Eurozone - FX

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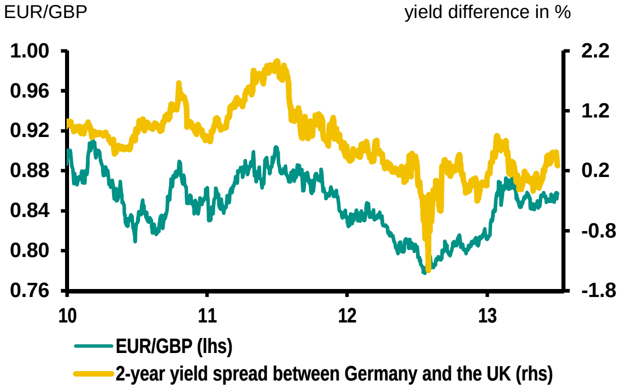
EUR/GBP

Sterling and interest rate differentials

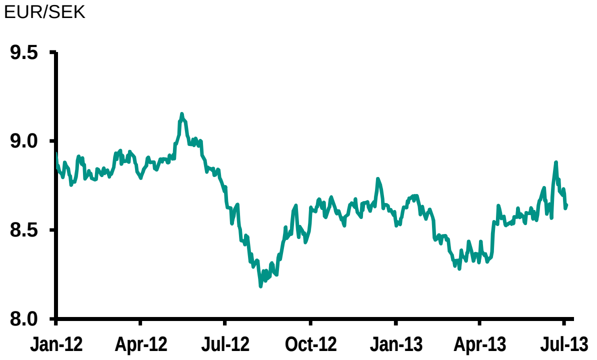


Source: Thomson Reuters Datastream

The MPC decided to keep policy unchanged in what was Mark Carney's debut meeting as Governor. However, the Committee struck a relatively dovish tone in the statement and sent a strong signal to financial markets that expectations of higher rates were 'not warranted'. In addition, although recent data had been in line with its base scenario, the significant rise in market interest rates would 'weigh on the outlook'. The comments led to a sharp scaling back of market rate expectations and weighed on sterling. EUR/GBP rallied from 0.852 to 0.864 immediately after the meeting, but fell back somewhat thereafter, as the ECB also sounded dovish. We expect the Bank Rate to remain on hold this year and next, but given that the economy has recently showed convincing signs of acceleration, while inflation is above target, we think the balance of risks is still tilted towards an earlier move despite the MPC's dovish communication. The modest appreciation path of the sterling that we forecast is based on this view.

EUR/SEK

Swedish krona against the euro



Source: Bloomberg

The Riksbank left its main policy rate unchanged at 1% and stated in its latest monetary policy rapport, that economic growth was higher than originally estimated in the first quarter, driven by strong growth in consumption and a return of household confidence. Exports are still weak, but orders had increased. Both employment and the labour force are increasing, but there has been a slower growth in wages this year compared to last year. Inflation is still low and inflation expectations are well anchored in the long term. But the household indebtedness is monitored. The assessment is that the real value of the krona is now in the weaker part of a reasonable long-term interval and it will therefore probably strengthen somewhat in the coming years. The Riksbank's forecast of the repo rate show no hikes until Q3 2014 and a 100bp rate hike between Q3 2014 and Q3 2015. We think the Riksbank is too optimistic on interest rates and we continue to expect a 25bp hike around the end of this year.

EUR/CHF

Swiss franc against the dollar

Source: Bloomberg

The Swiss National Bank reported foreign currency reserves of 434.9bn CHF (436bn expected) for the month of June and revised up the May level to 444.1bn from 441.4 bn. Weakness in the euro following the dovish ECB was not being felt in EUR/CHF. Instead the Swiss franc fell under heavy pressure versus the USD. This reaction signals that the dovish comments from both BoE and ECB triggered a realization that the US Federal Reserve will be the first major central bank to start its tightening cycle (at the start of 2015) and this was a major support for the USD across the board, including versus CHF. Last week, Swiss CPI came in higher-than-expected at -0.1% yoy (-0.4% expected). This signals that the deflationary pressures are easing, but we think it is too early to call victory and to stop capping the Swiss franc. We expect the CHF to weaken this year, as it will resume its role as a funding currency in carry trades.

