بنك الإمارات دبي الوطني
Emirates NBD

FX Week

Weekly
22 April 2018

Dollar to benefit from North Korea and China trade developments

There were potentially two positive developments over the weekend that should be constructive for risk appetite at the start of the week including for equities, bond yields and the dollar. The first of these was the news that North Korea is to suspend nuclear and ICBM tests and dismantle its nuclear sites according to North Korea's Korean Central News Agency. The suspension went into effect on Saturday with North Korea's Kim Jung Un seemingly wanting to shift his country's focus towards improving the economy and away from nuclear powered security. The announcement comes against the background of pending talks between the US and North Korea and portend a positive outcome that could help to diffuse one of the most intractable geopolitical problems of recent years, if not decades.

The second development was the announcement that US Treasury Secretary Steve Mnuchin is considering a trip to China in a bid to avert a pending trade war between the two countries that could in extremis cause the world economy to sink back into recession. Both announcements are still a long way from achieving lasting solutions to two of the world's biggest uncertainties, but on both counts there should be at least a reduction in risk aversion in the short term as a result. These steps also come against a background of markets already stepping away from contemplating the possibility of a US recession last week, as 10-year Treasury bond yields rose to just shy of 3.0%. This caused the yield curve to steepen as the perceived risk of the US economy falling back into recession lessened. Indeed, the 2s-10s spread had briefly hit 43 bps, not seen since 2007 and the financial crisis, causing global equity markets to become nervous.

Previously firmer bond yields had been associated with weaker equity markets, and a softer dollar, but in this instance the context is different with geopolitical and trade tensions now seemingly less of a concern. The dollar should therefore be able to continue its recent improvement at least until fresh doubts about trade and geopolitics resurface, which is entirely possible. The dollar also faces a heavy week in terms of corporate earnings figures, heavy Treasury supply, and important data releases, with the main focus likely to be on whether the 10-year yield can test and break above 3.0%. If this can happen it may be that the dollar can also begin to re-establish its former positive relationship with rising interest rates.

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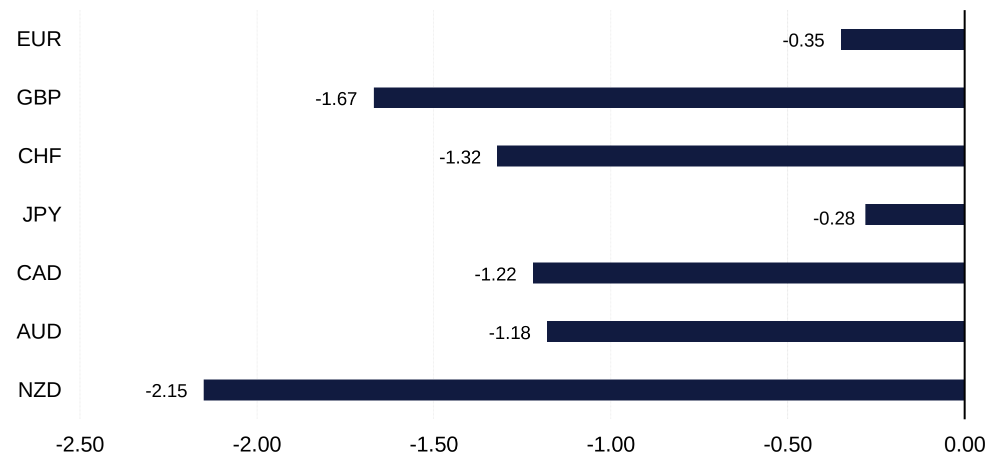
Weekly currency movement vs USD (%)



Source: Bloomberg, Emirates NBD Research

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USDJPY recovery reflects improving risk appetite

