بنك الإمارات دبي الوطني
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Tim Fox
Chief Economist
+971 4 230 7800
timothyf@emiratesnbd.com

www.emiratesnbdresearch.com

FX Week

Currencies were generally stronger last week at the dollar's expense, with only the JPY showing a little more weakness which is itself a sign of improving risk sentiment. The combination of relaxing lockdowns and some improvement in the high frequency survey data in May are providing some grounds for hope that the worst might be over as we head into June, which is causing the USD to lose ground.

Nonetheless the disconnect between markets and the main economic data remains stark, and investors are also overlooking the brewing US-China tensions. Whether they can also ignore the ugly protests in America this weekend also remains to be seen, although how this will play out in currency markets is unclear, and may well reinforce the negative USD bias already underway. This week will also bring more bad data from the U.S., Europe, and Asia, culminating in the US May jobs report on Friday, while the ECB meeting will also be in the spotlight following on from the fiscal stimulus program announced by the EU Commission last week.

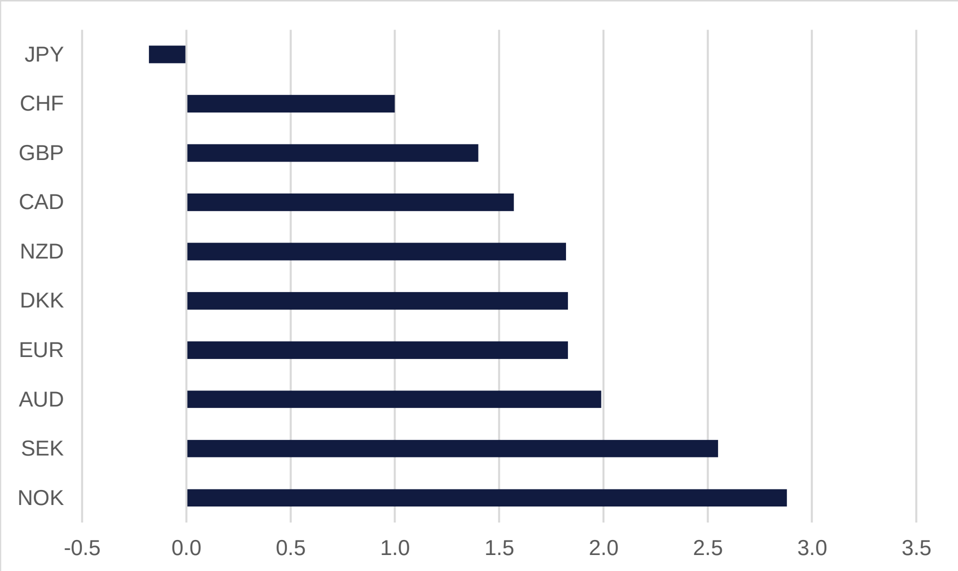
Indeed most noteworthy last week was the rally in the Euro which rose 1.85% against the dollar and is now close to the highest levels in three months against it, above 1.11,, up from levels below 1.07 seen at the height of the coronavirus crisis.

The European Commission's fiscal stimulus package was much bigger than originally expected at EUR 750bn (5.4% of EU GDP), up from the EUR500bn proposed on 18 May by France and Germany. Beyond the first EUR500bn which will be given as grants, the additional EUR 250bn will likely be in the form of loans, potentially with some conditions attached.

But the real significance of the stimulus plan was perhaps not in its size, but in the EU's preparedness to borrow on such scale for spending across the Eurozone. Importantly, the stimulus package would be funded by joint debt issuance, something which Germany (and other members) had resisted until a couple of weeks ago. Distributing funds directly from the EU budget with few or no conditions has become a political hot potato in meetings of EU leaders but this latest plan moves the economic bloc further toward some form of fiscal union, which would go a long way to boosting the integrity and resilience of monetary union, and hence explains the Euro's positive response.

However, there are still significant hurdles to be overcome. The proposal will need to be approved by all 27 member states, which may still prove difficult with so called 'frugal four' of Sweden, Austria, Denmark and the Netherlands still opposing debt mutualisation. Sweden already said it won't support the plan in its current form. Austria, the Netherlands and Denmark are also opposed to grants, so it may take time to resolve these differences. Funding is thus unlikely to be received by recipient countries (mainly Italy and Spain) until early next year, and in the first instance it will be relatively modest.

Weekly currency movement vs USD (%)



Source: Bloomberg, Emirates NBD Research

But in principle the movement seen from the EU last week has been in the right direction, more than making up for the concerns a few weeks ago about challenges to the Bundesbank and the ECB from the German Constitutional Court over QE. This issue will likely come back to the fore in a few weeks' time when the Bundesbank has to respond to the Court's ruling, which could cause the Euro to lose ground again. But it is doubtful if this will seriously compromise the ECB's QE program for long. In the long term if the EU shows that it has used this crisis to overcome such challenges to its system, and to reform its policy architecture, then it will have gone a long way to resolving some of the single currency's key design flaws and vulnerabilities.

