the cross over the week ahead is likely to be US inflation data, Japanese GDP and risk appetite, the pair remains technically vulnerable. Having broken and closed below the 23.6% one year Fibonacci retracement (109.25) over the last 5 trading days, there risks remain to the downside while the price remains below this key level which has alternatively acted as an intraday support and resistance over the last two weeks.

USDJPY vulnerable below 109.25



Source: Bloomberg

AUD and NZD soften amid central bank rhetoric

AUDUSD declined 1.50% last week, falling to 0.7813 amid the absence of risk appetite in the market and a dovish policy statement from the RBA. While the central bank kept interest rates unchanged at 1.50%, the MPC shared concerns over wage growth and low inflation.

NZD was equally under pressure following the first RBNZ policy meeting of 2018. After the central bank held interest rates at their record low of 1.75% and communicated the expectation that policy would not change until mid-2019, NZDUSD fell to a one month low. Policy makers also communicated a new assessment that inflation would reach the target level two years later than previously forecasted. This statement was supported by data released by Statistics New Zealand showing that average hourly earnings slowed from 1.2% q/q in Q3 2017 to 0.8% q/q in Q4 2017.

FX Forecasts

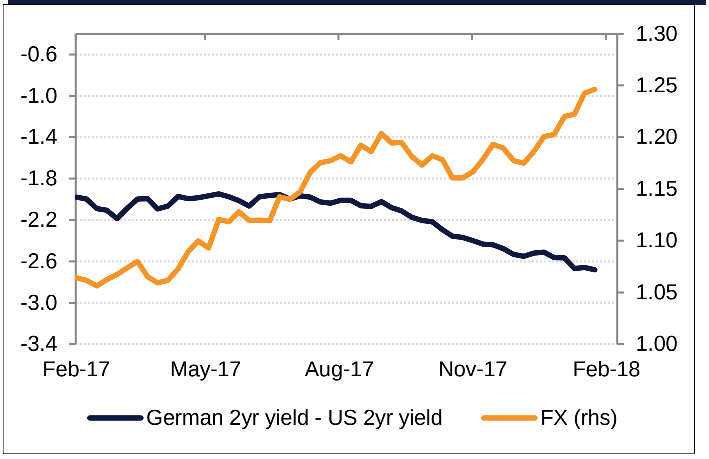
FX Forecasts - Major						Forwards		
	8-Feb	Q1 2018	Q2 2018	Q3 2018	Q4 2018	3m	6m	12m
EUR	1.2247	1.2200	1.2500	1.2200	1.2000	1.2324	1.2407	1.2592
JPY	108.74	112.00	114.00	118.00	120.00	108.13	107.46	105.94
CHF	0.9362	0.9600	0.9900	1.0100	1.0200	0.9295	0.9223	0.9068
GBP	1.3913	1.3800	1.4000	1.4200	1.4500	1.3966	1.4018	1.4128
AUD	0.7781	0.7600	0.7400	0.7200	0.7200	0.7780	0.7784	0.7795
NZD	0.7218	0.7000	0.7100	0.7100	0.7100	0.7212	0.7212	0.7214
CAD	1.2603	1.2500	1.2600	1.2600	1.2600	1.2589	1.2575	1.2550
EURGBP	0.8803	0.8841	0.8929	0.8592	0.8276	0.8825	0.8852	0.8913
EURJPY	133.19	136.64	142.50	143.96	144.00	133.19	133.19	133.19
EURCHF	1.1468	1.1712	1.2375	1.2322	1.2240	1.1456	1.1445	1.1420