USDJPY will be the main test of this, having historically had a strong correlation with US-Japan interest rate differentials. So far it has managed to recover from lows of 104.56 in late March to reach back to within sight of 108 today. The move reflects dollar firmness in the main as JPY crosses were relatively steady, but Japanese economic data also helps to justify a weaker JPY profile. Japanese March CPI came in at 1.1% y/y down from 1.5% in February, while the core rate eased to a 0.9% y/y rate from 1.0% y/y, taking it further away from the BOJ's target. This will likely reinforce the bias of the BOJ to remain on hold for a considerable time, much more than in the Eurozone for instance. Needless to say the BOJ meets towards the end of this week with no policy changes expected. Technically support for USDJPY is at 107.30, while a breach of last week's two-month high at 107.78 will be needed to reinforce the recent more positive trend.

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US data dominated by Q1 GDP

US economic data will arguably play a greater role for dollar crosses, however, as US Q1 GDP data is due out and expected to slow to a 2.4% rate of growth, after the 2.9% pace in Q4. Such a slowdown often happens at the start of the year, as seasonal adjustments appear inadequate. The main focus will probably be on consumer spending which is likely to have fallen back significantly after strong gains in Q4. Meanwhile, the Q1 employment cost index is expected to show employment costs rising, while consumer confidence, durable goods orders and home sales make up the balance of the data.

GBP sinks on Carney rate swipe

GBP lost significant ground last week (-1.7%) following BoE Governor Carney's latest intervention about the prospects UK interest rates. He said that while there will be 'a few interest rate rises over the next few years,' he didn't want 'to get too focused on timing' thus damping widespread expectations for the Bank to deliver another 25bp repo rate hike on May 10th. In contrast to Carney, Michael Saunders, who was one of the Monetary Policy Committee's two dissenters in favor of hiking rates at the March MPC meeting, stuck to his relatively hawkish message.

Notwithstanding Carney's latest remarks we are still anticipating that the BOE will raise interest rates next month. However, the Bank may also choose to reduce its inflation projections while toning down its hawkish guidance, in view of the muted second-round inflationary pressures, and in light of currency gains over the last several months. For the time being the GBPUSD will probably remain under some pressure, until closer to the policy meeting itself, and while the global environment remains risk friendly and dollar supportive. UK Q1 GDP data to be released in the coming week is expected to be slightly softer than in Q4, with a growth rates of 0.3% q/q and 1.4% y/y after Q4 figures of 0.4% q/q and 1.4% y/y. Ultimately, however, we still see GBP recapturing its upside trend and is expected to end the year at 1.45.

ECB messaging key as Eurozone data turns mixed

The Eurozone also faces some GDP data in a few of its constituent countries, for instance in France and Spain where softer growth is expected than in Q4. Softer activity indices are also expected which should help to maintain a downward bias for the EUR. The main issue for the EUR will probably be the ECB meeting, however, on Thursday. Although policy rates and guidance will likely remain unchanged, the comments of President Draghi will be of greater importance as he seeks to find the language to justify a gradual move away from QE, but not just yet. For the time being he is unlikely to be explicit about the timing of any changes in policy, with a change in such rhetoric more likely to come in the summer.

However, his observations about the economy and the risks to it will be picked up on, as they will provide early indications about the mood and about how long the ECB will likely remain patient for. Consolidation thus remains the main theme for the EUR for the time being, with the risk being of a run down to 1.22 in the coming days.

AUD hurt by RBA minutes

In terms of other currency pairs the AUD focus will be on inflation where Q1 CPI is expected to rise 0.6% q/q, after a 0.6% gain in Q4, taking the y/y rate to 2.0% up from 1.9% y/y. The AUD dropped in the wake of the release of the RBA's April minutes last week followed by pressure driven by broader USD strength. The RBA's minutes revealed a mixed view on the economy, with members noting that ‘more likely the next move in the rate would be up, rather than down,’ but also indicating that there ‘was not a strong case for a near-term adjustment in monetary policy.’ Overall then the AUD may remain exposed and vulnerable to any tightening by other central banks, limiting the topside for the currency.

