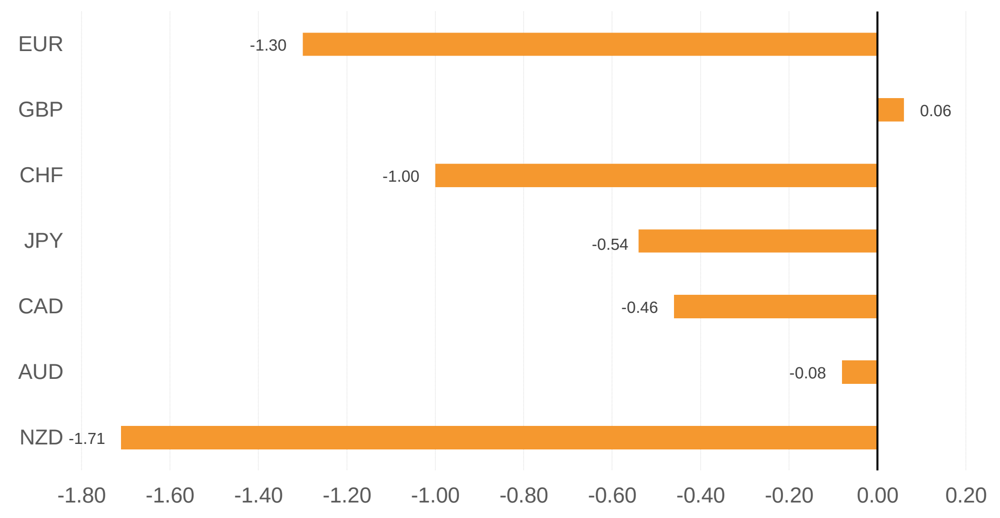
FX Week

Dollar recovers as Trump promises tax cuts

After spending most of last week under pressure the dollar recovered at the end of it after President Trump alluded to new growth oriented policies being on their way. Trump said that there would be 'something phenomenal in terms of tax' in the next two to three weeks which is something that financial markets have been hoping to see causing the S&P to hit new all-time highs. The weekend meetings between Trump and Prime Minister Abe of Japan are also likely to have been a relief for financial markets, as they passed off without any of the harsh rhetoric about trade or currency manipulation that might have been feared. Trump did say that 'we will all be on a level playing field soon,' with regard to FX policies but that was as far as it went, leaving USD gains intact overall. The two leaders pledged to begin new talks on bilateral trade and investment with Trump calling Japan a 'steadfast ally' following their meetings. Sentiment was also aided by President Trump seeking to mend fences with China, apparently telephoning President Xi Jinping to express support for the 'One China' policy.

After being the one of the main underperformers in the early part of the week USDJPY rallied going into the weekend which also helped the USD to strengthen against other currencies as well. In the end the USD rallied against most other major currencies with the exception of GBP which saw only a slight weekly gain. External factors were also prominent last week, especially in Europe with alarm rising about the political risks facing the Eurozone this year. Greek debt concerns have returned, with the IMF and the Eurozone advocating different approaches to the problem ahead of EUR7bn debt repayment due in the summer. The weekend saw some progress made towards a deal but there is still time for problems to reemerge. The situation is not made any easier by election risks in a number of Eurozone countries this year, including in France and Germany. The right-wing Front National in France, which is leading in the opinion polls, was reported as favouring converting the bulk of French debt into French francs should they win in May, contributing to French debt markets struggling over the week. The first test of political risk will come in the Netherland's next month, where right-wing populist parties are also in the lead.

Weekly currency movement vs USD (%)



Source: Bloomberg, Emirates NBD Research

Weekly

12 February 2017

Tim Fox
Chief Economist
+971 4 230 7800
timothyf@emiratesnbd.com

Mohammed Al-Tajir
Manager, FX Analytics and Product Development
+971 4 609 3005
MohammedTAJ@emiratesnbd.com

Data likely to confirm Eurozone recovery

ECB President Draghi also hit back against criticism from the US administration that the ECB is manipulating the Euro exchange rate, reiterating the need for asset purchases in the Eurozone to run their course, and with other ECB officials indicating that they could continue into 2018. Data releases this week will be largely backward looking and confirm the picture of an ongoing recovery and rising inflation. German and Eurozone Q4 GDP numbers will be released on Tuesday as well as final German inflation data for January. Eurozone Q4 GDP is expected to be confirmed 0.5% q/q, with domestic demand the main driving force as the ECB continues to lend support. Industrial production in December is likely to have been weak, however, after German production showed a bigger than expected slump during the month. The most interesting number may be the forward looking German ZEW investor confidence index for February, which will show how unsettled investors are by the growing tensions with the new US government.