FX Forecasts - Emerging						Forwards		
	8-Feb	Q1 2018	Q2 2018	Q3 2018	Q4 2018	3m	6m	12m
SAR	3.7503	3.7500	3.7500	3.7500	3.7500	3.7500	3.7510	3.7552
AED	3.6730	3.6730	3.6730	3.6730	3.6730	3.6735	3.6741	--
KWD	0.3003	0.3050	0.3050	0.3050	0.3050	0.3009	0.3023	--
OMR	0.3850	0.3850	0.3850	0.3850	0.3850	0.3856	0.3867	0.3892
BHD	0.3770	0.3770	0.3770	0.3770	0.3770	0.3762	0.3763	0.3792
QAR	3.6515	3.6400	3.6400	3.6400	3.6400	3.6660	3.6735	3.6860
EGP	17.6648	17.2500	17.0000	16.8000	16.8000	18.1000	18.4700	19.0900
INR	64.258	64.000	65.000	66.000	66.000	64.9400	65.6300	66.9600
CNY	6.3298	6.5000	6.7000	6.9000	7.0000	6.3625	6.3960	6.4530

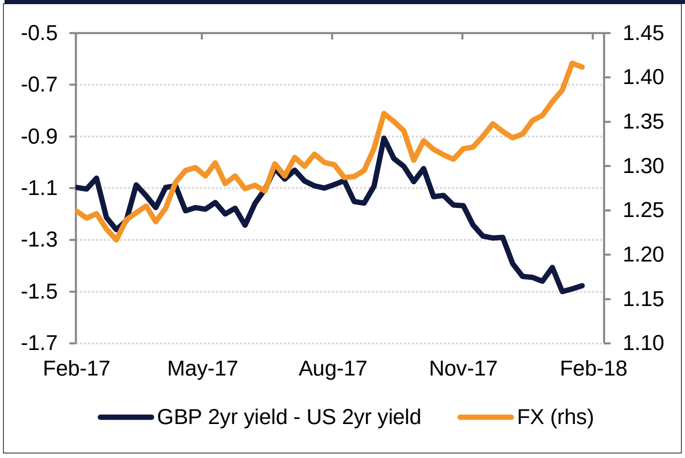
Source: Bloomberg, Emirates NBD Research
**Denotes USD peg*

