بنك الإمارات دبي الوطني
Emirates NBD

FX Week

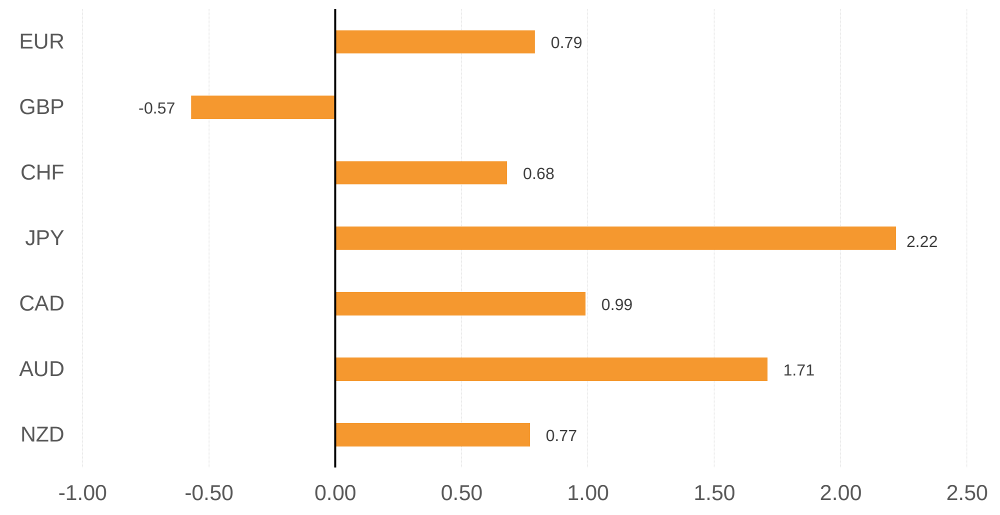
Dollar increasingly overlooking fundamentals

Weekly
5 February 2017

Last week ended with the January US employment report. However, despite the rise in non-farm payrolls being the strongest in four months at 227,000, it is becoming clearer that macro fundamentals are only part of the story when it comes to the dollar. Data is increasingly being 'Trumped' by the often random communications and executive orders from the President with regard to trade, immigration, and even currencies. In the two weeks since Donald Trump was inaugurated things have moved on to such a point where the markets place more weight on these messages than on the evidence about economic growth and the implication that this might have for interest rates.

This is partly because even the Fed appears unsure about how to react to the data. Despite the economic data since the start of the year being noticeably stronger than at the end of 2016 when the Fed raised interest rates, the Fed's policy statement released last week was broadly similar to the one it published in December. There were relatively small changes reflecting stronger conditions, but the overall takeaway is that the FOMC appears cautious in an environment of heightened uncertainty over the direction of US fiscal policy. Markets reduced the likelihood of the Fed tightening monetary policy in March, and moved further towards anticipating a hike in June in line with our own forecast. Comments from San Francisco Fed President Williams maintained the possibility of a March move, but few are genuinely believing in it anymore with surveys showing 72% support for June.

Weekly currency movement vs USD (%)



Source: Bloomberg, Emirates NBD Research

Such has been the White House's focus on immigration and trade and protectionism that the pro-growth policies that were anticipated under Trump are getting lost, perceived to be losing their place in the priorities of the new administration. In particular the markets are observing a more aggressive stance towards currencies, with criticism last week of Germany's use of the EUR to gain an unfair trade advantage. This follows on from the withdrawal from TPP and the pledge to renegotiate NAFTA, all adding to the whiff of protectionism and isolationism which is also captured in Trump's anti-immigration rhetoric and policies. Such has been the type of expressions used that trade wars with China, Mexico and even the EU cannot be ruled out.

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Thus it was not only the strong NFP's that were overlooked, but also the improvements in the manufacturing ISM and ADP Employment reports which all pointed to stronger growth in Q117. The trade data which will be released in the coming week will arguably start to assume more significance given Trump's focus on reducing imports, whereas the consumer confidence data that stands at a 13 year high may begin to carry less weight in the markets mind.