TRY awaits rate decision

Finally in terms of EM markets the focus will likely fall on the TRY in view of its recent sharp losses and the pressure this is exerting on the Turkish Central Bank to raise interest rates this week. USDTRY has backed off recent highs of 4.20, but as it remains above 4.0 it is clearly not out of the woods, leaving a 100bps rate hike a strong possibility.

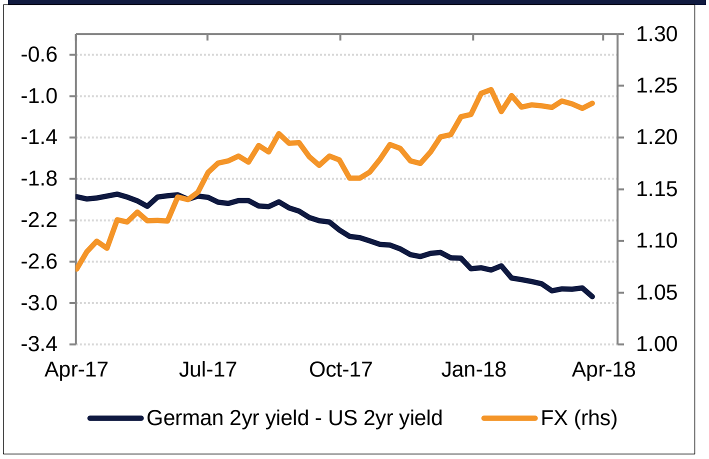
FX Forecasts

FX Forecasts - Major						Forwards		
	20-Apr	Q2 2018	Q3 2018	Q4 2018	Q1 2019	3m	6m	12m
EUR	1.2288	1.2500	1.2700	1.2700	1.2800	1.2374	1.2466	1.2672
JPY	107.66	105.00	108.00	108.00	110.00	106.99	106.26	104.62
CHF	0.9746	0.9800	0.9800	0.9800	0.9800	0.9669	0.9588	0.9418
GBP	1.4000	1.4200	1.4500	1.4500	1.4800	1.4058	1.4118	1.4246
AUD	0.7672	0.7600	0.7700	0.7800	0.7800	0.7675	0.7681	0.7698
NZD	0.7207	0.7200	0.7200	0.7200	0.7200	0.7206	0.7208	0.7216
CAD	1.2761	1.2600	1.2600	1.2600	1.2600	1.2736	1.2714	1.2674
EURGBP	0.8776	0.8803	0.8759	0.8759	0.8649	0.8801	0.8828	0.8893
EURJPY	132.28	131.25	137.16	137.16	140.80	132.28	132.28	132.28
EURCHF	1.1981	1.2250	1.2446	1.2446	1.2544	1.1970	1.1958	1.1940
FX Forecasts - Emerging						**Forwards**		
	20-Apr	Q2 2018	Q3 2018	Q4 2018	Q1 2019	3m	6m	12m
SAR	3.7502	3.7500	3.7500	3.7500	3.7500	-	-	3.7540
AED	3.6730	3.6730	3.6730	3.6730	3.6730	3.6735	3.6741	-
KWD	0.3002	0.3020	0.3020	0.3020	0.3020	0.2941	0.2916	-
OMR	0.3850	0.3850	0.3850	0.3850	0.3850	0.3853	0.3860	0.3885
BHD	0.3771	0.3770	0.3770	0.3770	0.3770	0.3761	0.3762	0.3791
QAR	3.6545	3.6400	3.6400	3.6400	3.6400	3.6635	3.6673	3.6750
EGP	17.6206	17.2500	17.2500	17.0000	17.0000	17.9600	18.2700	19.0400
INR	66.108	66.000	67.000	66.000	66.000	66.9900	67.6900	68.9700
CNY	6.2964	6.7000	6.9000	7.1000	7.1000	6.3155	6.3400	6.3820