After these bold plans the focus is now moving to the ECB meeting on Thursday. ECB President Christine Lagarde said last week that the Eurozone economy is on track to shrink by 8-12% this year, closer to the ECB's most pessimistic scenario rather than the "mild" scenario of -5%. The ECB will update its forecasts at the policy meeting, when it is expected to increase the size of asset purchases. All of the progress from the EU is causing us to review our FX forecasts, upgrading our EURUSD forecast for the rest of this year.

The pound is still dragging its heels however, weighed down by some talk of negative rates in the UK and by trade negotiations between the UK and EU which are not making much progress. With only one more round of talks left until the UK must decide if it wants to extend its post-Brexit access to the EU's customs union and single market beyond the end of 2020, there remains a possibility that the UK will leave the EU's single market at year-end.

The RBA also meets on Tuesday although no change to the current 0.25% rate setting is expected. The RBA has said it will not lift the cash rate until there is progress on jobs and inflation, and it is likely to repeat this commitment.

Finally the economic data out of India over the weekend painted a rather grim picture. The GDP growth for Q4 FY 2020 came in at 3.1% to lower the full year FY 2020 expansion to 4.2%. While looking at the data, it must be noted that the fourth quarter GDP data (ending in March 2020) only reflects a partial impact of the coronavirus induced lockdown. Consequently, as a result of lower growth, India's fiscal deficit shot up to 4.6% in FY 2020 against government estimates of 3.6%.

The data could put further pressure on the INR which has been underperforming broader emerging market currencies. Over the last month, the INR has remained flat compared to a gain of +3.7% in the JP Morgan EM currency index. However, the scope of weakness appears limited amid our view of USD weakness heading into the quarter-end. Accordingly, we remain comfortable with our current forecasts.

FX Forecasts

FX Forecasts – Major						Forwards		
	29-May	Q2 2020	Q3 2020	Q4 2020	Q1 2021	3m	6m	12m
EURUSD	1.1101	1.1000	1.1200	1.1500	1.1500	1.1123	1.1145	1.1195
USDJPY	107.83	110.00	111.00	112.00	112.00	107.68	107.51	107.07
USDCHF	0.9616	1.0000	1.0000	1.0200	1.02000	0.9590	0.9564	0.9506
GBPUSD	1.2343	1.2500	1.3000	1.3500	1.3500	1.2348	1.2352	1.2364
AUDUSD	0.6667	0.6600	0.6600	0.7000	0.7000	0.6667	0.6666	0.6662
NZDUSD	0.6205	0.6400	0.6400	0.6800	0.6800	0.6202	0.6197	0.6191
USDCAD	1.3780	1.3800	1.3800	1.3500	1.3500	1.3780	1.3780	1.3780
EURGBP	0.8995	0.8880	0.8615	0.8518	0.8518	0.9009	0.9024	0.9056
EURJPY	119.77	121.00	124.32	128.80	128.80	119.77	119.77	119.77
EURCHF	1.0675	1.1000	1.1200	1.1730	1.1730	1.0667	1.0658	1.0641
	29-May	Q2 2020	Q3 2020	Q4 2020	Q1 2021	3m	6m	12m
SAR	3.7558	3.7500	3.7500	3.7500	3.7500	3.7582	3.7602	3.7688
AED	3.6730	3.6730	3.6730	3.6730	3.6730	3.6748	3.6767	3.6815
KWD	0.3083	0.3020	0.3020	0.3020	0.3020	0.3093	0.3101	-
OMR	0.3850	0.3850	0.3850	0.3850	0.3850	0.3883	0.3912	0.3973
BHD	0.3773	0.3770	0.3770	0.3770	0.3770	0.3777	0.3779	0.3781
QAR	3.6610	3.6400	3.6400	3.6400	3.6400	3.6598	3.6587	3.6565
EGP	15.8424	15.8500	16.0000	17.0000	17.0000	16.5650	17.1550	18.2650
INR	75.616	75.000	73.000	72.000	72.000	76.2300	76.9700	78.5000
CNY	7.1364	7.1500	7.2000	7.2000	7.2500	7.1632	7.1897	7.2372
SGD	1.4135	1.40	1.40	1.35	1.3000	1.4122	1.4113	1.4106
							3.7503	
	29-May	Q2 2020	Q3 2020	Q4 2020	Q1 2021			
MAD	9.7886	9.7500	9.7500	9.7000	9.7000	9.8297	9.8653	9.9265
TND	2.8660	2.9000	3.0000	3.0000	2.9000	2.9460	3.0310	3.2360
TRY	6.8240	6.8000	6.8000	6.6000	6.5000	-	-	-

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

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Emirates NBD Research & Treasury Contact List

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

Aazar Ali Khwaja
Senior Executive Vice President
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

Edward Bell
Senior Director, Market Economics
+9714 230 7701
edwardpb@emiratesnbd.com

Aditya Pugalia
Financial Markets Research
+9714 230 7802
adityap@emiratesnbd.com

Daniel Richards
MENA Economist
+9714 609 3032
danielricha@emiratesnbd.com

Mohammed Altajir
FX Analytics and Product Development
+9714 609 3005
mohammedtaj@emiratesnbd.com

Shady Shaher Elborno
Head of Macro Strategy
+9714 609 3015
shadyb@emiratesnbd.com

Jamal Mattar
Research Associate
+9714 444 3607
jamaly@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

Egypt
+20 22 726 5040

Emirates NBD Capital

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