



بنك الإمارات دبي الوطني
Emirates NBD

Weekly
5 March 2017

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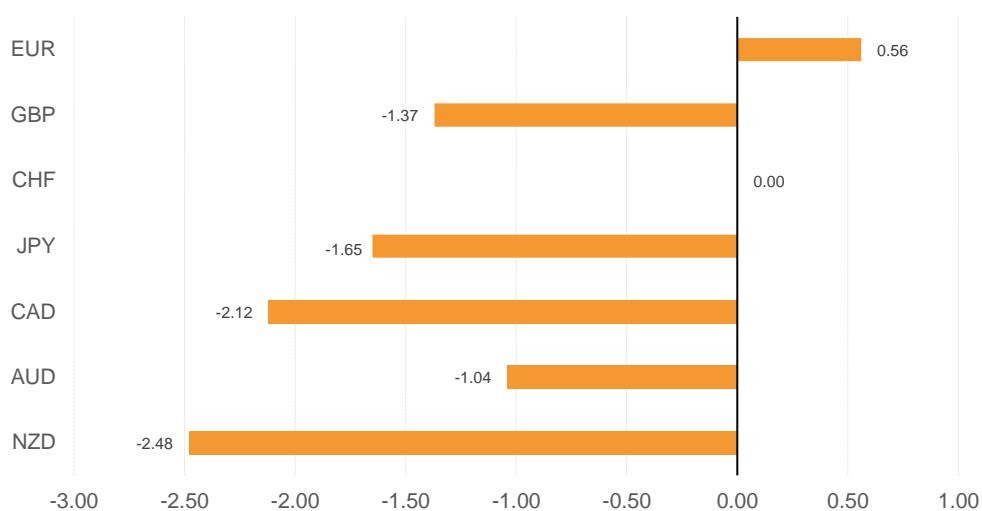
FX Week

Yellen telegraphs a March rate hike....

The dollar was boosted last week by President Trump's speech to Congress as well as by indications by Fed officials that interest rates are likely to be raised in March. Expectations of a Fed tightening grew as the week progressed, helped along by firm economic data and by statements from a number of Fed officials. The implied probability of a Fed rate hike in March has jumped to nearly 100% after Fed Chair Yellen said that a further increase in short term interest rates was likely to be appropriate at the Fed's policy meeting on March 14 and 15 if employment and inflation continue to evolve as expected. Prior to this the usually dovish Fed Governor Lael Brainard said that a rate hike would likely be appropriate 'soon', while similar hawkish comments were made by other Fed Governors including John Williams and William Dudley.

US economic data was mixed over the week as a whole but the main highlights were positive, with the ISM manufacturing index rising to 57.7 in February, the highest level since August 2014, and the service sector ISM climbed to a 16-month high of 57.6. Consumer confidence also rose to a 15-year high in February and regional manufacturing indices also suggested a strong expansion in the manufacturing sector is underway. The Fed's preferred measure of inflation, the core PCE deflator was unchanged at 1.7% y/y, not far off the Fed's 2% inflation target, but the Fed appears to have seen enough in the other data to justify another rise in rates, with Yellen also adding that barring any unexpected developments rates are likely to be raised quicker this year than in 2015 and 2016. This suggests at least two rate hikes, as we have been expecting, but also indicates the possibility of three in line with the Fed's December dot plot.

Weekly currency movement vs USD (%)



Source: Bloomberg, Emirates NBD Research

With only employment data standing in the way

The only material data that still stands in front of a March move is the February employment report at the end of the coming week. The consensus expectation is for a rise of 185K in non-farm payrolls growth, but it would probably have to be a lot weaker to challenge the consensus view that the Fed will pull the trigger. As things stand the risks are probably that jobs growth could be a lot stronger than the consensus estimate. Such an outcome, combined with firm wages growth, could see the dollar rally further.

Trump gives dollar a boost

The other factor that helped the dollar last week was President Trump's speech to Congress. This was not so much because of what he said but more the way he said it, with the tone considered to be the most Presidential address he has made since taking office. Trump confirmed his stimulus plan, which is based on tax reform and USD1000bn public spending program, but shed little light on how it would be achieved.

Amongst the details that were given earlier in the week were proposals to boost defence spending by 10% (USD 54bn), with the increased spending to be financed through equivalent cuts to other federal agencies except Social Security and Medicare. The State Department and environmental agencies are expected to bear the brunt of budget cuts, although other services such as education and medical research could also be affected.