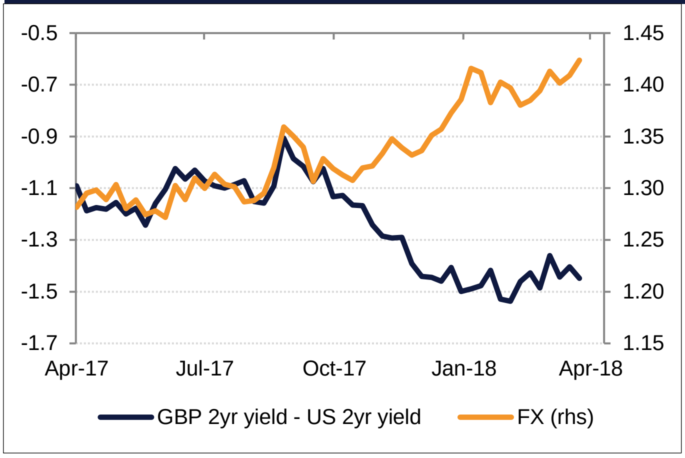
Source: Bloomberg, Emirates NBD Research
**Denotes USD peg*

Major FX and Nominal Interest Rates

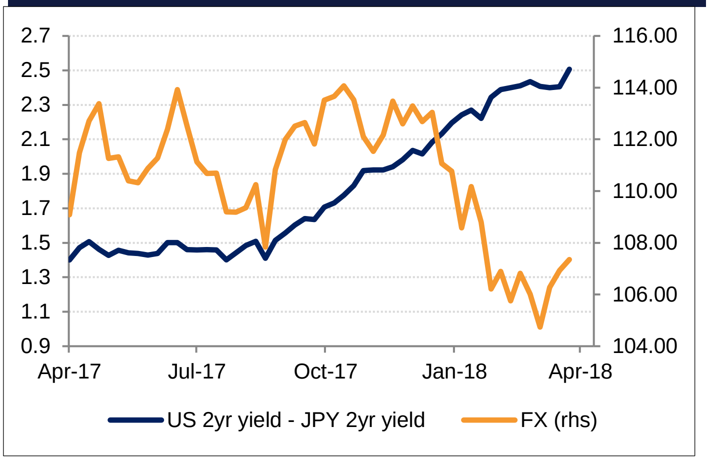
Interest Rate Differentials - EUR



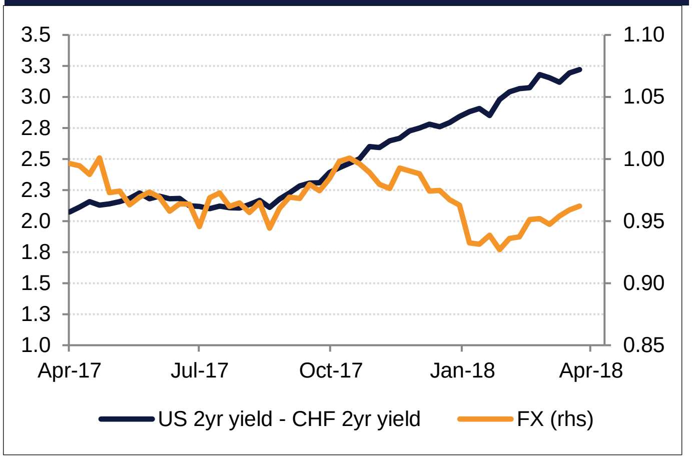
Interest Rate Differentials - GBP



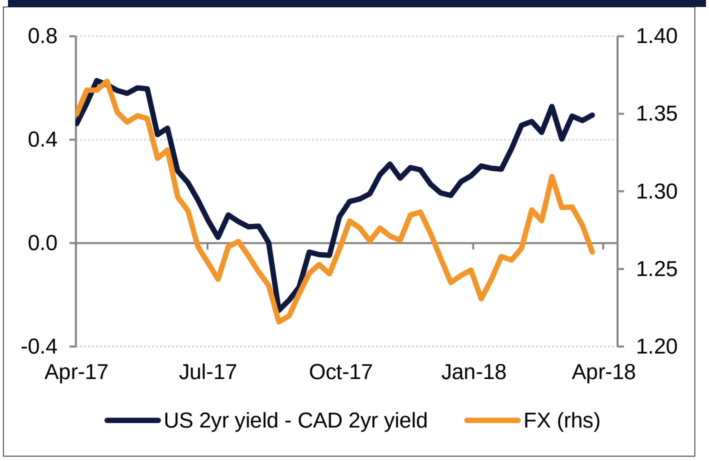
