



بنك الإمارات دبي الوطني
Emirates NBD

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FX Week

UK election impact muted, for now

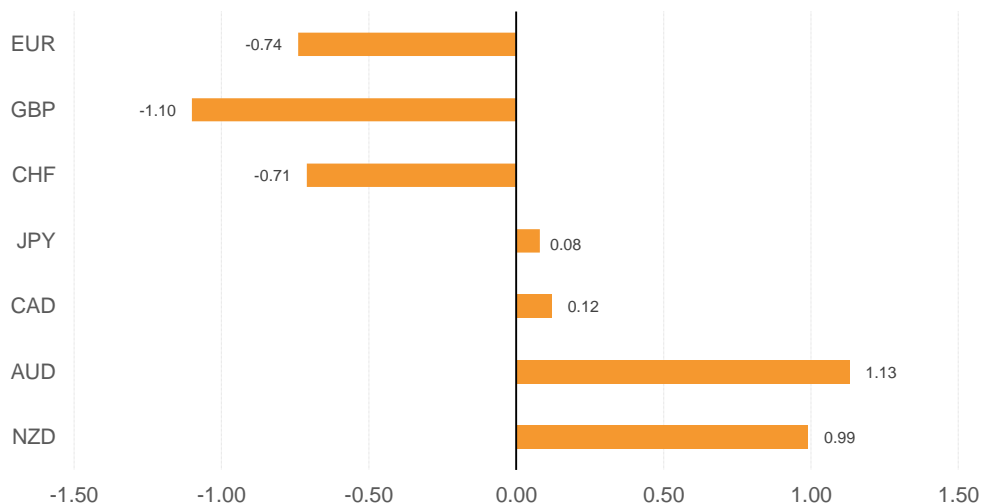
There are a number of lessons to take away from the momentous risk events that occurred last Thursday. Of the Comey testimony, the ECB meeting and the UK election, it was the UK election that caught the market by surprise. However, considering the magnitude of that political shock (that saw Theresa May returned to office without a majority and needing to strike an alliance with a small regional party), the financial market reaction was if anything relatively muted. GBP fell by 1.6% against the USD on the day, but equities rallied and the Gilts market was little changed. UK markets were reassured to a degree by the promise of an alliance that will keep the Conservative party in office, at least in the short term. Elsewhere too, the markets took the Comey testimony and the ECB decisions relatively calmly. However, each outcome will still have consequence for some time to come and will continue to impact financial markets into the future, even though the immediate reaction might appear to have been contained.

Although there were a few opinion polls that were forecasting a narrow UK election result, the majority were looking for a strong Conservative Party victory, and very few if any actually forecast the likelihood of a 'hung' Parliament in which no single party would hold a majority. The factors responsible for this outcome, which saw Theresa May's mandate undermined and forced her to seek an alliance with the small Democratic Unionist Party (DUP) of Northern Ireland, are issues for other notes and articles. What is important for GBP going forward are the following.

But election may not end UK political trauma

Theresa May's threadbare majority of two, once the Conservatives have formed their alliance with the DUP, will be inherently unstable and will never be far from the risk of collapsing. Another election in 2017 is entirely possible, bringing with it a now greater risk of an opposition Labour Party victory. Markets may have to contend with this possibility which would in turn entail risks of significantly higher public spending and taxation. UK markets would be unlikely to react well to such a prospect, although perversely the pound might benefit eventually if interest rates were seen as likely to rise. In the near term sterling is likely to remain unsettled by the continuation of political noise, with the risk of another election meaning that its vulnerability has not gone away.