Moves towards deregulation of the financial sector in the US announced late last week may go some way to assuaging concerns that the Trump White House has lost sight of its pro-growth and reformist agenda. This should help to boost sentiment in the equity markets at least, but for the dollar to rally the markets probably need to see greater attention given to fiscal policy as also promised before the election.

Dollar slide slowed by less-responsive Euro

The USD's losses would probably have been greater if it had not been for the sluggishness of the EUR, which despite firmer Eurozone economic data struggled to hold onto levels above 1.08. This is because despite the firmness of Eurozone inflation (1.8% on a headline basis) and of PMI readings the markets still doubt if these will be enough to cause the ECB to change track and begin to taper QE in the coming months. In addition the EUR remains saddled with political risk which limits its upside, with Dutch elections due in March to be followed by French elections in May. In terms of the latter, the markets are beginning to price in the risk of an unexpected outcome, with the extreme right looking to capitalize on the current weakness of the two main establishment parties. After Brexit and Trump's election win last year, a populist win in the heart of Europe would create further instability – an outcome that can no longer be ruled out.

GBP volatile amidst mixed messages

GBP experienced another rollercoaster week, buoyed for a while by USD weakness and by upgraded Bank of England growth forecasts, but undercut by Governor Carney's interpretation that interest rates can still stay low for longer. The Bank had revised up its 2017 growth forecast from 1.4% to 2.0% which saw the pound reach just above 1.27 briefly. However, the more critical message conveyed was that the BoE said that the equilibrium unemployment rate has dropped, with Carney noting that significant slack in production capacity as well as negative effects related to Brexit could still hurt growth in the future. The pound subsequently reversed course and ended the week at its lows below 1.25. Despite USD softness currently we still anticipate that the pound could face renewed Brexit related weaknes especially around the time of the triggering of Article 50 in March, with uncertainty about the government's negotiation strategy remaining despite the publication of a Brexit policy paper last week.

JPY boosted by risk aversion

USDJPY was also volatile but it ended the week close to its lows as risk aversion boosted the JPY overall with global equities also volatile in the context of concerns about the priorities of President Trump. Softer US bond yields also hampered the USD's ability to sustain rallies, while JGB yields veered to the upside forcing the Bank of Japan to intervene to cap the 10-year rate at 0.15%. Ultimately an abatement in risk aversion on Friday helped the USD to recover a little ground, but with the markets still unsure about the direction of US policy the chances are that USDJPY will remain heavy until there is greater visibility about Trump's strategy. Japanese data will probably be of secondary significance for the time being therefore, with machinery orders, producer prices and current account data the main economic releases this week.

Swiss Franc softens against other majors

The CHF depreciated against most of the other majors last week, with the exception of USD and GBP. Confidence in the franc was shaken after economic data showed that Swiss retail sales contracted 3.5% y/y in December, greater than expected. In addition to this, the Manufacturing PMI slowed from 56.0 in December to 54.6 in January, disappointing market expectations for a reading of 55.9. In the week ahead, we believe that fundamentally there is further downside risk for the currency, with employment data due for release on the 9th of February expected to show that the unemployment rate rose from 3.5% in December 2016, to 3.6% in January 2017.

Technical analysis of the USDCHF (daily candle charts) shows that the pair has remained in a downtrend since 4th of January 2017. However the same chart reveals that over the last week there were two attempts to break below the 200 day MA of 0.9875 which failed to materialize into further losses. Any additional failures to break and close below this level in the week ahead could pave the way for a reversal of the current downtrend.

USDCAD breaks lower but monthly uptrend still intact

At the start of last week, we witnessed USDCAD breaking below its 200 day MA of 1.3132 and consecutively closing below this level for five consecutive trading days with the pair depreciating 0.98% over this period to close at 1.3023. This same decline, saw the pair break below the one year 38.2% Fibonacci retracement of 1.3055 as well as the 100 week MA of 1.3099, indicating that the short term potential for further declines remains a realistic scenario. We expect there to be strong support around 1.2936, the baseline of the monthly uptrend that has been in effect since May 2015.

AUD ends week firmly

The AUD ended last week as the second best performing major currency (after JPY). The currency received wide support after economic data showed that Australia's trade balance widened to a record surplus of AUD 3,511m in December from AUD 2,040 in November. This helped AUDUSD appreciate 1.72% last week, to close at 0.7680, a move that took the pair above the one year 76.4% Fibonacci retracement of 0.7632.