Interest Rate Differentials – JPY



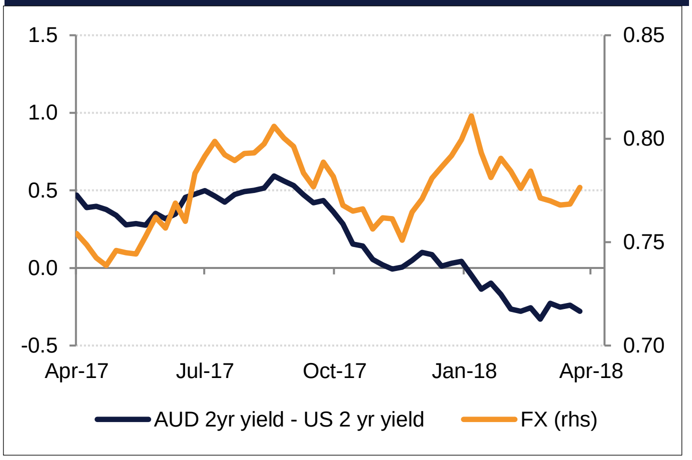
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD



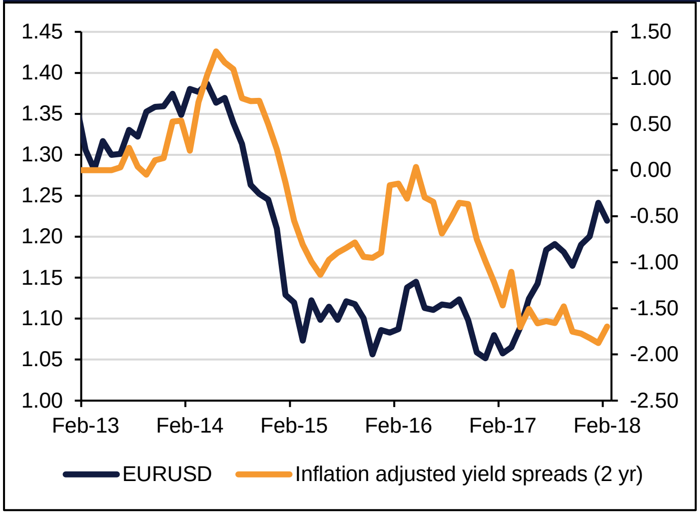
Interest Rate Differentials - AUD



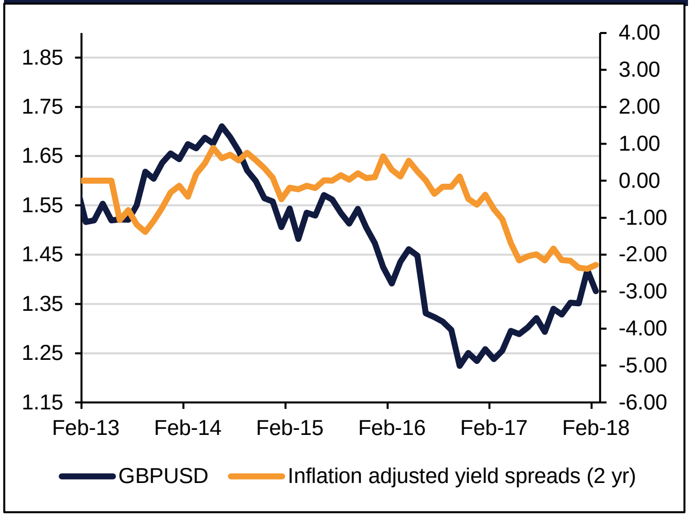
Source: Bloomberg, Emirates NBD Research