Weekly currency movement vs USD (%)



Source: Bloomberg, Emirates NBD Research

Brexit prospects in the balance

Against this highly uncertain backdrop Brexit negotiations will have to begin on the 19th of June. So far, both May and the EU have stressed that there should be no delay in starting these. Observations have been made that the election result will strengthen the likelihood of a soft Brexit over a hard one, as the Conservative Party will have to compromise with its alliance partners and others over its determination to exit the single market. Ultimately, such a scenario might be seen as growth and GBP friendly, but at the moment it is too early to have much conviction about this. The onset of the negotiations will be tense and testing for Theresa May, and UK markets are likely to reflect this. Only if she manages to strike some early negotiation wins, and overcome some of the domestic political challenges will this prospect begin to look realistic.

Sterling to stay vulnerable for now

The consequences for GBP are likely to be ones of volatility and uncertainty. The clouds have not yet properly lifted on the election result, and there is still the possibility of some surprising events in the days and weeks to come. GBP is likely to remain on its back feet while the dust settles, consistent with our end Q2 1.25 forecast. If another election is called, it could easily fall further. Without being able to accurately predict how the political drama, and the Brexit negotiations, will continue to play out, our sense remains however, that the medium term trajectory will be more positive. Reaching our end-year forecast of 1.35 will clearly be a lot more challenging than it appeared a week ago though, with higher US interest rates and a stronger USD probably also complicating things.

US Fed to tighten as political clouds build

In fact with the Federal Reserve set to raise interest in coming days, the dollar may be buoyed for the time being, especially as the looming political risks in Washington appear to have steadied a little. Although former FBI Director Comey's testimony last week was compulsive viewing, it did not materially take the arguments against President Trump a lot further. That is not to say that the focus on his Presidency will go away, but rather that it will take time to come to a head. It is clear that the real action will be with the Special Counsel's investigation rather than the Congressional ones, and it is unlikely that the outcome of this will be seen before 2018. Until then, the main impact will be felt on Trump's dwindling ability to get major legislation through Congress, with the amount of fiscal stimulus that can be expected this year being progressively revised down.

This may in turn begin to have the impact of reining in monetary policy tightening expectations down the road, although it is unlikely if this week's FOMC meeting will be affected. A 25bps hike is widely expected, with the possibility that Janet Yellen will also discuss in more detail plans for reducing the size of the Fed's balance sheet, in the first instance through phasing out the reinvestment of maturing securities. Apart from this the US calendar this week also has a raft of important economic data including CPI inflation, industrial production, retail sales and consumer confidence. These will probably offer mixed messages about the strength of the US economy, with inflation likely to be subdued while retail sales and confidence readings should remain relatively firm.

ECB dampens hawkish sentiment

The third risk event of last week, the ECB meeting, also passed off relatively calmly, with its main outcomes more or less in line with expectations. While leaving interest rates unchanged and keeping its asset purchases at EUR60bn per month until the end of the year, the ECB also removed the reference to further interest rate cuts from its forward guidance. Inflation forecasts were lowered slightly while growth forecasts were pushed up, but the ECB also chose to keep tapering off the agenda, implying that it probably will not feature until 2018. As this contrasted with the hawkish sentiment that has been developing of late the EUR fell back from its

highs, and now appears poised for a period of sideways trading as the markets absorb the various political risks that are now approaching. Indeed, with ECB interest rate hikes probably now unlikely until 2019 the chances are that the EUR's recent strength could unravel a little further.

The first of the political events to watch will be the French parliamentary elections that started today, although these will not conclude until June 18th when second round run-offs take place. The result is expected to be a strong endorsement for President Macron, providing some relief for Eurozone markets. Early elections in Italy now looks less likely to take place, which might also be a reassurance, but Greek debt talks loom near the end of this week when the Eurogroup will meet. Meanwhile Eurozone economic data should also provide confidence that the recovery is proceeding. Eurozone eyes will also be watching the UK closely as talks over Brexit begin next week, with any perceived weakness in the UK's negotiating position likely to be taken positively by the single currency.

Outside of the Fed, rate changes unlikely for now

Apart from the FOMC meeting on Wednesday interest rate policy announcements will also be made in the UK, Switzerland and Japan this week. However, in these cases there seems little likelihood that any changes in interest rates will happen. The SNB will be again signal its opposition to an appreciating CHF, while the BOE is likely to remain cautious in the face of the ongoing political drama and as inflation readings stabilize after rising sharply in April.