Debate still revolves around how long it will take for the Trump plans to be enacted, but it seems likely that it will be add fuel to an economy that is already at full-capacity with attendant inflation risks.

Divergence of monetary policy likely to remain

Elsewhere there are few if any signs that other central banks are gearing up to act in the way the Fed is, which is likely to mean that the US-G10 2-year interest rate spread is likely to widen further in the dollar's favour over the course of the year.

The ECB is the other central bank with scrutiny on it in view of the rise in headline inflation in the Eurozone to 2.0% in February. Previous communications from the ECB have indicated a willingness to look through such a rise, as core inflation still at 0.9% signifies that inflationary pressures are mostly due to energy prices, and are thereby likely to be transitory. However, this will not stop attention being on the upcoming ECB meeting this week to see if any of Draghi's previous language is moderated. There will undoubtedly be pressure on him to explain why the asset purchase program remains so large at EUR780bn per year and why he is pledging to continue making such purchases through the rest of the year.

In particular with German inflation standing at 2.2% the Bundesbank is expected to increase the pressure on Draghi to slow the program down. We suspect that Draghi will remain resistant to such pressure which could result in the EUR turning lower again, once the press conference is out of the way. French political developments are unlikely to help much either with uncertainty over the centre-right candidate Francois Fillon helping to keep the extreme right Front National very much in the race.

Brexit woes continue to weigh down the pound

Brexit related uncertainties are continuing to bedevil sterling which sunk below 1.23 against the dollar and fell against the Euro after the UK House of Lords amended the government's Brexit plan. This is unlikely to interfere with the government's March 31st Deadline for triggering article 50, but market uncertainties about the economic fallout are likely to see GBP continue to struggle for a while. The UK's Markit/CIPS services sector PMI slipped to 53.3 in February, adding to the impression that the economy has lost a little momentum in Q1. Industrial production data to be released this week may have fallen back a little as well after a strong December reading, but trade balance data should show that the external sector is improving in the wake of the pound's post-Brexit drop.

USDJPY to be guided by pace of Fed hikes

As we have highlighted on a number of occasions USDJPY's fortunes are closely tied to the prospect for US interest rates, so it is no surprise that the pricing in on a March Fed rate hike has given it a lift, taking it to 114 currently from 111.75 a week ago. The question now, however, is how much further it can rally now that a Fed tightening is virtually fully priced in. What may make a difference is if the markets begin to discount more than two interest rate rises this year, something that has not yet happened. Our sense is that this is probably where the markets are heading, although this development may have to wait until after the jobs data are released at the end of the week. That being the case we still see upside risks in USDJPY but it may still take a little more time for them to properly materialize. To the extent that domestic Japanese news makes a difference this week, Q4 GDP is expected to be updated with the risk being that it sees a small upward revision to 1.5% q/q pace from 1.0% previously

RBA to guide AUD lower

An RBA meeting on Tuesday is probably the highlight of the week for the AUD, but it already stood out last week as one of the currencies most hurt by the stronger dollar, as well as by a correction in commodity prices, dropping by 1.04%. The key question from the RBA meeting is not whether the RBA changes policy, as it probably will not, but how dovish it is in its accompanying statement. As we have not quite given up on a further cut in interest rates, we suspect that the RBA will leave itself room for maneuver to ease policy going forward should they wish, which will in turn continue to lean on the AUD.

NZD declines in line with outlook

The NZD also lost significant ground last week, [in line with our outlook a fortnight ago](#), seeing the biggest drop over the week as a whole, -2.48%. Other commodity currencies were also in the firing line including the CAD which was further undermined by the relative 'dovishness' of the Bank of Canada at its 1 March meeting as it emphasized its cautious approach to growth, in contrast to the more hawkish rhetoric from the Fed. The threat of a renegotiation of NAFTA by US President Trump is also a concern, although it is unlikely if such a revision would be aimed at Canada, more likely having Mexico in the frame. However, even here a more conciliatory line is beginning to be observable from the US with US Commerce Secretary Wilbur Ross last week talking about ways of helping Mexico with its volatile currency, even positing the possibility of the US offering credit lines to Mexico. USDMXN fell sharply at the end of last week, falling below its 200-day moving average, even as Mexico denied that credit lines were even being sought.