The US calendar will be dominated by Fed Chair Yellen's semi-annual testimony on Tuesday and Wednesday , although it is unlikely that she will deviate much from the statement of the last FOMC meeting a fortnight ago which showed the Fed to be cautious in an environment of heightened uncertainty over the direction of US fiscal policy. The data calendar is also a full one this week, with consumer prices, retail sales and industrial production all due out, and containing the potential to twist the argument in favour of a faster pace of monetary tightening. We think it is unlikely that Yellen will rule out a March rate rise, consistent with the Fed's message that all FOMC meetings are 'live ones'.

USDJPY should be the main beneficiary of firmer US interest rates, as it was the biggest casualty as yields fell early last week. Promises to cut taxes should feed through into greater optimism about growth, and any hawkishness on the part of Janet Yellen would also help to push it back up towards 115 in the first instance.

Sterling endures volatile week

GBP was whippy last week albeit within relatively narrow ranges, buffeted by the alternating dominance of US and UK political factors. The lower house of the UK parliament passed a bill authorizing the government to trigger Article 50 of the Lisbon Treaty, thus starting the process of formal Brexit negotiations. However, it still remains for the upper house to endorse the Bill which will happen in coming weeks, and we see the pound as remaining vulnerable as the Brexit talks begin to play out. Some offset to this should be provided by UK data however, as production and trade data for December were strong, and the likelihood is that inflation data due out this week will also underpin expectations of tighter monetary policy later this year, with retail sales and labour market data also expected to be firm.

CAD pares weekly losses as employment data supports

Economic data released on Friday supported the CAD after showing tightening labour market conditions. While the participation rate in January increased to 65.9% from 65.8% the previous month, the unemployment rate unexpectedly declined from 6.9% to 6.8%. Such data helped the CAD pare some of the week's earlier losses and helped USDCAD decline from highs of 1.3212 to close at 1.3083.

Technical observations indicate further declines could be in store. The pair remains in the daily downtrend that has been in effect since December 28th 2016 and ended the week trading below the 200 day MA of 1.3141 as well as below the 100 week MA (1.3102) for a second consecutive week, the first time it has done this since January 2013.

On the other hand some other fundamental considerations support a rebound in the pair, especially with President Trump promising to announce USD friendly tax cuts in the weeks ahead.

AUD rallies on RBA announcement

The AUD outperformed most of the other major currencies last week, after RBA Governor Lowe highlighted that the Australian economy had been given a boost by higher commodity prices and improvements in the global economy. Investors focused on this part of his statement and largely overlooked comments about the strength of the AUD being a headwind to growth. In addition, the currency was given a further boost on Friday after a 4.6% surge in copper prices, a consequence of strikes at Peru's MMG copper mine.

In the week ahead, we expect data to be the key driver of AUD price action, with Australian employment expected to be the main point of interest. The market consensus is that the unemployment rate will remain unchanged at 5.8% in January, something that the RBA will be looking at closely. Having risen from 5.6% in October, any evidence of labour market weakness could catalyze a selloff in AUD.

Kiwi falls as RBNZ brings market back to reality

In line with our expectations in last week's publication, the RBNZ held the interest rate at a record low of 1.75%, with Governor Graeme Wheeler saying that the market was "getting ahead of itself" in speculating that the central bank would begin tightening monetary policy. Following this announcement, the implied market probability of a hike by November 2017 fell from 76.1% to 43.4%. While this change demonstrates that the market has moved closer to reality, the central bank projection that interest rates will not begin to rise until Q4 2019 leads us to believe that even the current implied rate is still exceptionally high.