Major FX and Nominal Interest Rates

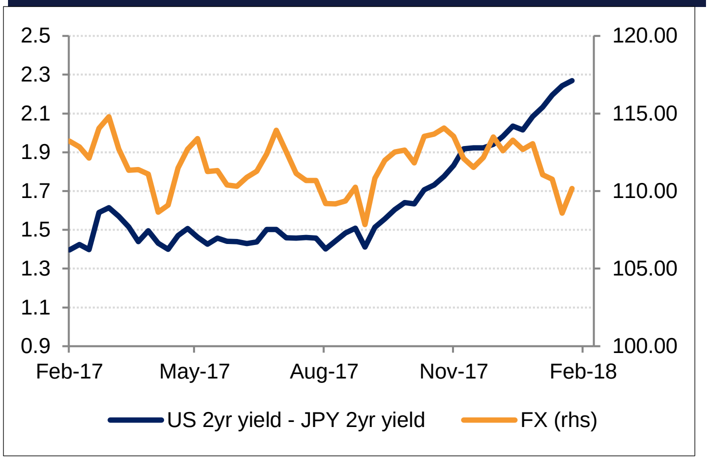
Interest Rate Differentials - EUR



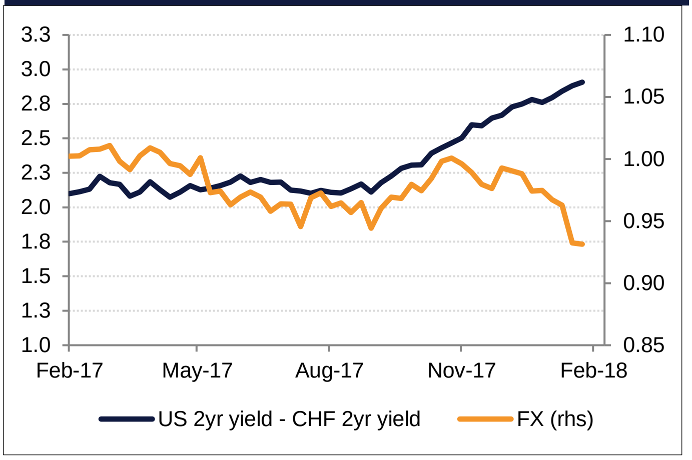
Interest Rate Differentials - GBP



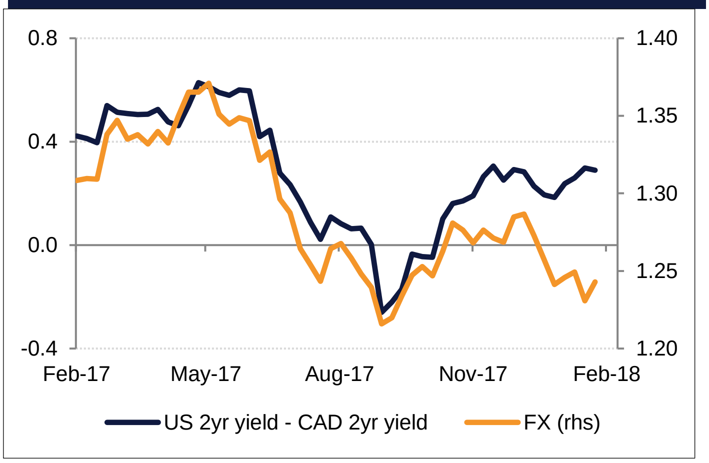
Interest Rate Differentials – JPY



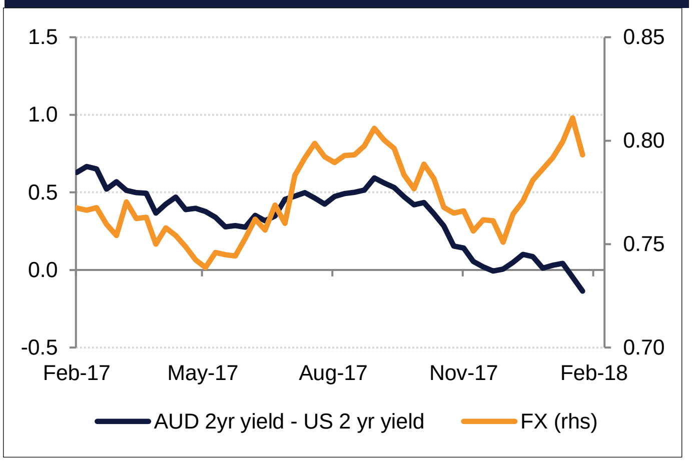
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD



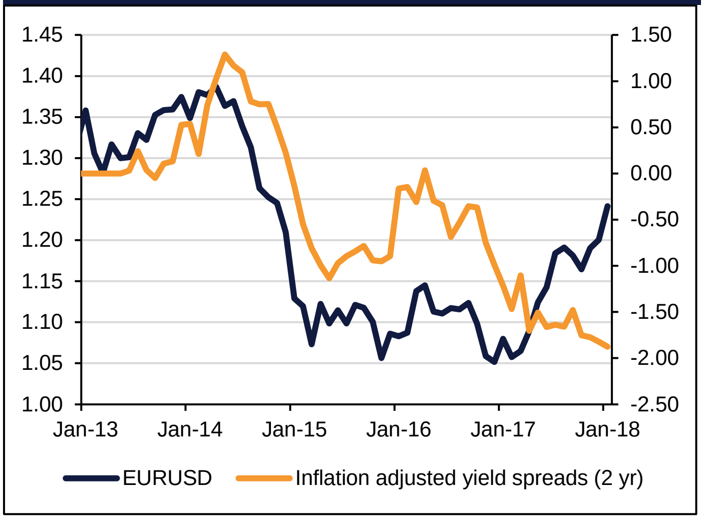
Interest Rate Differentials - AUD



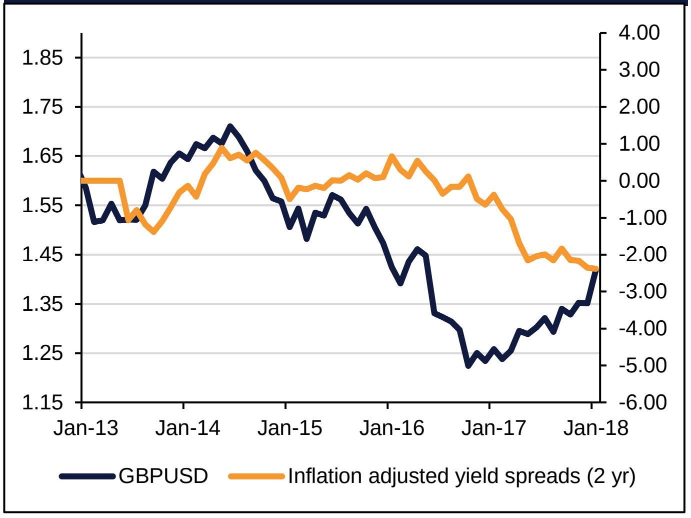
Source: Bloomberg, Emirates NBD Research