FX Forecasts

FX Forecasts - Major						Forwards		
	3-Mar	Q1 2017	Q2 2017	Q3 2017	Q4 2017	3m	6m	12m
EUR	1.0622	1.0500	1.0200	1.0000	1.0000	1.0667	1.0719	1.0837
JPY	114.04	116.00	120.00	122.00	124.00	113.59	113.05	111.83
CHF	1.0079	1.0300	1.0500	1.1000	1.1000	1.0025	0.9963	0.9829
GBP	1.2291	1.2200	1.1800	1.2500	1.3500	1.2318	1.2351	1.2430
AUD	0.7596	0.7300	0.7200	0.7000	0.7000	0.7582	0.7571	0.7553
NZD	0.7031	0.6900	0.6700	0.6500	0.6700	0.7013	0.6998	0.6971
CAD	1.3380	1.3500	1.3400	1.3200	1.3000	1.3366	1.3347	1.3302
EURGBP	0.8632	0.8607	0.8644	0.8000	0.7407	0.8650	0.8669	0.8708
EURJPY	121.13	121.80	118.32	120.00	122.00	121.13	121.13	121.13
EURCHF	1.0702	1.0815	1.0710	1.1000	1.1000	1.0690	1.0676	1.0648

FX Forecasts - Emerging						Forwards		
	3-Mar	Q1 2017	Q2 2017	Q3 2017	Q4 2017	3m	6m	12m
SAR	3.7503	3.7500	3.7500	3.7500	3.7500	3.7516	3.7553	3.7703
AED	3.6727	3.6700	3.6700	3.6700	3.6700	3.6750	3.6770	--
KWD	0.3058	0.2900	0.2900	0.2900	0.3000	0.3060	0.3073	--
OMR	0.3850	0.3800	0.3800	0.3800	0.3800	0.3862	0.3880	0.3927
BHD	0.3770	0.3760	0.3760	0.3760	0.3760	0.3774	0.3776	0.3785
QAR	3.6415	3.6400	3.6400	3.6400	3.6400	3.6448	3.6488	3.6598
EPN	16.1480	18.0000	18.5000	18.7500	19.0000	16.8150	17.9700	18.4000
INR	66.805	68.000	66.000	65.000	65.000	67.3500	68.1300	69.6600
CNY	6.9040	7.0000	7.1000	7.2000	7.4000	6.9630	7.0210	7.1290

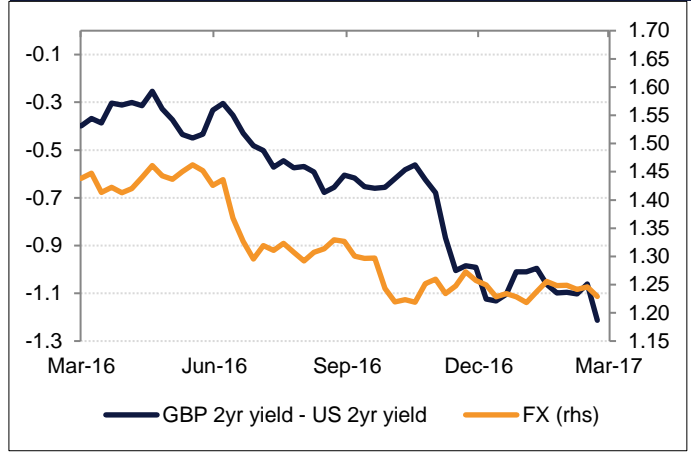
Source: Bloomberg, Emirates NBD Research
 *Denotes USD peg