NZDUSD reverses daily uptrend

Source: Bloomberg, Emirates NBD Research

Over the course of the week, NZDUSD declined 1.71% from its opening of 0.7315 to 0.7190 in a move that saw it break out of the daily upward trend that had been in effect since the 23rd December 2016. The same move took the pair below the one year 76.4% Fibonacci retracement of 0.7190, a support level that now acts as resistance. Looking forward we expect further declines for the pair with strong support coming in the 0.7106-0.7135 zone, an area which includes many key levels (50 day MA (0.7106), 100 day MA (0.7134), 200 day MA (0.7119) and the one year 61.8% Fibonacci retracement (0.7127)). Provided the pair breaks and closes below this zone, as we expect, we maintain our Q1 2017 forecast of 0.69.

FX Forecasts

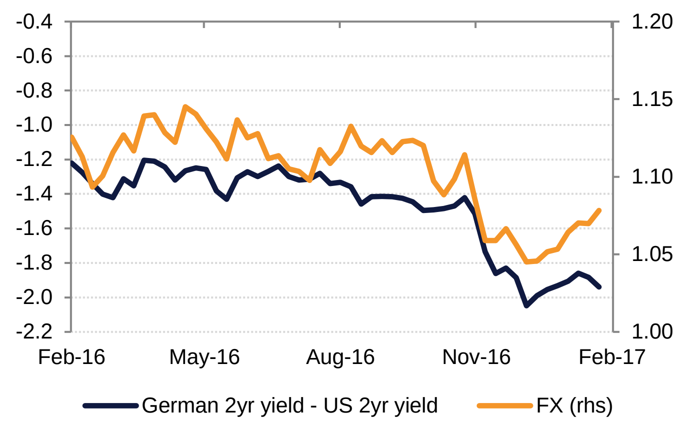
FX Forecasts - Major						Forwards		
	10-Feb	Q1 2017	Q2 2017	Q3 2017	Q4 2017	3m	6m	12m
EUR	1.0643	1.0500	1.0200	1.0000	1.0000	1.0686	1.0737	1.0855
JPY	113.22	116.00	120.00	122.00	124.00	112.79	112.29	111.06
CHF	1.0024	1.0300	1.0500	1.1000	1.1000	0.9973	0.9913	0.9779
GBP	1.2491	1.2200	1.1800	1.2500	1.3500	1.2516	1.2546	1.2619
AUD	0.7674	0.7300	0.7200	0.7000	0.7000	0.7658	0.7644	0.7622
CAD	1.3083	1.3500	1.3400	1.3200	1.3000	1.3073	1.3059	1.3023
EURGBP	0.8513	0.8607	0.8644	0.8000	0.7407	0.8530	0.8550	0.8593
EURJPY	120.48	121.80	118.32	120.00	122.00	120.48	120.48	120.48
EURCHF	1.0671	1.0815	1.0710	1.1000	1.1000	1.0660	1.0646	1.0617
NZDUSD	0.7190	0.6900	0.6700	0.6500	0.6700	0.7170	0.7153	0.7120

FX Forecasts - Emerging						Forwards		
	10-Feb	Q1 2017	Q2 2017	Q3 2017	Q4 2017	3m	6m	12m
SAR	3.7506	3.7500	3.7500	3.7500	3.7500	3.7516	3.7545	3.7692
AED	3.6730	3.6700	3.6700	3.6700	3.6700	3.6750	3.6773	--
KWD	0.3053	0.2900	0.2900	0.2900	0.3000	0.3048	0.3063	--
OMR	0.3850	0.3800	0.3800	0.3800	0.3800	0.3862	0.3880	0.3933
BHD	0.3770	0.3760	0.3760	0.3760	0.3760	0.3774	0.3776	0.3785
QAR	3.6412	3.6400	3.6400	3.6400	3.6400	3.6455	3.6495	3.6605
EPN	17.7390	18.0000	18.5000	18.7500	19.0000	17.8300	18.0200	18.8000
INR	66.884	68.000	66.000	65.000	65.000	67.4900	68.2800	69.8400
CNY	6.8785	7.0000	7.1000	7.2000	7.4000	6.9505	7.0110	7.1210