Over the week ahead, the main drivers of the pair are likely to be the RBA's monetary policy statement and China's January trade data. While no change to monetary policy is expected from the central bank, it is possible that they highlight the current appreciation of the currency as being a headwind to growth and we expect the statement to take a modestly dovish stance.

NZD softens on employment miss

The Kiwi softened against most of the other majors over the previous week after being weighed down by softer than expected employment data. While the market expected unemployment to a decline to 4.8%, data showed that in Q4 2016 unemployment rose to 5.2% from 4.9% in Q3. In the same period, average hourly earnings contracted 0.3% compared with market expectations for a gain of 0.6%.

Such data will be of concern to the RBNZ when they meet to set monetary policy this week, a meeting at which they are expected to keep the Official Cash Rate at the record low of 1.75%. Inspection of the current positioning of swap traders reveals that the next action the market expects is a hike, with a less than 1.3% chance of a cut in 2017, but such economic data suggests that market expectations may be premature and we would not be surprised to the NZD trading softer in the aftermath of next week's meeting as the RBNZ maintains the scope to keep monetary policy accommodating.

Indian budget opens way for RBI rate cut

The Government of India announced its budget statement for FY2018 last week. As expected, the government provided for a small fiscal stimulus by making some reduction in personal and corporate income taxes. Additionally, capital spending by the government is proposed to increase 14% y/y. On the indirect tax front, no substantial changes have been made given the impending implementation of the Goods & Services Tax. The fiscal deficit for FY2018 is targeted at 3.2% of the GDP versus 3% targeted initially for FY 2018E in the fiscal consolidation roadmap and 3.5% for FY2017. On the whole, the budget reflects policy continuity, and is likely to allow for a cut in interest rates in the coming week from 6.25% to 6.00% in order to boost consumption, which has been hit by India's demonetization program. The INR is unlikely to be unduly affected by such a move as it is widely discounted.