Major FX and Nominal Interest Rates

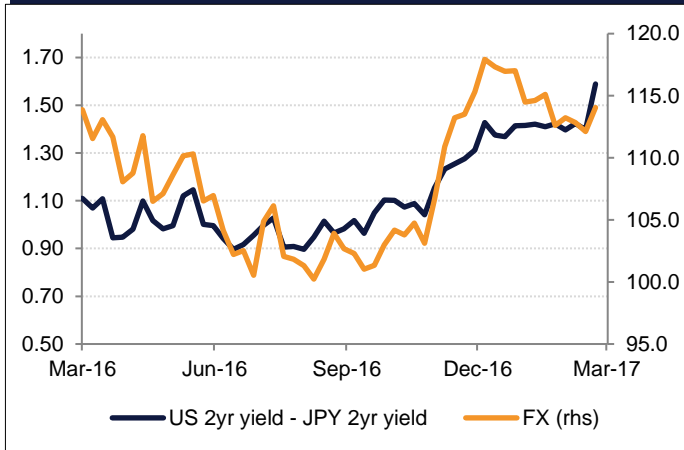
Interest Rate Differentials - EUR



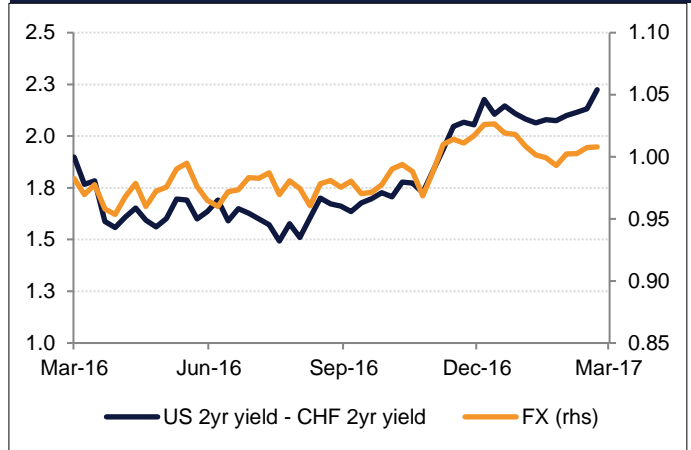
Interest Rate Differentials - GBP



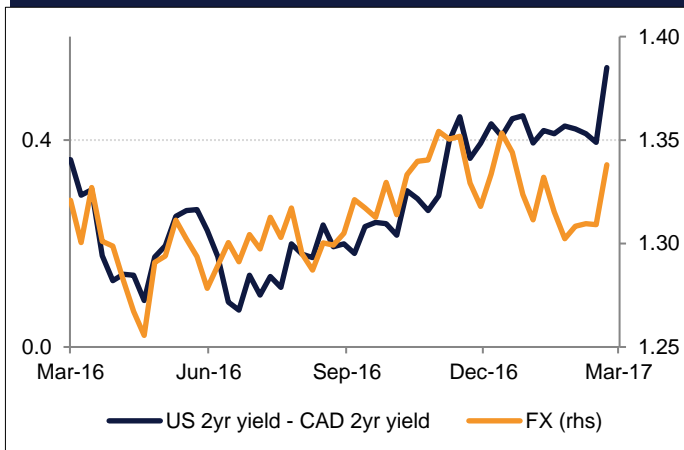
Interest Rate Differentials - JPY



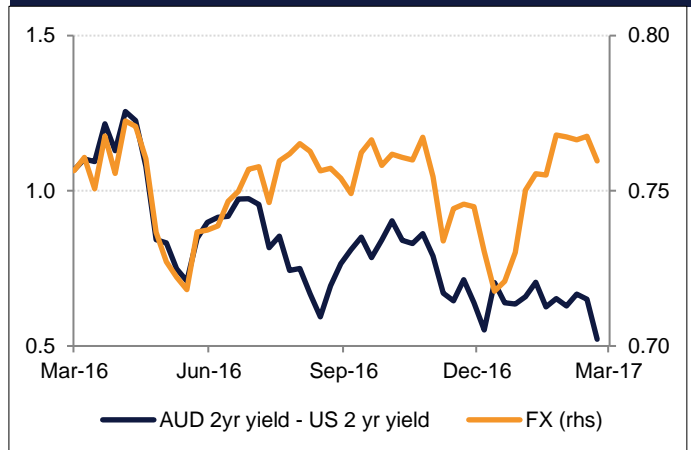