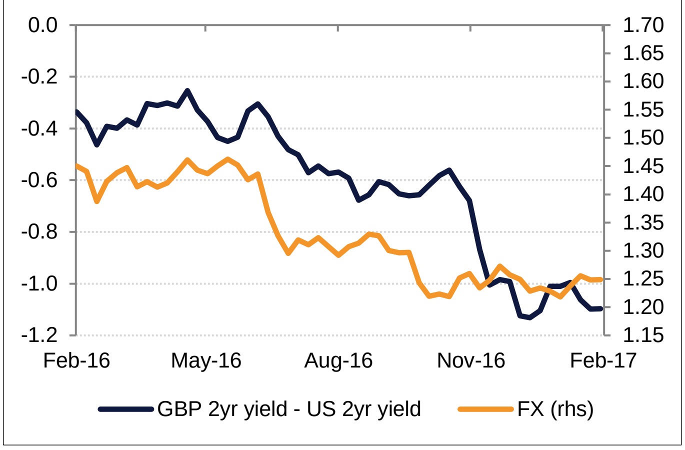
Source: Bloomberg, Emirates NBD Research
**Denotes USD peg*

Major FX and Nominal Interest Rates

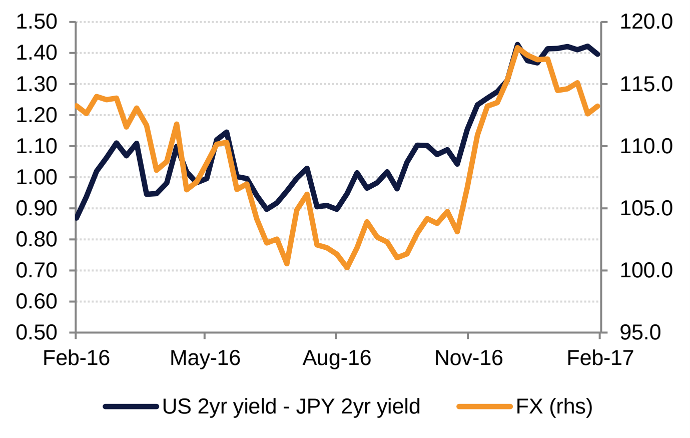
Interest Rate Differentials - EUR



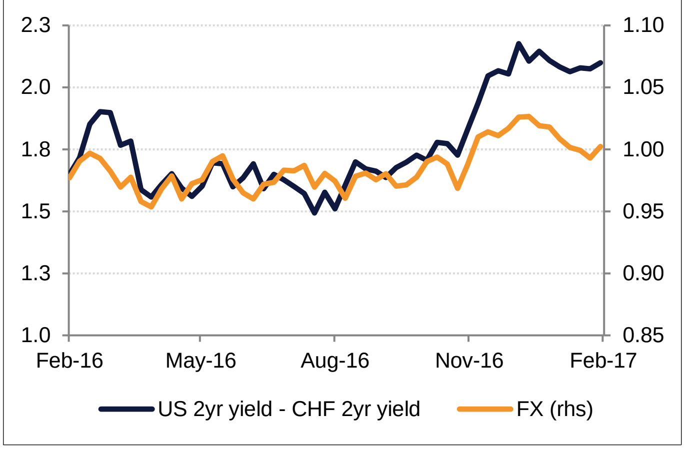
Interest Rate Differentials - GBP



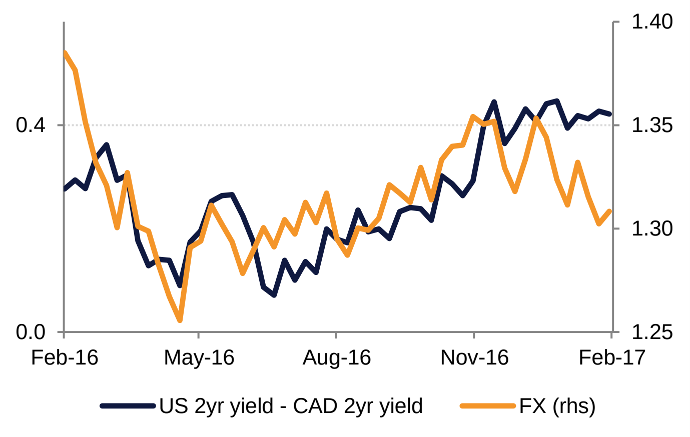