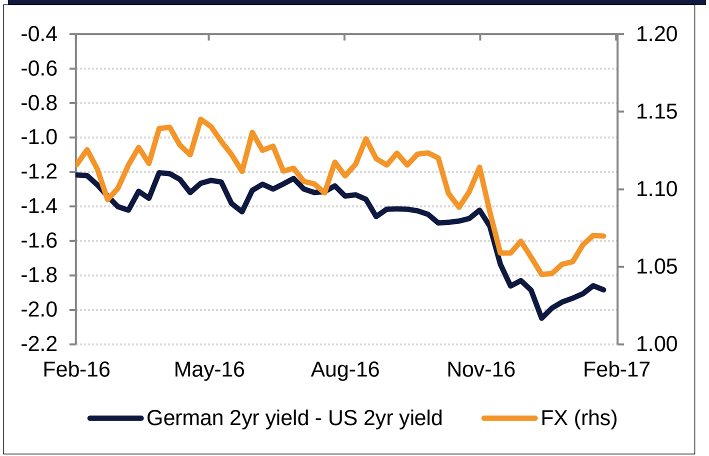
FX Forecasts

FX Forecasts - Major						Forwards		
	3-Feb	Q1 2017	Q2 2017	Q3 2017	Q4 2017	3m	6m	12m
EUR	1.0783	1.0500	1.0200	1.0000	1.0000	1.0827	1.0877	1.0996
JPY	112.61	116.00	120.00	122.00	124.00	112.21	111.71	110.51
CHF	0.9930	1.0300	1.0500	1.1000	1.1000	0.9879	0.9821	0.9689
GBP	1.2484	1.2200	1.1800	1.2500	1.3500	1.2510	1.2540	1.2613
AUD	0.7680	0.7300	0.7200	0.7000	0.7000	0.7664	0.7650	0.7627
CAD	1.3023	1.3500	1.3400	1.3200	1.3000	1.3012	1.2999	1.2963
EURGBP	0.8640	0.8607	0.8644	0.8000	0.7407	0.8657	0.8677	0.8720
EURJPY	121.44	121.80	118.32	120.00	122.00	121.44	121.44	121.44
EURCHF	1.0703	1.0815	1.0710	1.1000	1.1000	1.0692	1.0678	1.0649
NZDUSD	0.7315	0.6900	0.6700	0.6500	0.6700	0.7295	0.7277	0.7241
FX Forecasts - Emerging						**Forwards**		
	3-Feb	Q1 2017	Q2 2017	Q3 2017	Q4 2017	3m	6m	12m
SAR	3.7504	3.7500	3.7500	3.7500	3.7500	-	3.7555	3.7736
AED	3.6730	3.6700	3.6700	3.6700	3.6700	3.6752	3.6773	-
KWD	0.3051	0.2900	0.2900	0.2900	0.3000	0.3055	0.3070	-
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	3.6411	3.6400	3.6400	3.6400	3.6400	3.6453	3.6492	3.6604
EPN	18.6384	18.0000	18.5000	18.7500	19.0000	19.2150	18.8925	20.4000
INR	67.316	68.000	66.000	65.000	65.000	67.8100	68.5400	70.0600
CNY	6.8672	7.0000	7.1000	7.2000	7.4000	6.9165	6.9825	7.0975

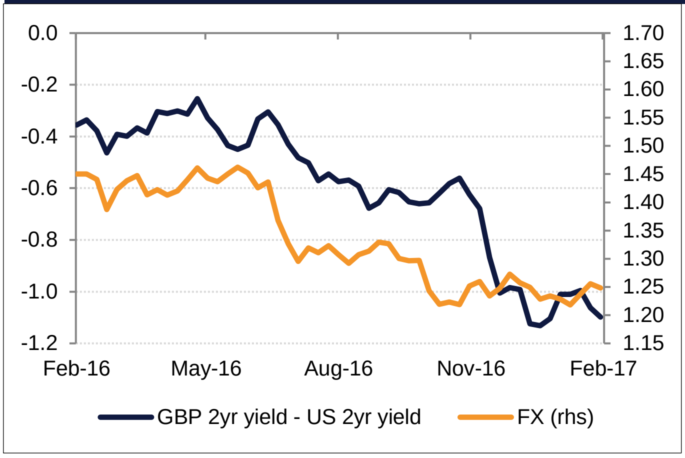
Source: Bloomberg, Emirates NBD Research
**Denotes USD peg*