Major FX and Real Interest Rates

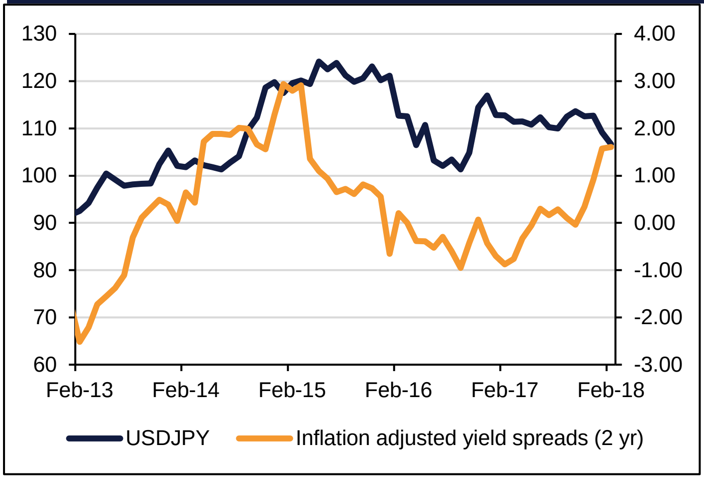
Interest Rate Differentials - EUR



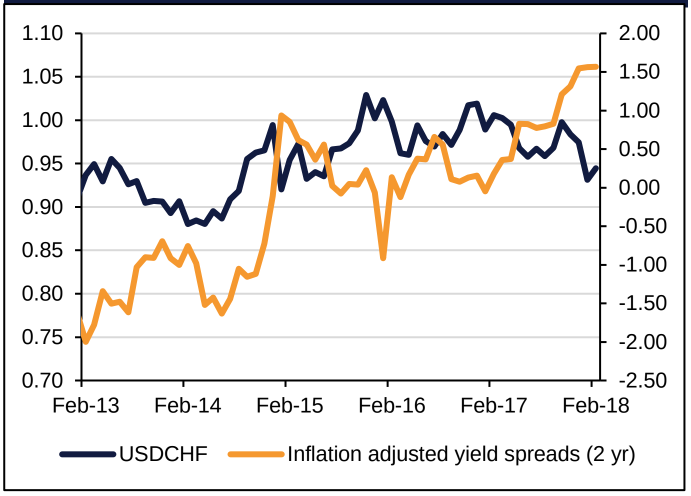
Interest Rate Differentials - GBP



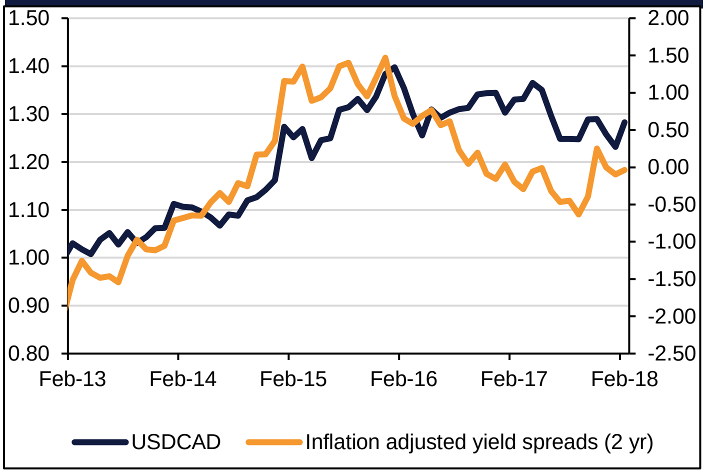
Interest Rate Differentials – JPY