Interest Rate Differentials –JPY



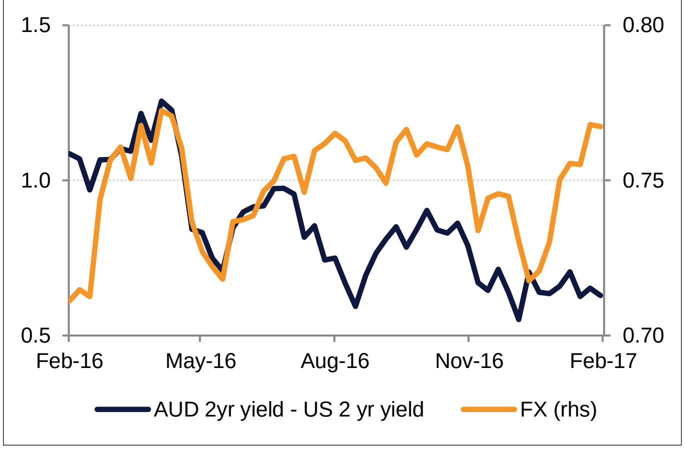
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD



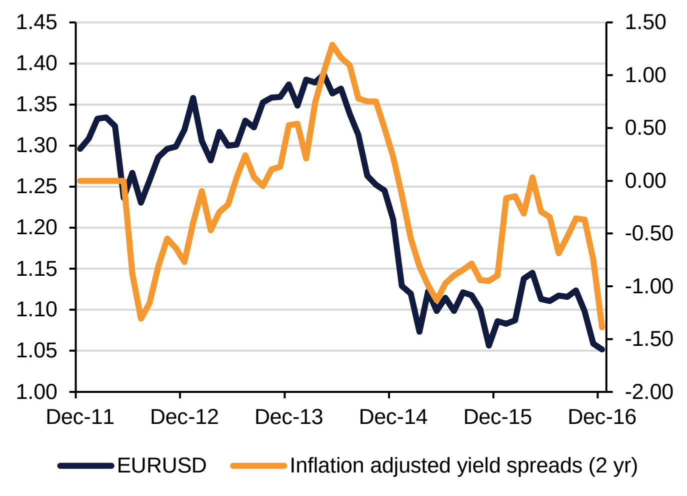
Interest Rate Differentials - AUD



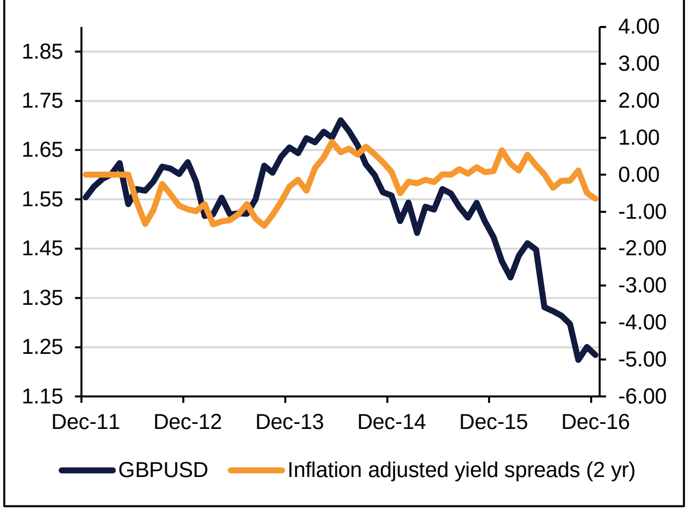
Source: Bloomberg, Emirates NBD Research