Interest Rate Differentials - CHF



Interest Rate Differentials - CAD

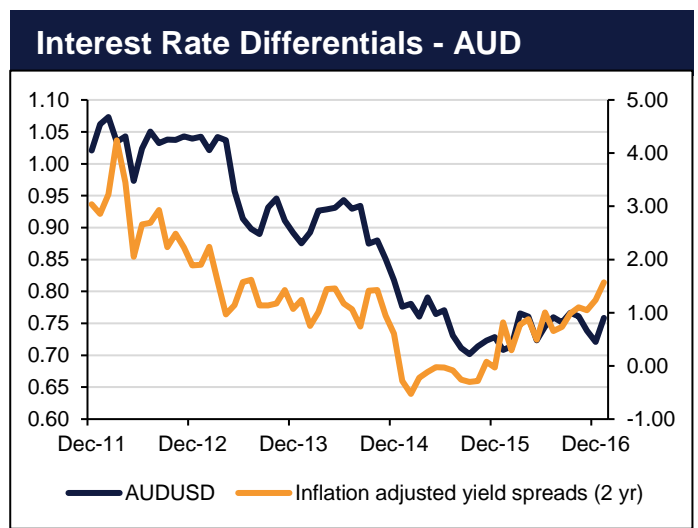
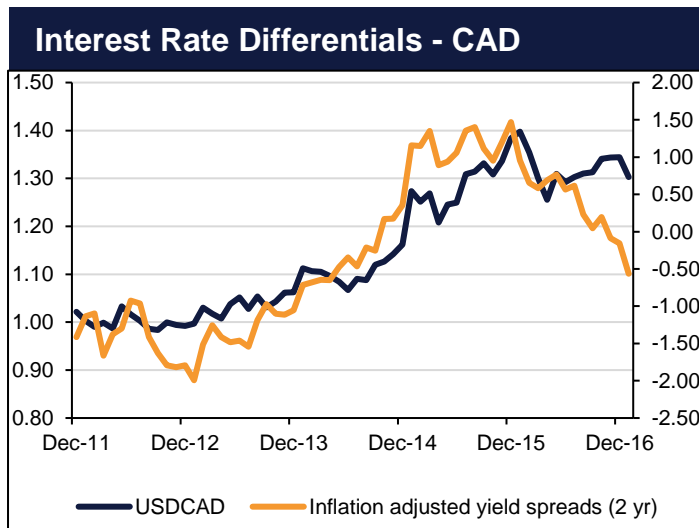
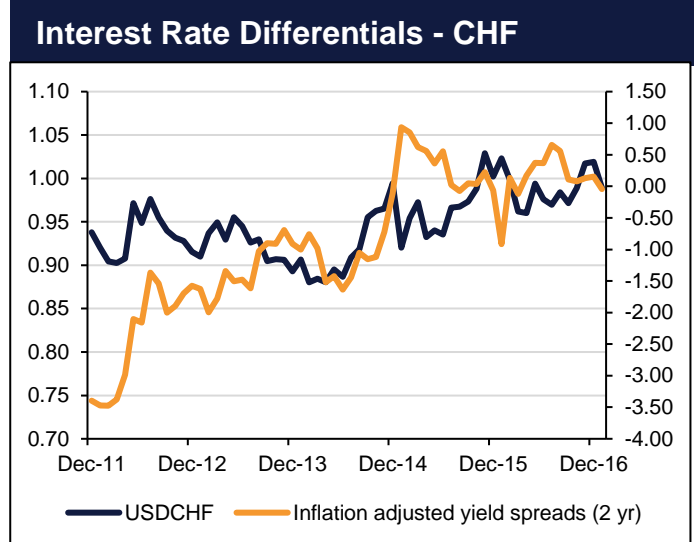
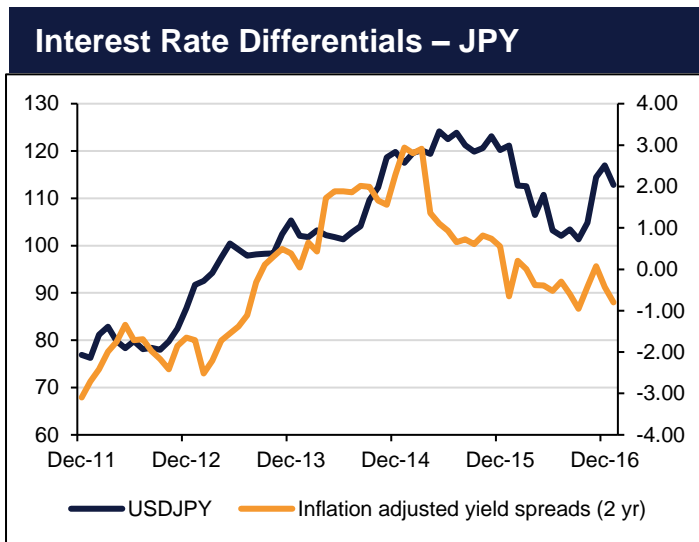
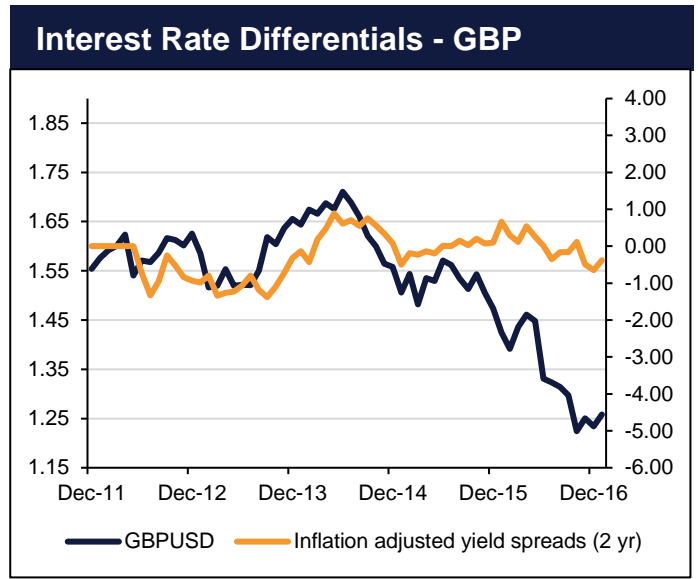
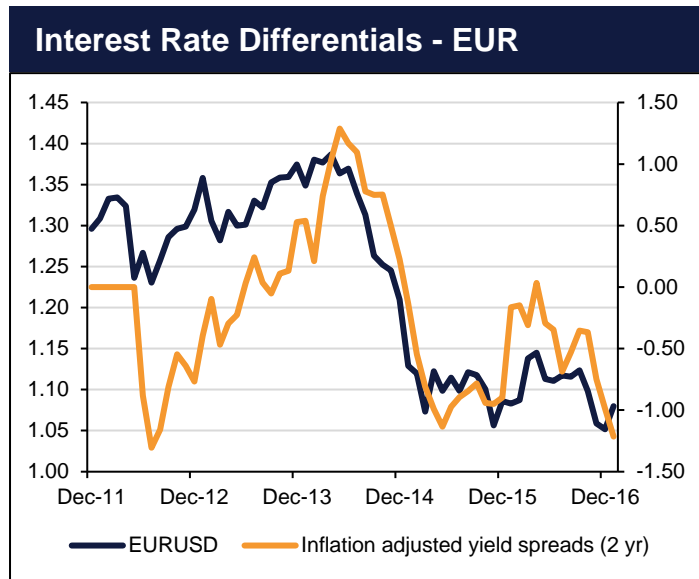