Major FX and Nominal Interest Rates

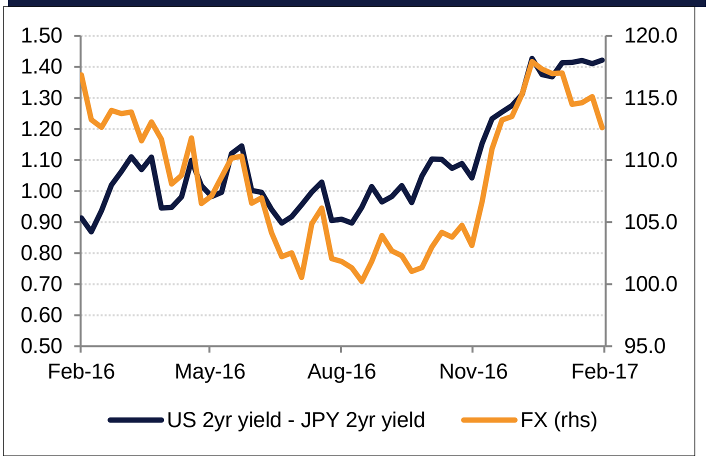
Interest Rate Differentials - EUR



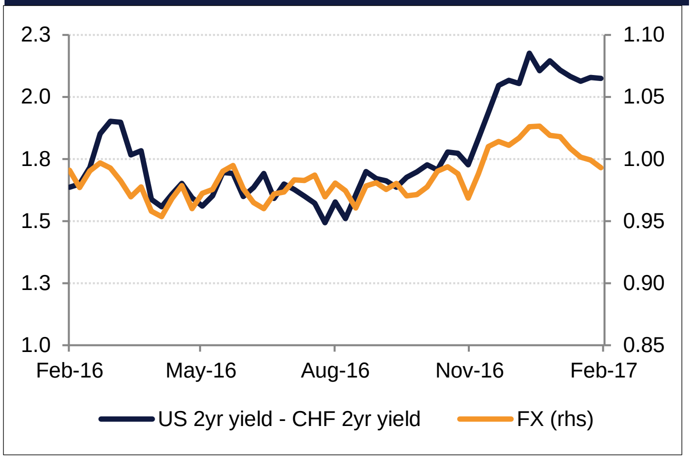
Interest Rate Differentials - GBP



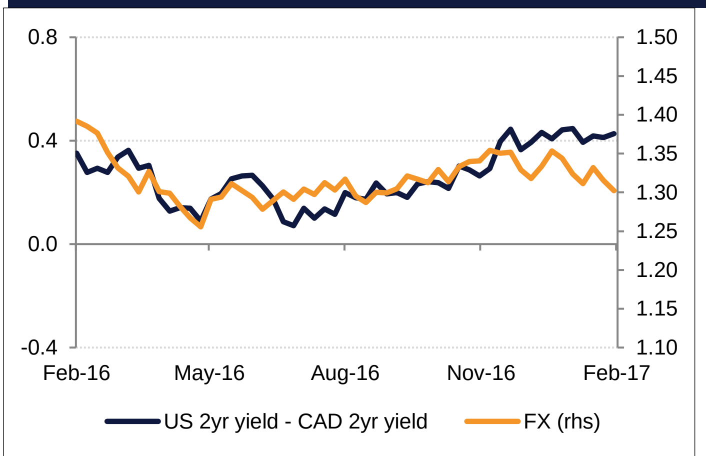
Interest Rate Differentials –JPY



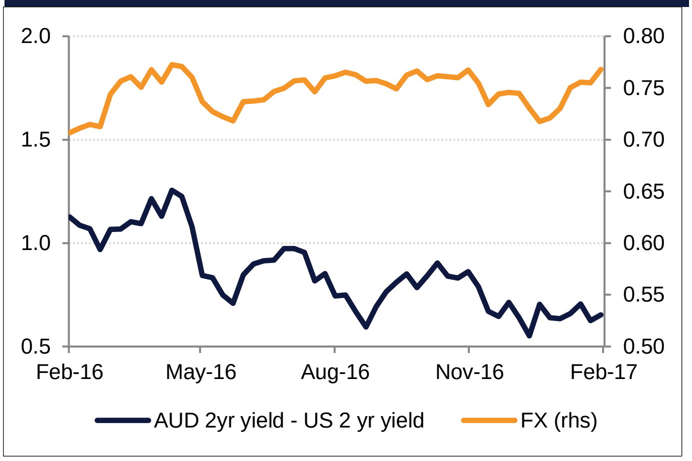
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD



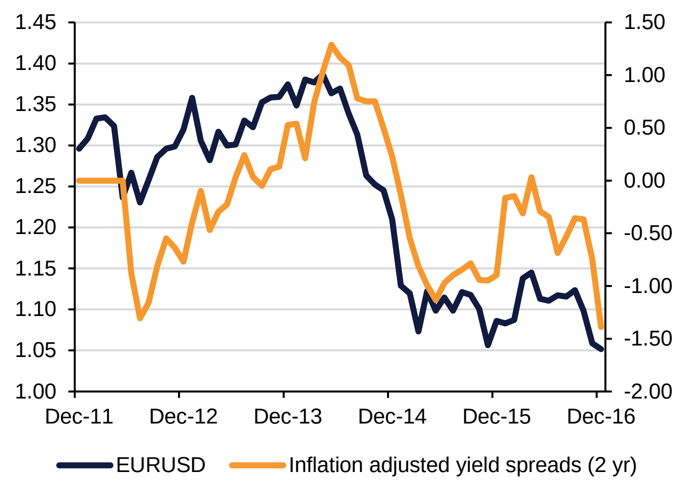
Interest Rate Differentials - AUD



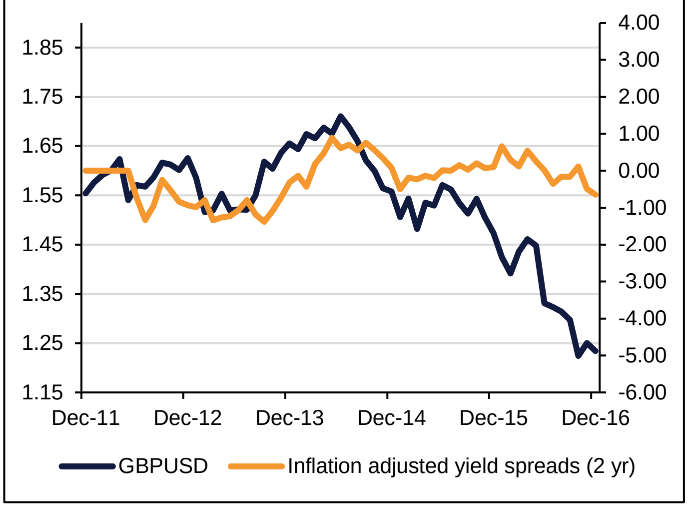
Source: Bloomberg, Emirates NBD Research