Major FX and Real Interest Rates

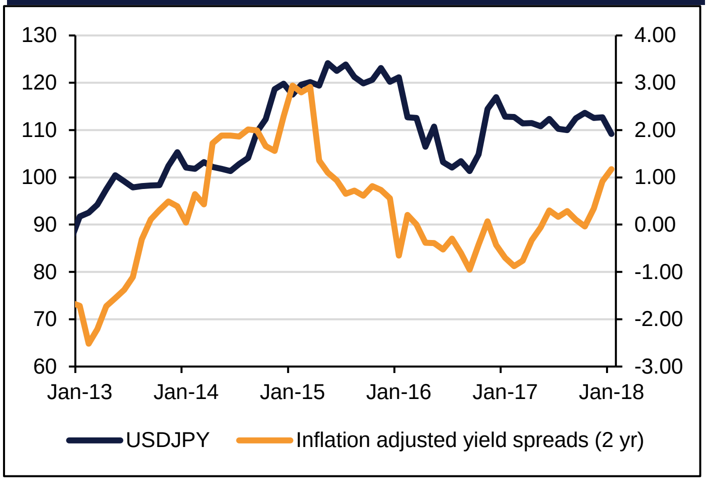
Interest Rate Differentials - EUR



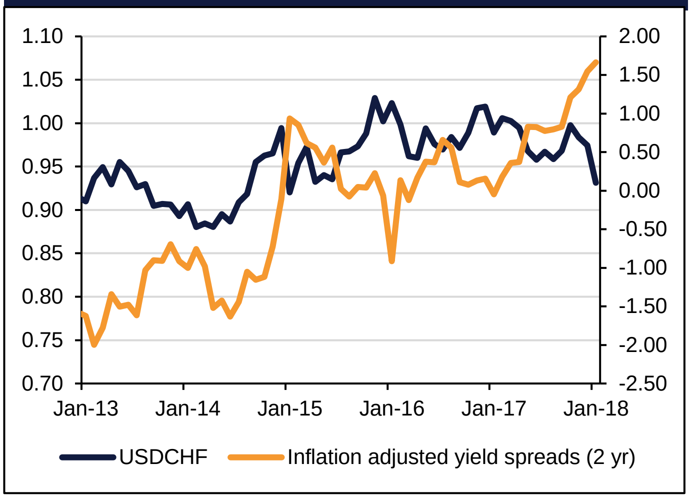
Interest Rate Differentials - GBP



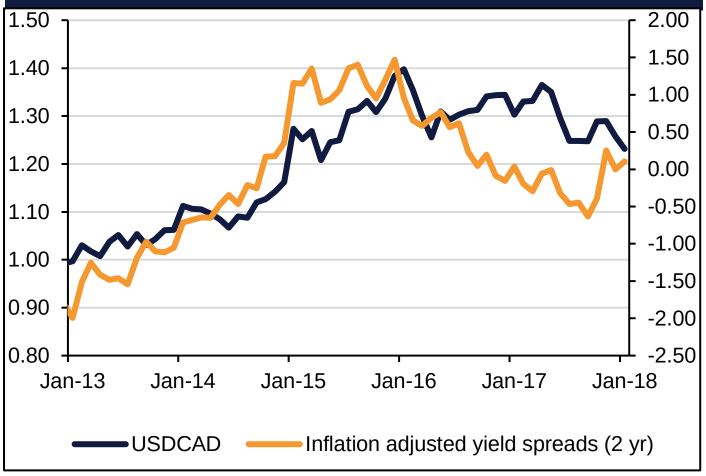
Interest Rate Differentials – JPY



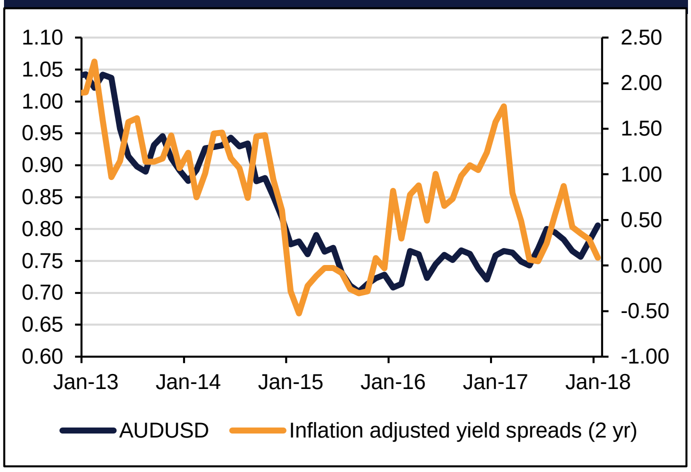
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD



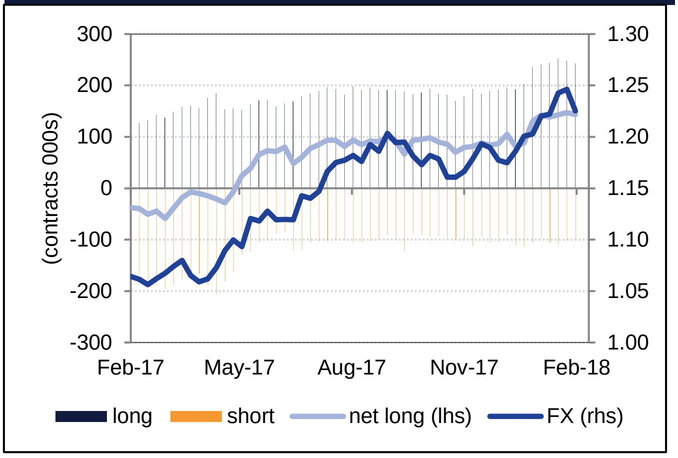
Interest Rate Differentials - AUD



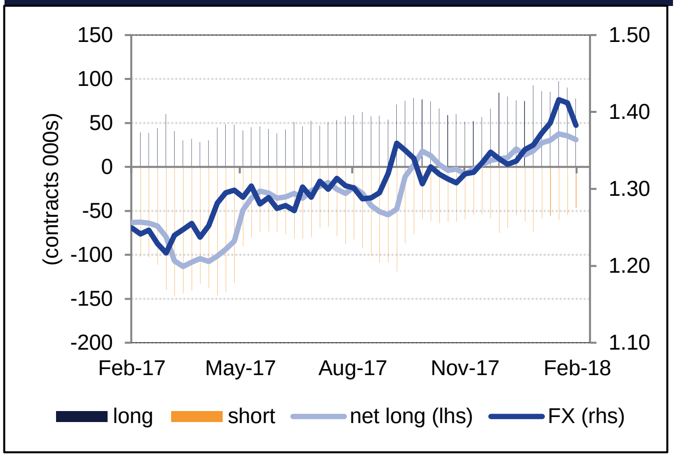
Source: Bloomberg, Emirates NBD Research