Interest Rate Differentials - AUD



Source: Bloomberg, Emirates NBD Research

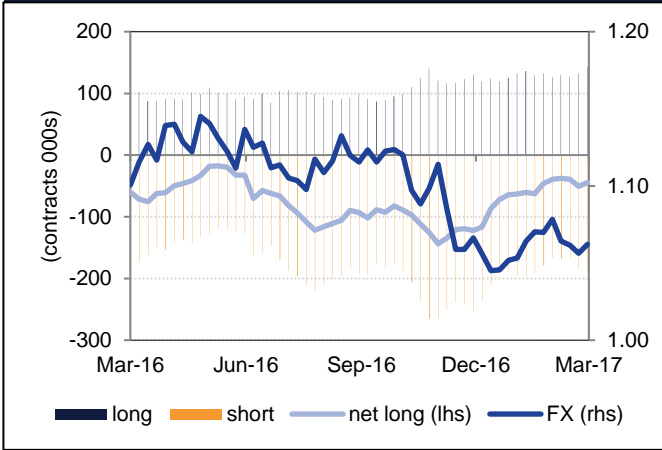
Major FX and Real Interest Rates



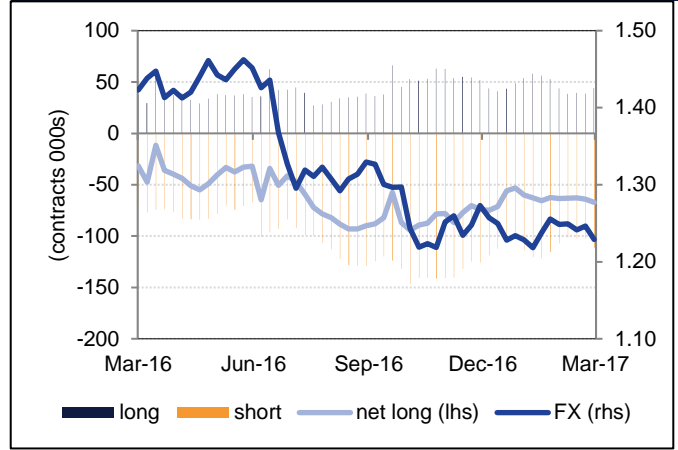
Source: Bloomberg, Emirates NBD Research