FX Forecasts

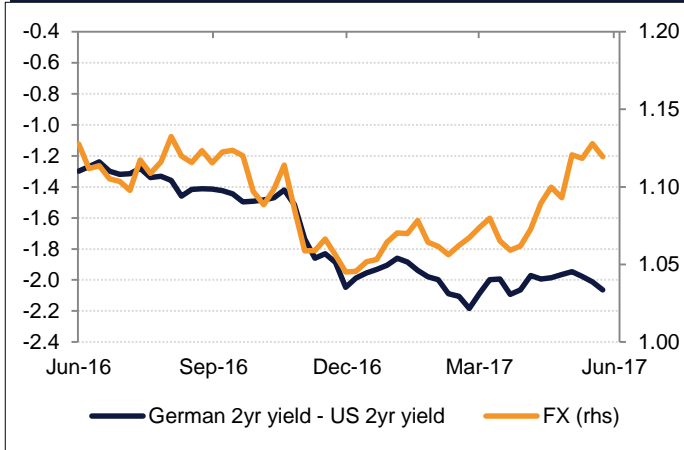
FX Forecasts - Major						Forwards		
	9-June	Q2 2017	Q3 2017	Q4 2017	Q1 2018	3m	6m	12m
EUR	1.1195	1.0800	1.0500	1.0300	1.0200	1.1250	1.1306	1.1427
JPY	110.32	116.00	120.00	122.00	124.00	109.87	109.39	108.30
CHF	0.9694	1.0300	1.0500	1.1000	1.1000	0.9638	0.9578	0.9454
GBP	1.2746	1.2500	1.3000	1.3500	1.4000	1.2782	1.2820	1.2901
AUD	0.7527	0.7300	0.7200	0.7000	0.7000	0.7517	0.7509	0.7496
NZD	0.7213	0.6900	0.6700	0.6500	0.6700	0.7201	0.7189	0.7164
CAD	1.3470	1.3500	1.3400	1.3200	1.3000	1.3446	1.3422	1.3376
EURGBP	0.8782	0.8640	0.8077	0.7630	0.7286	0.8800	0.8818	0.8856
EURJPY	123.51	125.28	126.00	125.66	126.48	123.51	123.51	123.51
EURCHF	1.0855	1.1124	1.1025	1.1330	1.1220	1.0844	1.0832	1.0806

FX Forecasts - Emerging						Forwards		
	9-June	Q2 2017	Q3 2017	Q4 2017	Q1 2018	3m	6m	12m
SAR	3.7505	3.7500	3.7500	3.7500	3.7500	3.7534	3.7558	3.7740
AED	3.6729	3.6720	3.6720	3.6720	3.6720	3.6742	-	-
KWD	0.3035	0.3050	0.3050	0.3050	0.3050	0.3043	0.3062	-
OMR	0.3850	0.3850	0.3850	0.3850	0.3850	0.3857	0.3865	0.3918
BHD	0.3773	0.3770	0.3770	0.3770	0.3770	0.3777	0.3783	0.3795
QAR	3.6568	3.6400	3.6400	3.6400	3.6400	3.6770	3.6903	3.7203
EPN	18.1285	18.0000	18.5000	18.7500	19.0000	18.7100	19.1600	20.0800
INR	64.254	64.500	65.000	66.000	67.000	64.9000	65.5800	66.9100
CNY	6.7980	7.0000	7.1000	7.2000	7.4000	6.8365	6.8795	6.9680