Major FX and Real Interest Rates

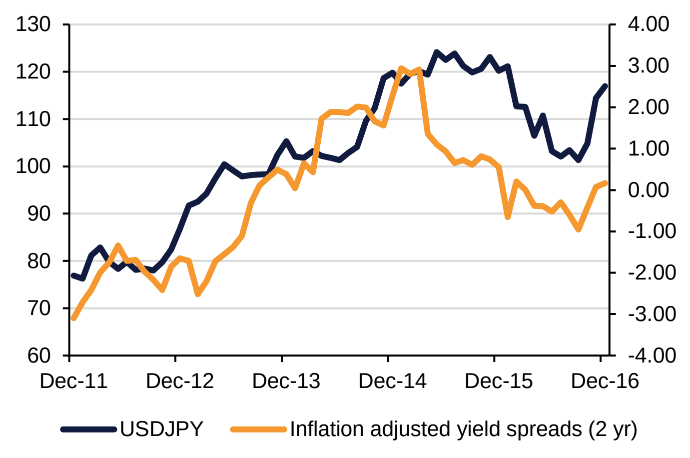
Interest Rate Differentials - EUR



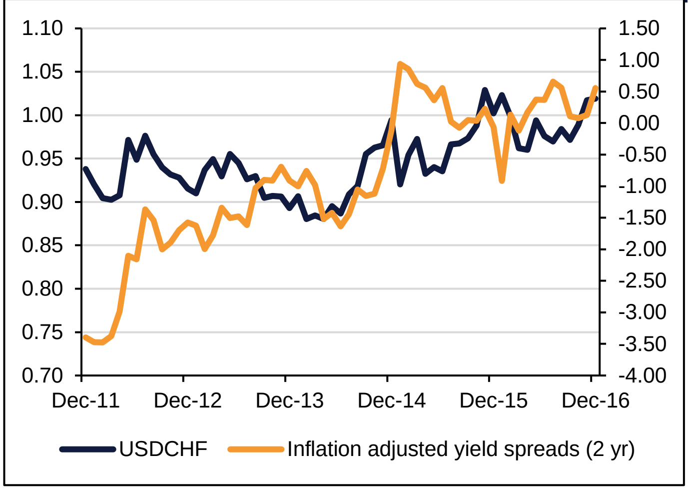
Interest Rate Differentials - GBP



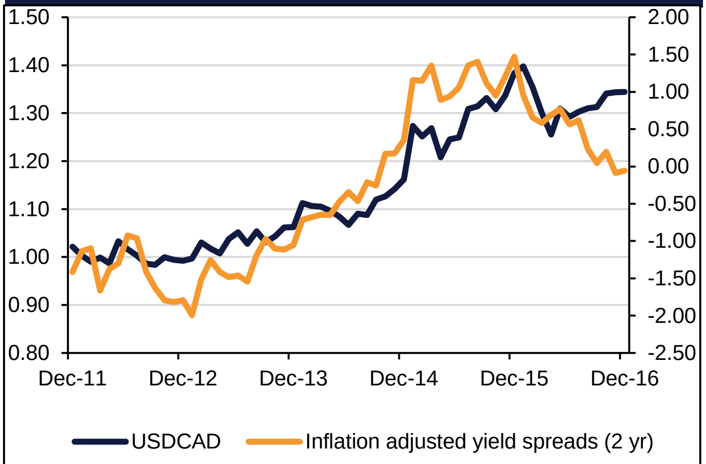
Interest Rate Differentials –JPY



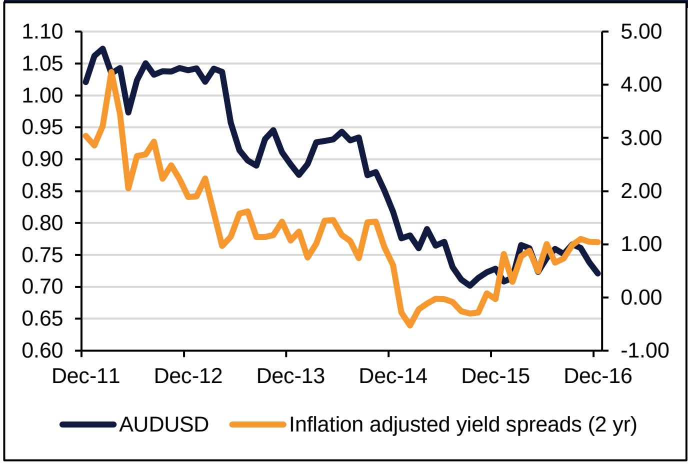
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD



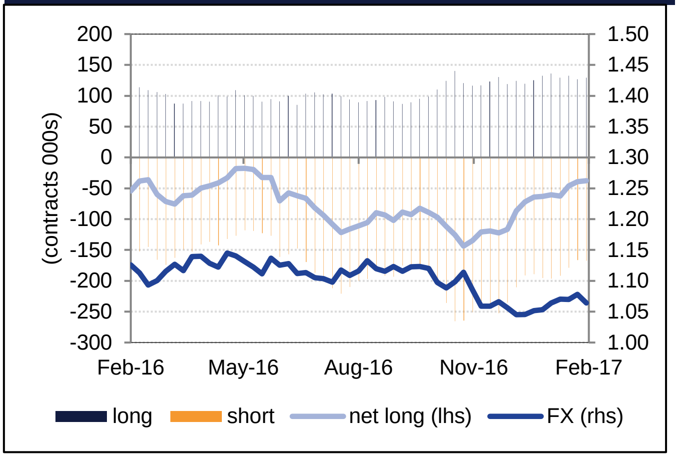
Interest Rate Differentials - AUD



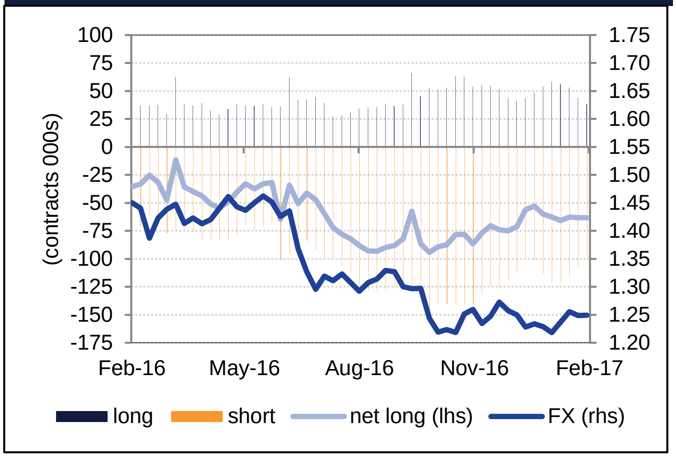
Source: Bloomberg, Emirates NBD Research