Major FX and Real Interest Rates

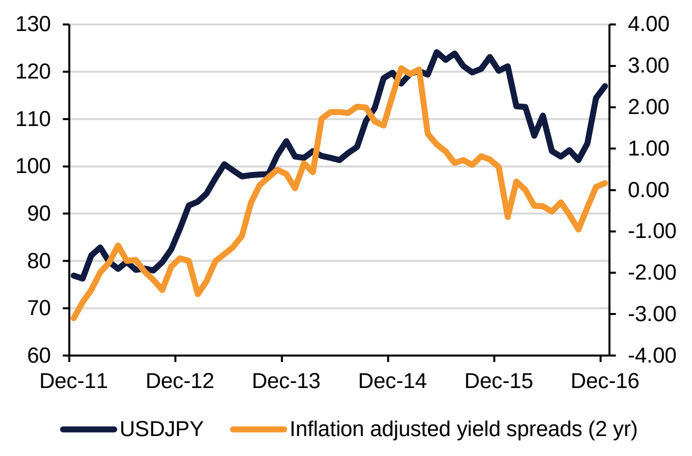
Interest Rate Differentials - EUR



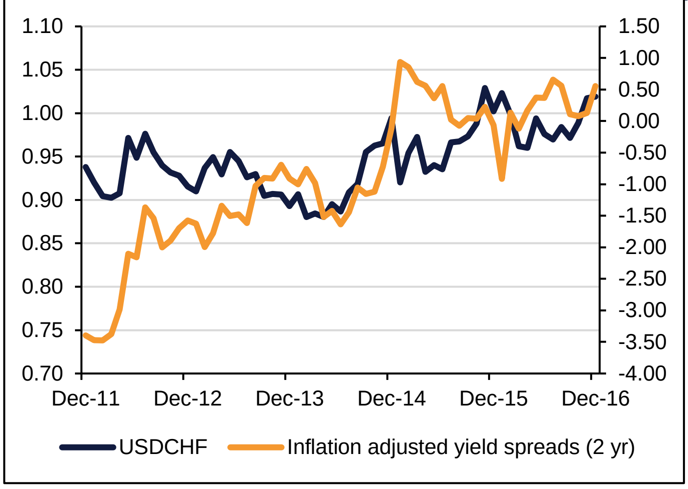
Interest Rate Differentials - GBP



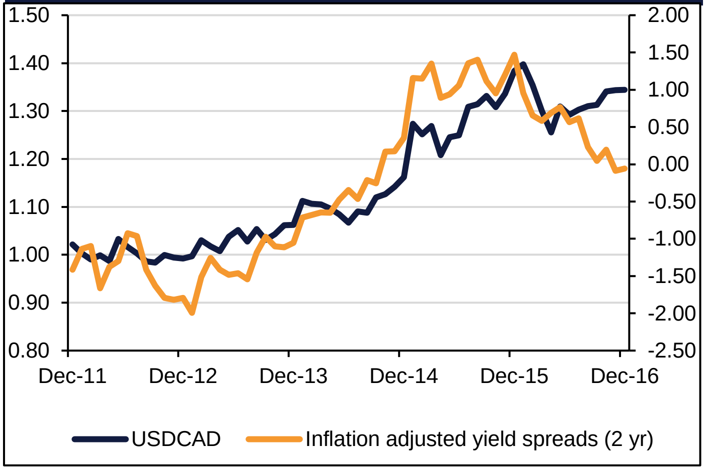
Interest Rate Differentials –JPY



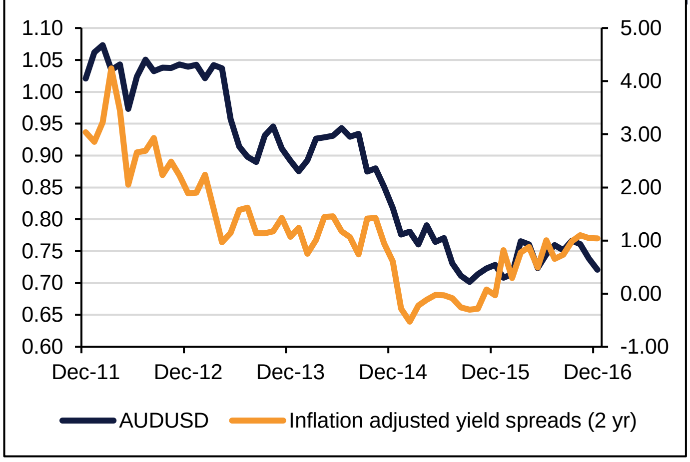
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD



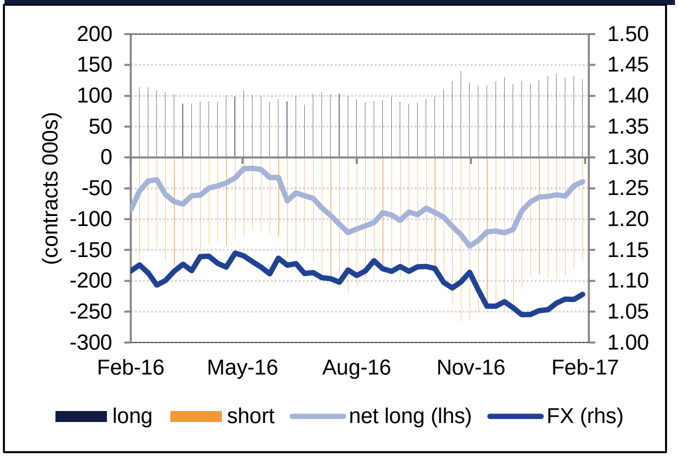
Interest Rate Differentials - AUD



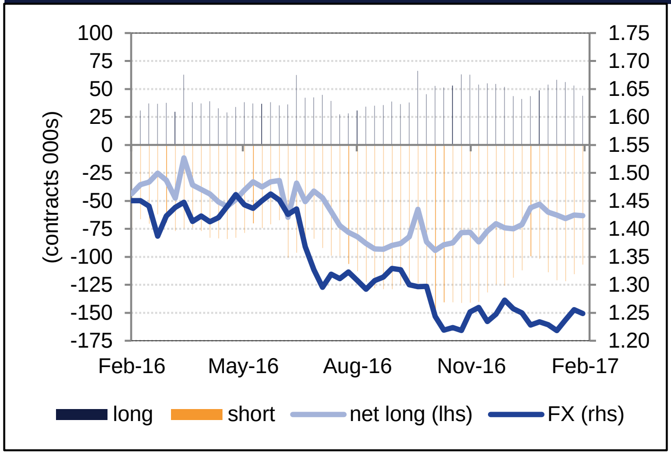
Source: Bloomberg, Emirates NBD Research