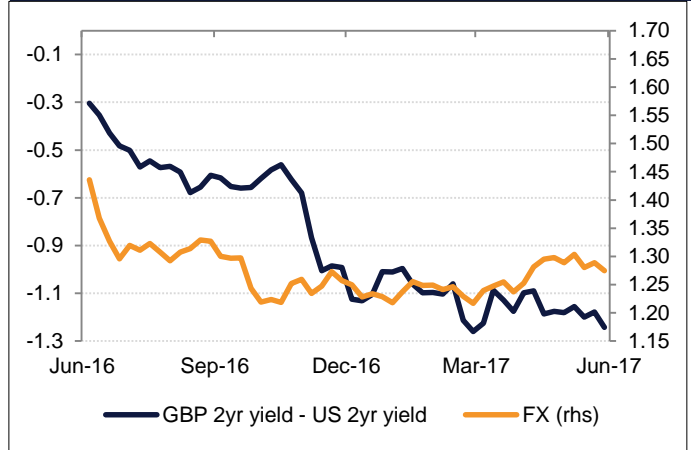
Source: Bloomberg, Emirates NBD Research
 *Denotes USD peg

Major FX and Nominal Interest Rates

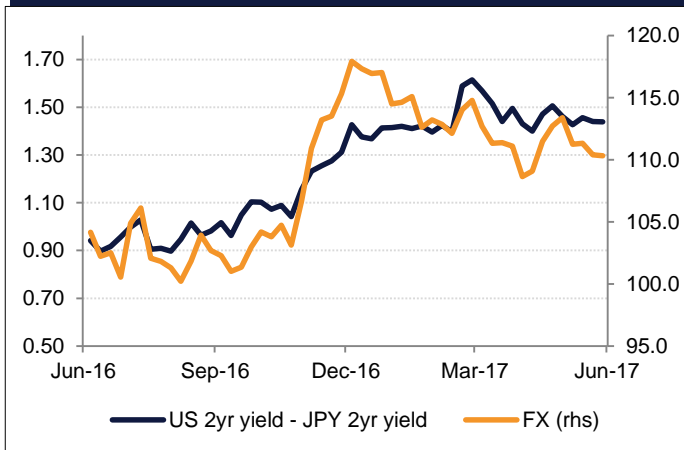
Interest Rate Differentials - EUR



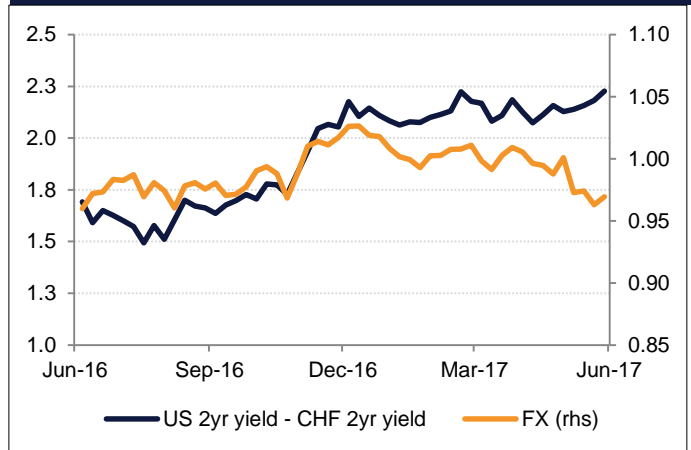
Interest Rate Differentials - GBP



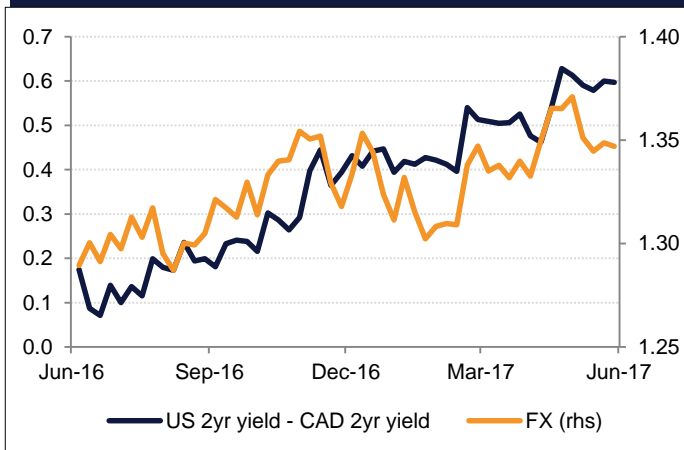
Interest Rate Differentials - JPY



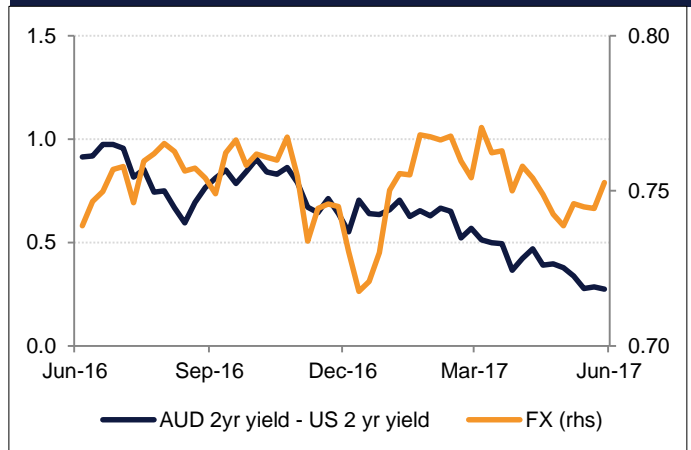
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD

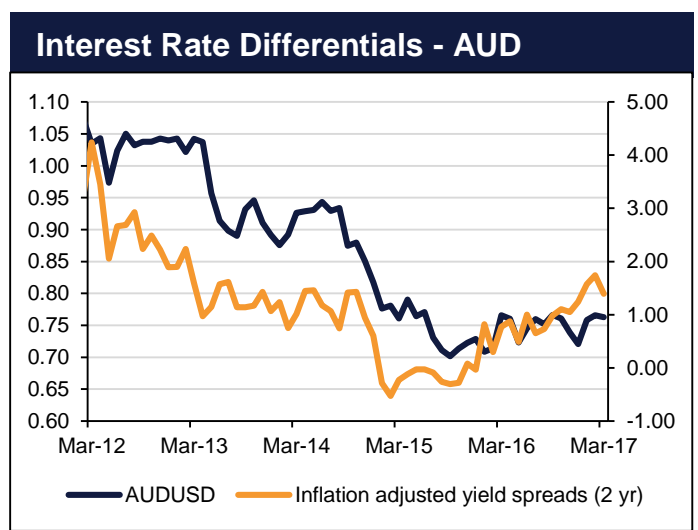
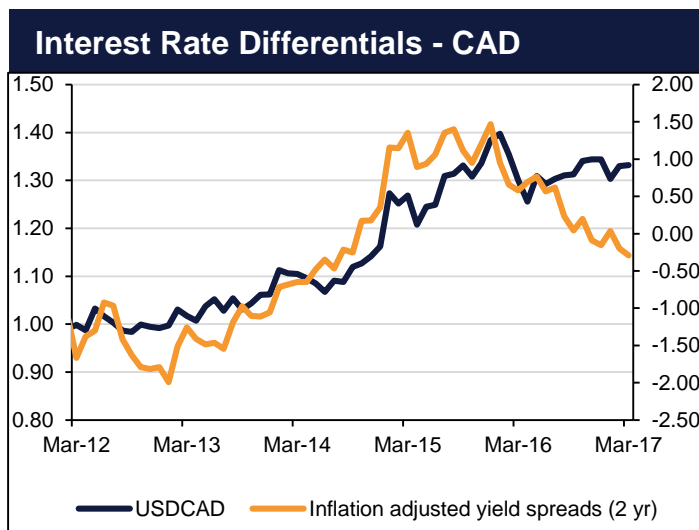
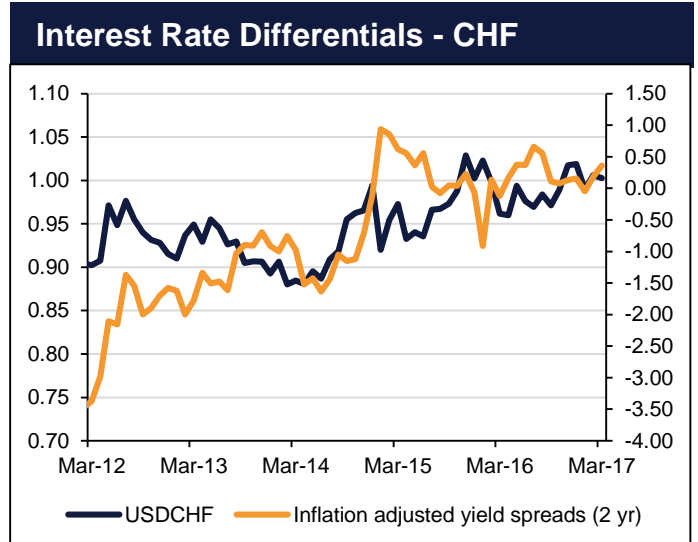