Major Currency Positions

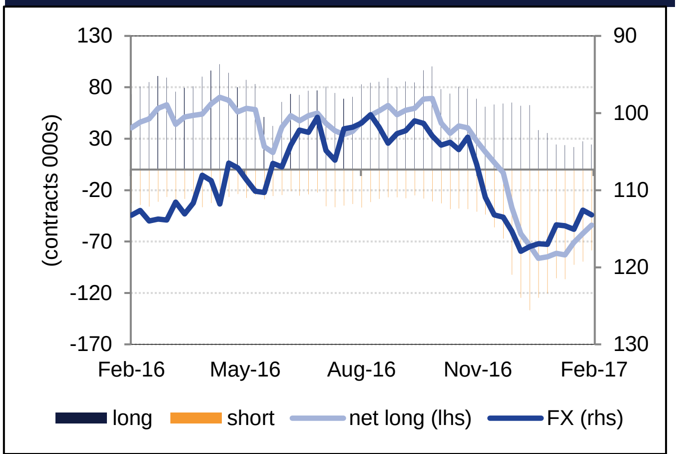
CFTC – Speculative Positions - EUR



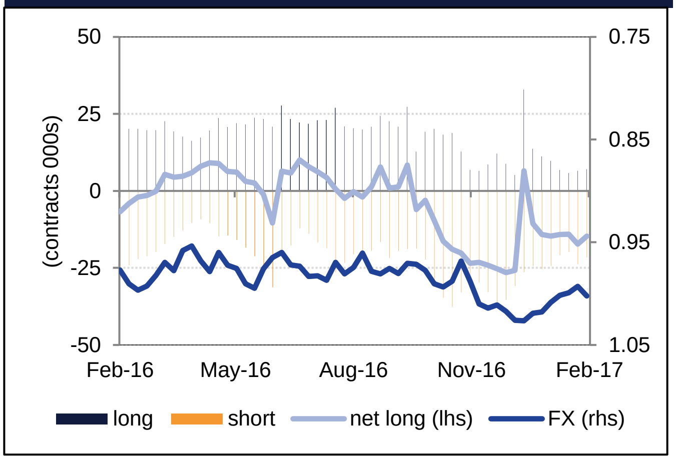
CFTC – Speculative Positions - GBP



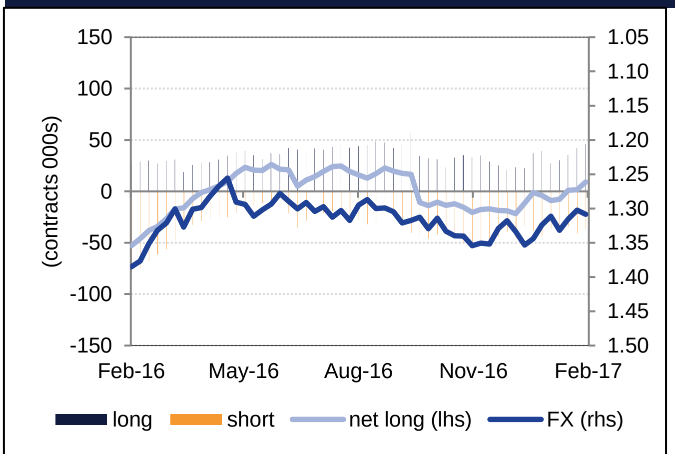
CFTC – Speculative Positions - JPY



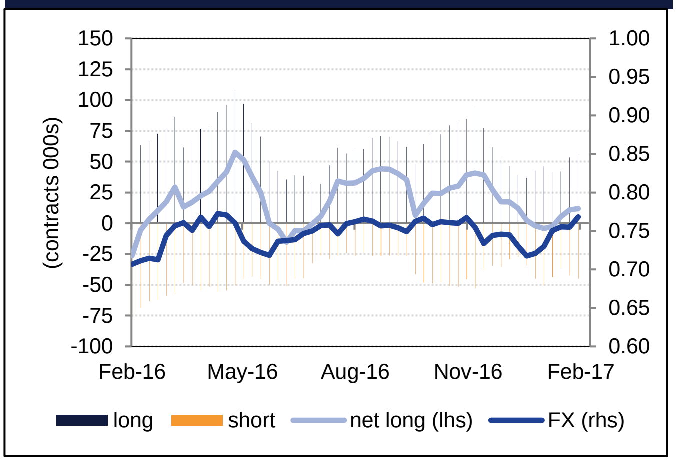
CFTC – Speculative Positions - CHF



CFTC – Speculative Positions - CAD



CFTC – Speculative Positions - AUD



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Emirates NBD Research & Treasury Contact List

Emirates NBD Head Office
12thFloor
Baniyas Road, Deira
P.OBox777
Dubai

Jonathan Morris
General Manager Wholesale Banking
JonathanM@emiratesnbd.com

Aazar Ali Khwaja
Group Treasurer & EVP Global Markets & Treasury
+971 4 609 3000
aazark@emiratersnbd.com

Tim Fox
Head of Research & Chief Economist
+9714 230 7800
timothyf@emiratesnbd.com

Research

Khatija Haque
Head of MENA Research
+9714 230 7803
khatijah@emiratesnbd.com

Anita Yadav
Head of Fixed Income Research
+9714 230 7630
anitay@emiratesnbd.com

Shady Shaher Elborno
Head of Macro Strategy
+9714 2012300
shadyb@emiratesnbd.com

Jean Paul Pigat
Senior Economist
+9714 230 7807
jeanp@emiratesnbd.com

Edward Bell
Commodity Analyst
+9714 230 7701
edwardpb@emiratesnbd.com

Mohammed Al-Tajir
Manager, FX Analytics and Product Development
+9714 609 3005
mohammedtaj@emiratesnbd.com

Athanasios Tsetsonis
Sector Economist
+9714 230 7629
athanasiost@emiratesnbd.com

Aditya Pugalia
Analyst
+9714 230 7802
adityap@emiratesnbd.com

Sales & Structuring

Group Head – Treasury Sales
Tariq Chaudhary
+971 4 230 7777
tariqmc@emiratesnbd.com

Saudi Arabia Sales
Numair Attiyah
+966 11 282 5656
numaira@emiratesnbd.com

Singapore Sales
Supriyakumar Sakhalkar
+65 65785 627
supriyakumars@emiratesnbd.com

London Sales
+44 (0) 20 7838 2241
vallancel@emiratesnbd.com

Egypt
Gary Boon
+20 22 726 5040
garyboon@emiratesnbd.com

Emirates NBD Capital

Ahmed Al Qassim
CEO- Emirates NBD Capital
AhmedAQ@emiratesnbd.com

Hitesh Asarpota
Head of Debt Capital Markets.
+971 50 4529515
asarpotah@EmiratesNBD.com

Investor Relations

Patrick Clerkin
+9714 230 7805
patricke@emiratesnbd.com

Group Corporate Affairs

Ibrahim Sowaidan
+9714 609 4113
ibrahims@emiratesnbd.com

Claire Andrea
+9714 609 4143
clairea@emiratesnbd.com