Major Currency Positions

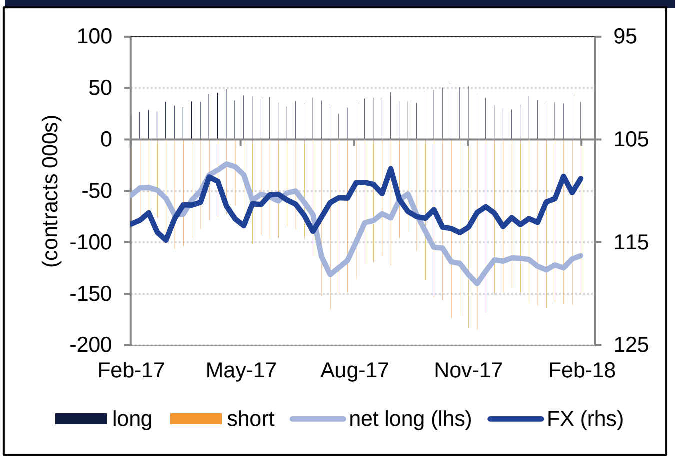
CFTC – Speculative Positions - EUR



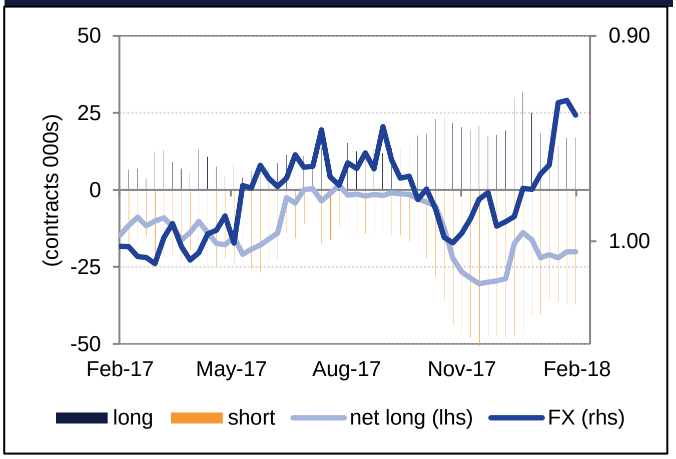
CFTC – Speculative Positions - GBP



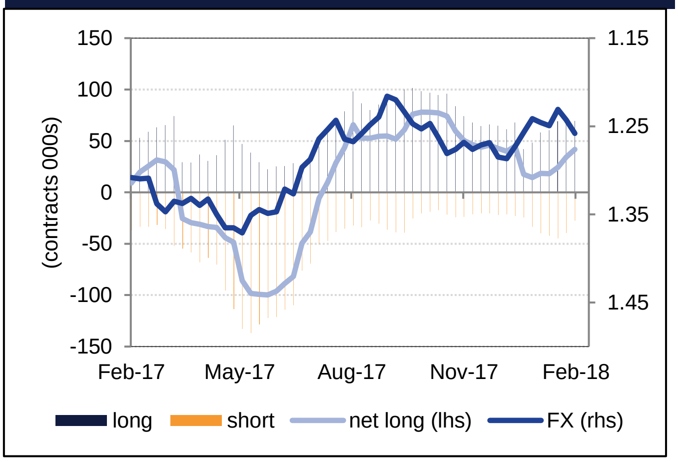
CFTC – Speculative Positions - JPY



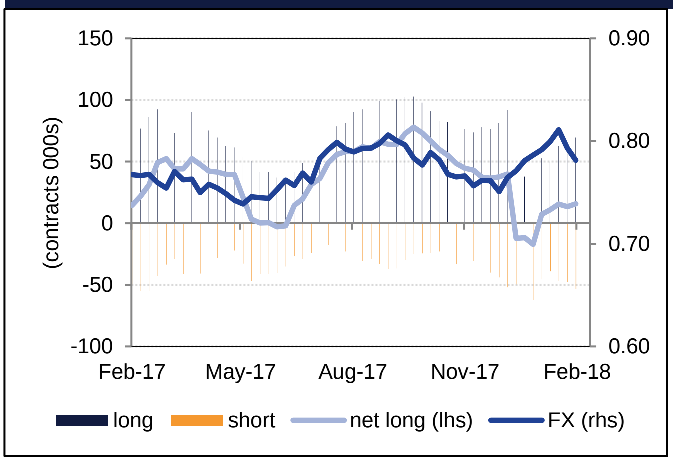
CFTC – Speculative Positions - CHF



CFTC – Speculative Positions - CAD



CFTC – Speculative Positions - AUD



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