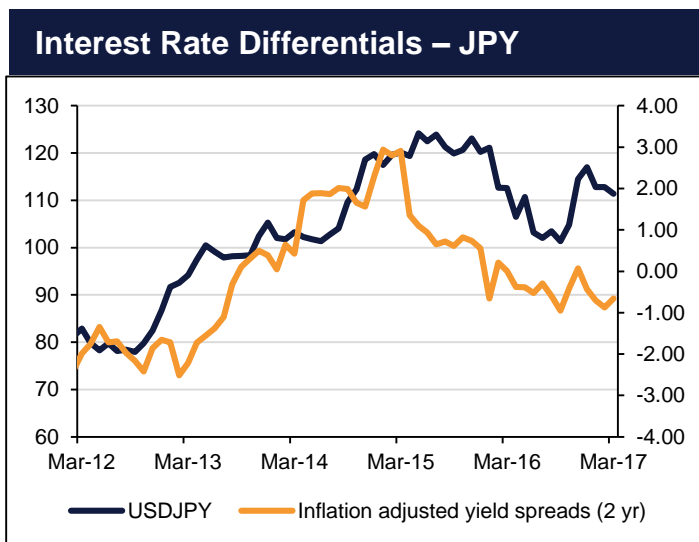
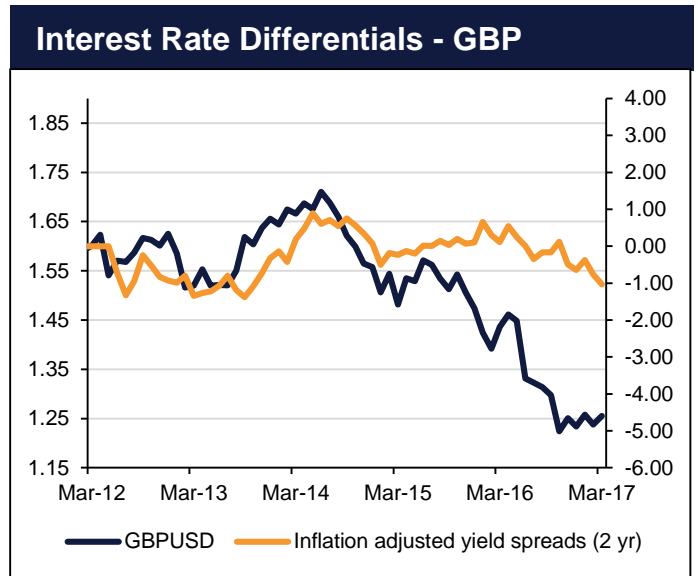
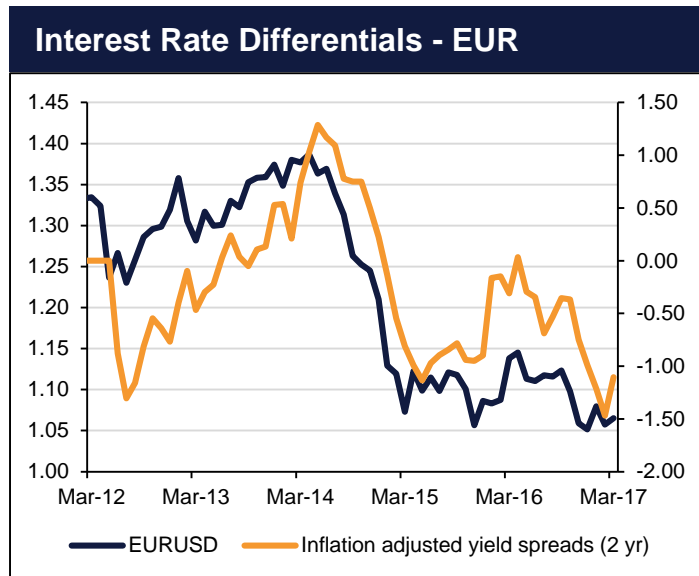