Major Currency Positions

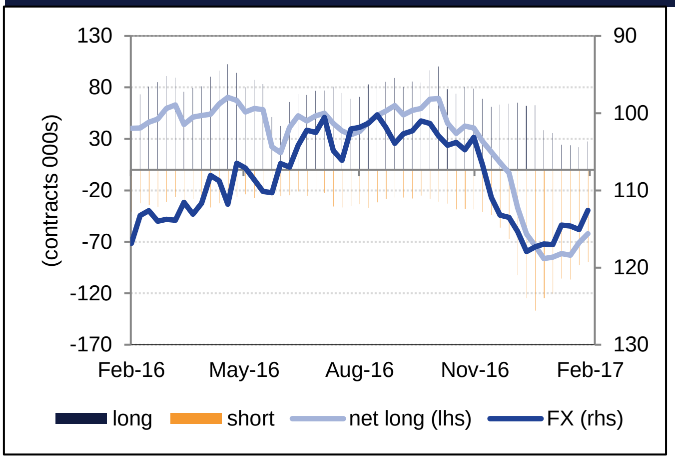
CFTC – Speculative Positions - EUR



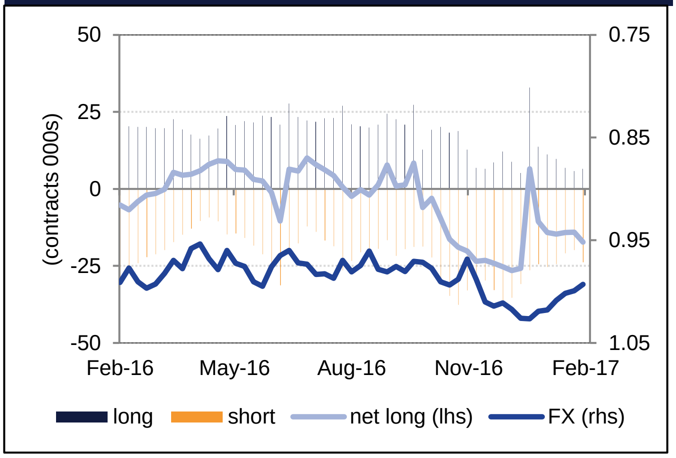
CFTC – Speculative Positions - GBP



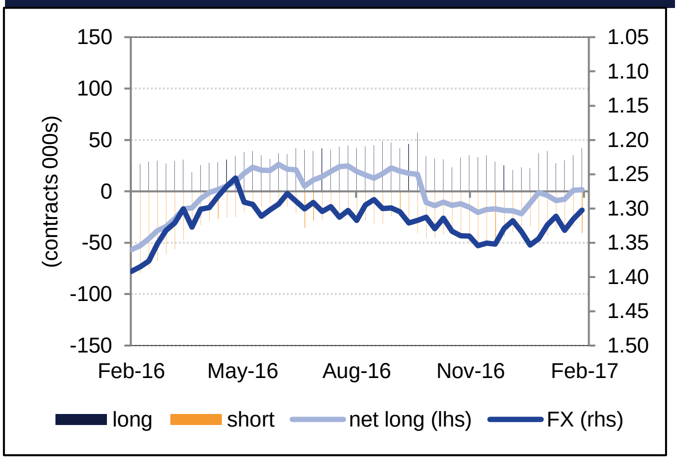
CFTC – Speculative Positions - JPY



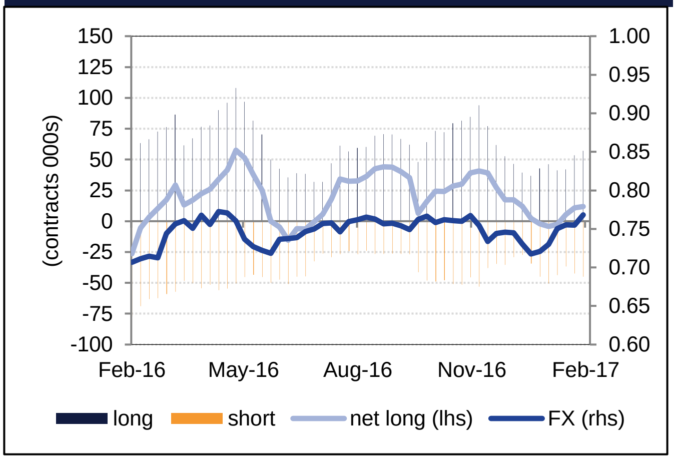
CFTC – Speculative Positions - CHF



CFTC – Speculative Positions - CAD



CFTC – Speculative Positions - AUD



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