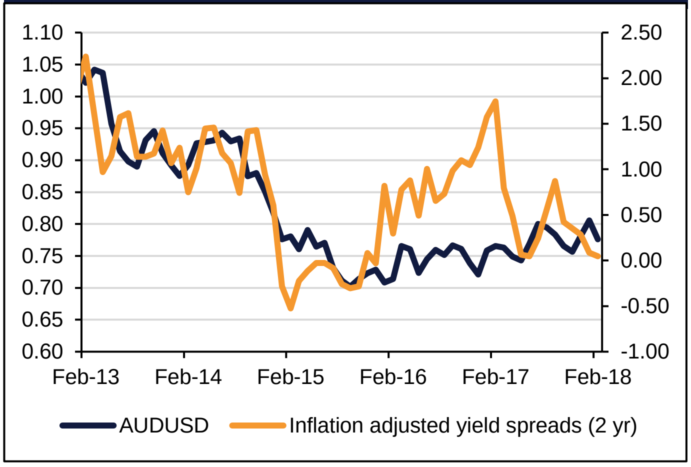
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD



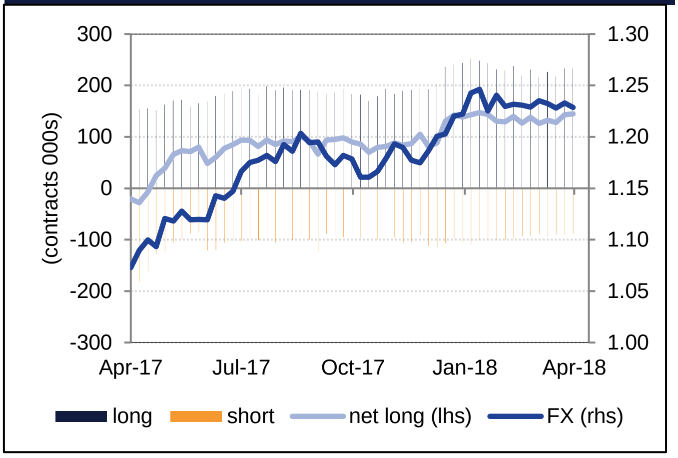
Interest Rate Differentials - AUD



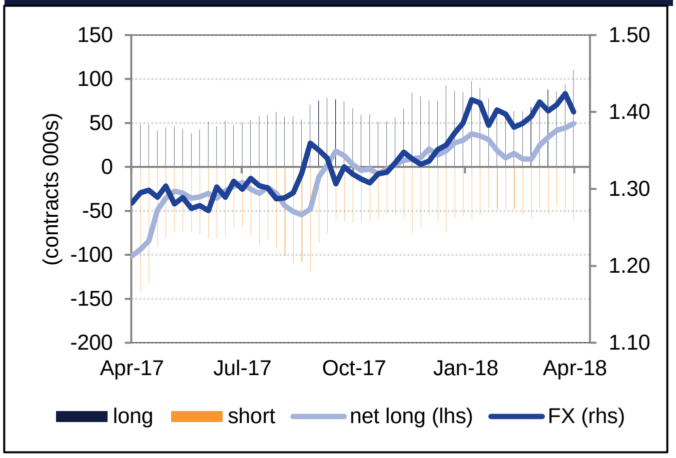
Source: Bloomberg, Emirates NBD Research