Interest Rate Differentials - AUD



Source: Bloomberg, Emirates NBD Research

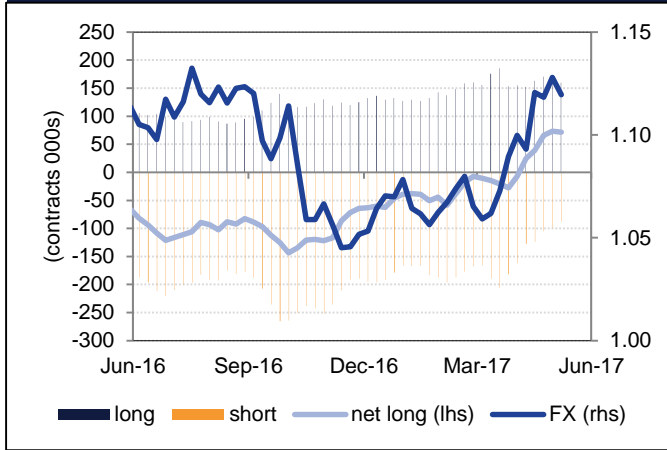
Major FX and Real Interest Rates



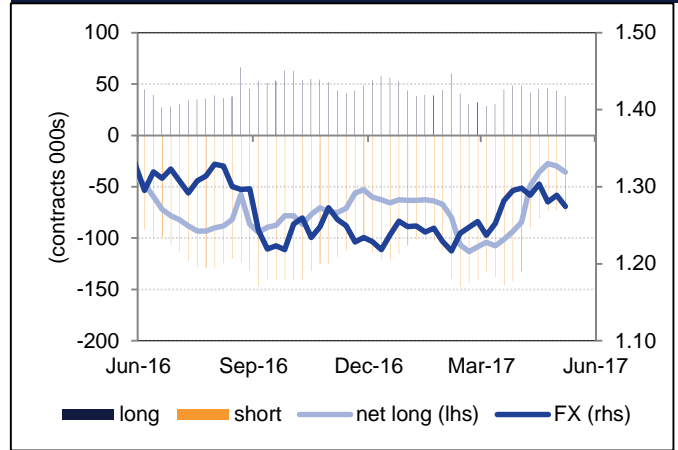
Source: Bloomberg, Emirates NBD Research