Major Currency Positions

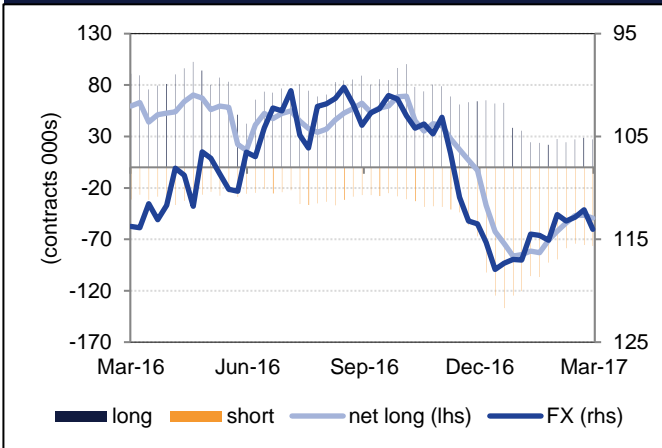
CFTC – Speculative Positions - EUR



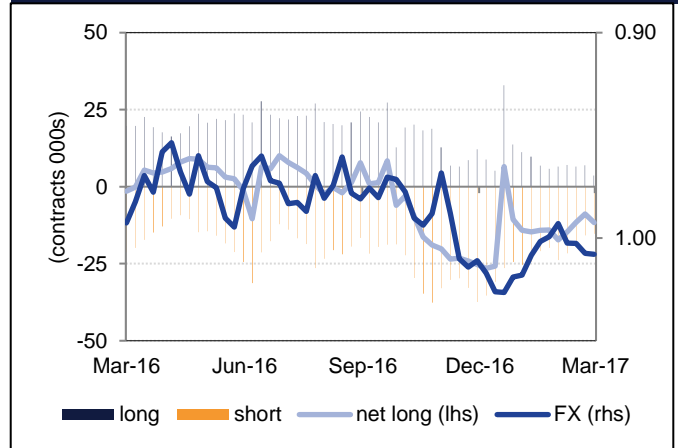
CFTC – Speculative Positions - GBP



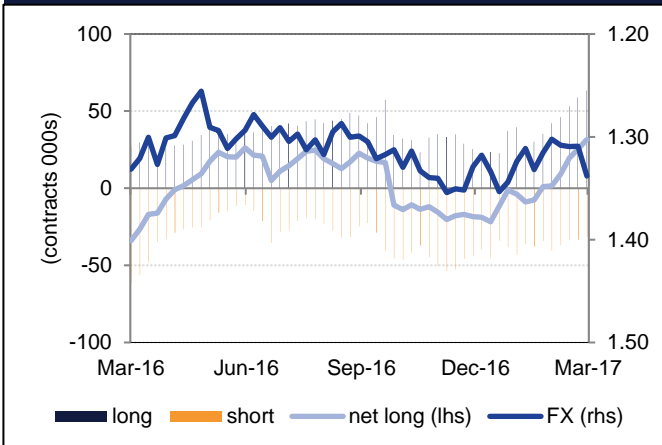
CFTC – Speculative Positions - JPY



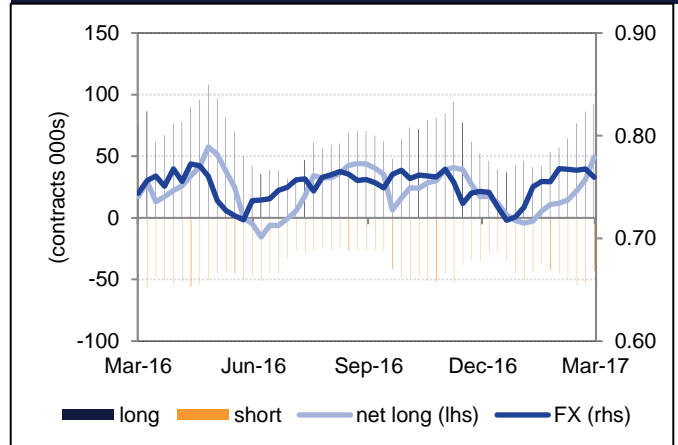
CFTC – Speculative Positions - CHF



CFTC – Speculative Positions - CAD



CFTC – Speculative Positions - AUD



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