Major Currency Positions

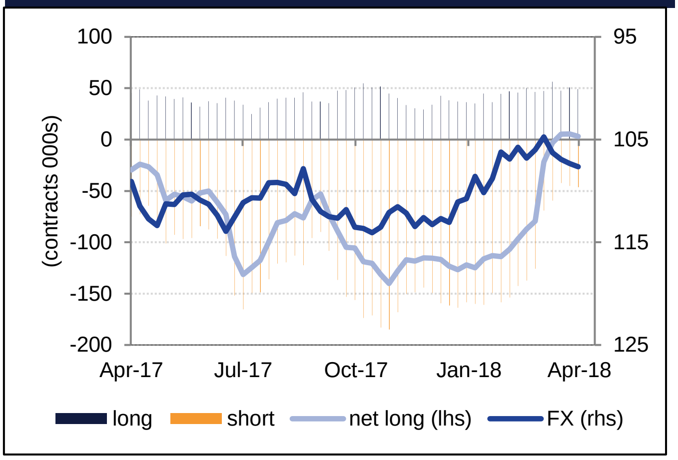
CFTC – Speculative Positions - EUR



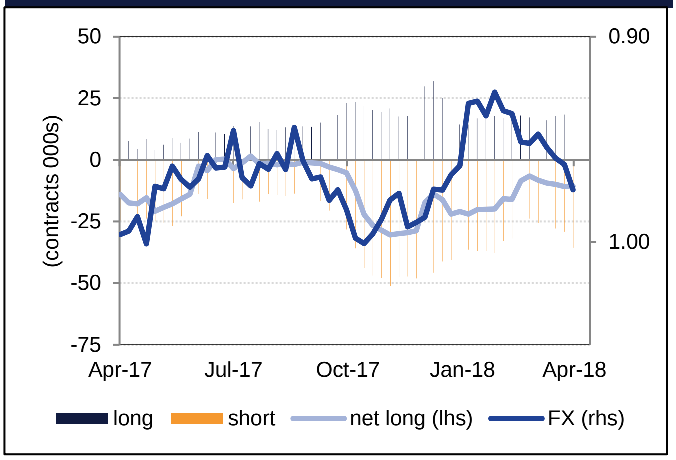
CFTC – Speculative Positions - GBP



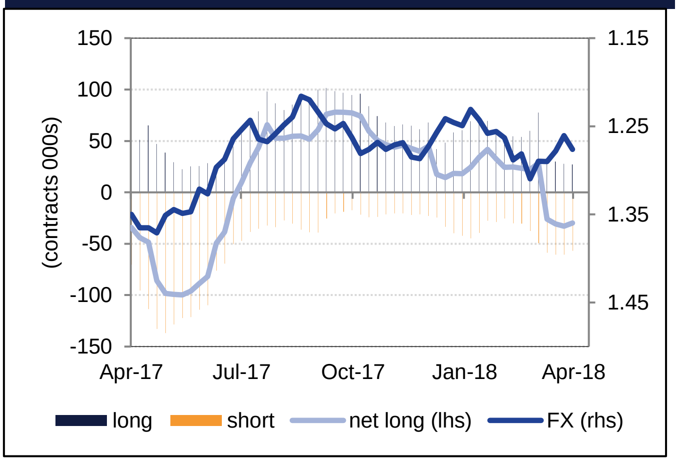
CFTC – Speculative Positions - JPY



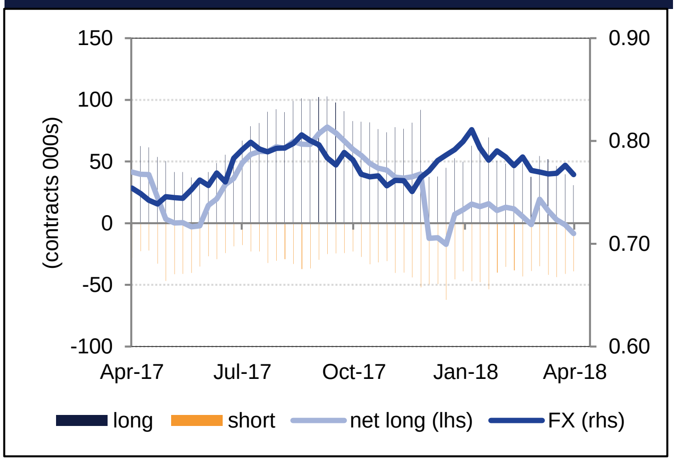
CFTC – Speculative Positions - CHF



CFTC – Speculative Positions - CAD



CFTC – Speculative Positions - AUD



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