Major Currency Positions

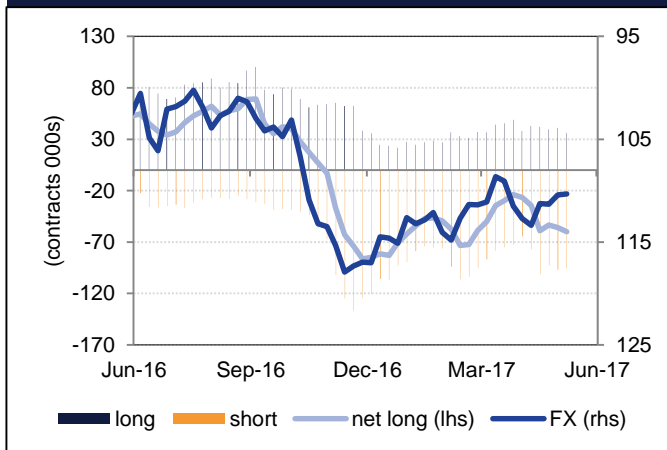
CFTC – Speculative Positions - EUR



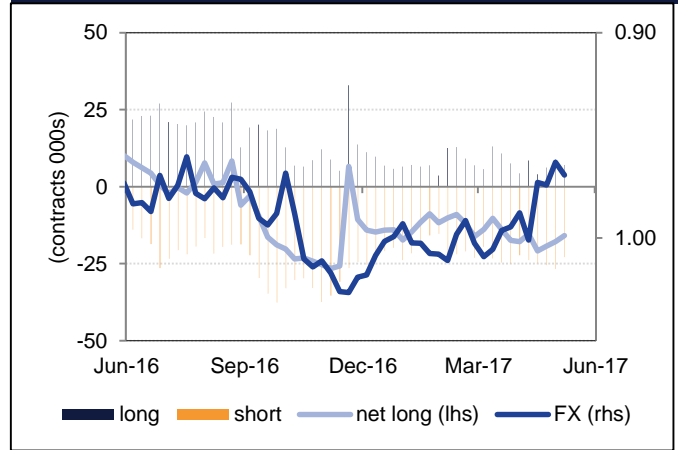
CFTC – Speculative Positions - GBP



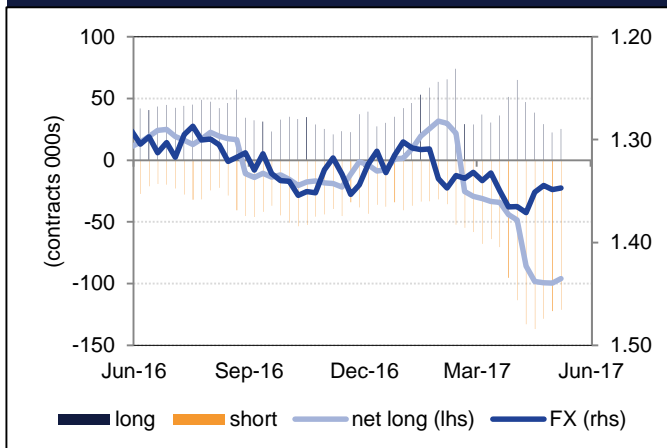
CFTC – Speculative Positions - JPY



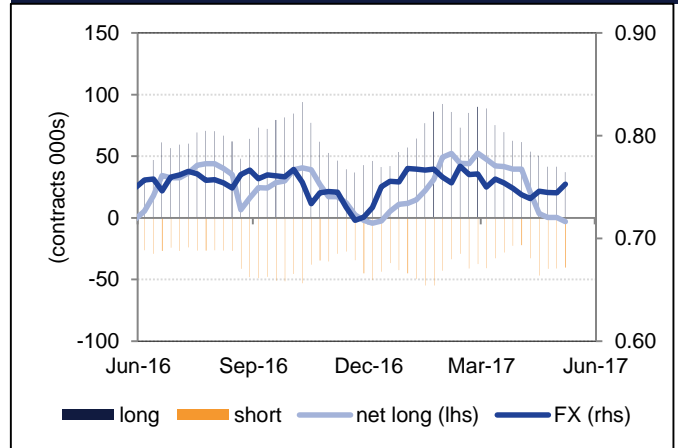
CFTC – Speculative Positions - CHF



CFTC – Speculative Positions - CAD



CFTC – Speculative Positions - AUD



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