Asia - FX

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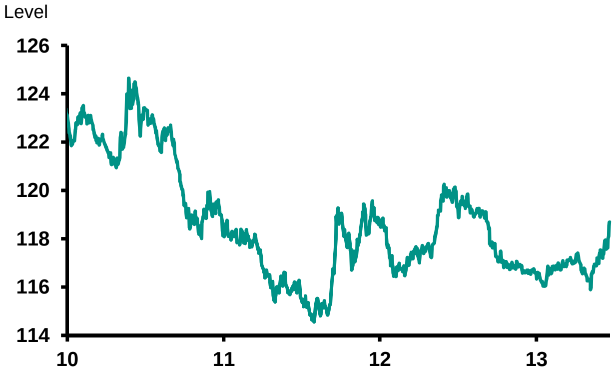
IDR and CNY

Asian currencies eased lower last week due to weak data releases and weaker Japanese yen (see below). The Indian rupee (INR) eased below 60 against the USD after the service sector PMI declined from 53.6 to 51.7. Higher oil prices also weighed on the INR. The weak INR will no doubt complicate the government's and central bank's efforts to lower inflation and narrow the current account deficit. The weak sentiment in the Indonesian rupiah paused due to fears that the central bank will intervene in the market to defend the currency, and that interest rates will be hiked this week due to rising inflationary pressures. On the bright side, the Chinese yuan (CNY) was fixed stronger against the USD despite data out of China reflecting a slower pace of expansion. The decline in the 7 day repo rate, which reflects improving funding availability, also supported the CNY. Looking ahead, we expect a pick-up in global growth to support risk appetite in Asian currencies later this year.

Asia dollar index

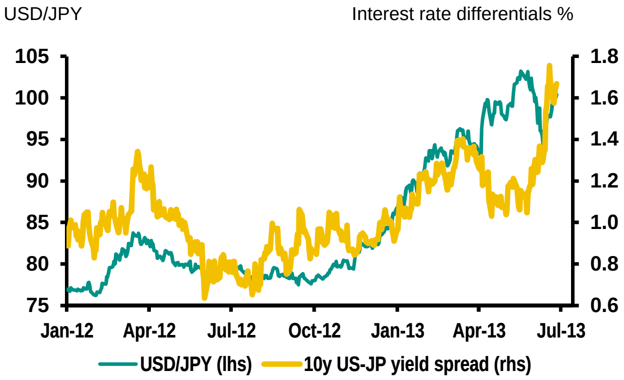


Source: ABN AMRO Group Economics

JPY

The yen extended its decline against the USD for the third consecutive week, due to widening interest rate differentials between the US and Japan. Market concerns surrounding Egypt, Portugal and Greece supported the yen only temporarily supported the yen. Meanwhile, the BoJ struck a relatively dovish tone. Governor Kuroda said that monetary easing is having a positive impact on the economy which is recovering smoothly. Kuroda also reiterated the BoJ's commitment in achieving the 2% inflation target by stating that the BoJ will continue to ease until the 2% inflation growth is stable. Indeed, we think it is likely that the BoJ will step up its asset purchase program later this year and this should further fuel weakness in the yen towards our year-end target of 110 against the USD. The BoJ is expected to leave monetary policy unchanged this week.

Yen against the dollar and rate differentials



Source: Bloomberg

Commodity exporters - FX

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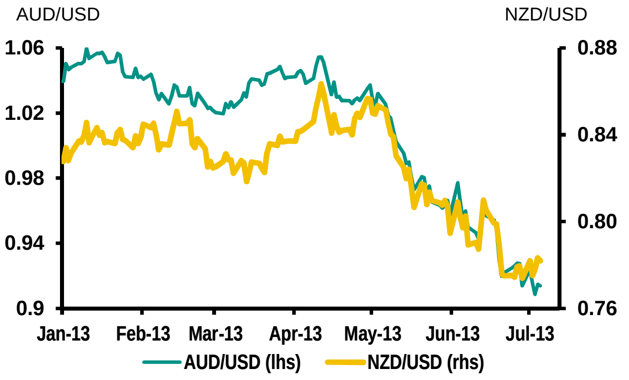
AUD/NZD

The AUD appreciated to 0.925 against the USD ahead of the RBA monetary policy decision, due to unwinding of extreme short positions in the AUD. However, the bears set in again after the RBA maintained its monetary easing bias and noted that further declines in the exchange rate is likely, despite its recent fall. We believe that the decision to leave the cash rate unchanged was a close call. The AUD extended its decline the following day, after RBA governor Stevens said that the economy would probably get a lower exchange rate, if needed. Data releases last week were mixed and did not change our view that a lower cash rate is needed to rebalance the economy. We expect the RBA to cut rates by 25bp next month, with the AUD expected to decline towards 0.90 in the coming months. The NZD was relatively stable given the lack of major domestic data releases. Looking ahead, we remain comfortable with our Q3 AUD/USD and NZD/USD forecasts of 0.90 and 0.76.

AUD/USD and NZD/USD

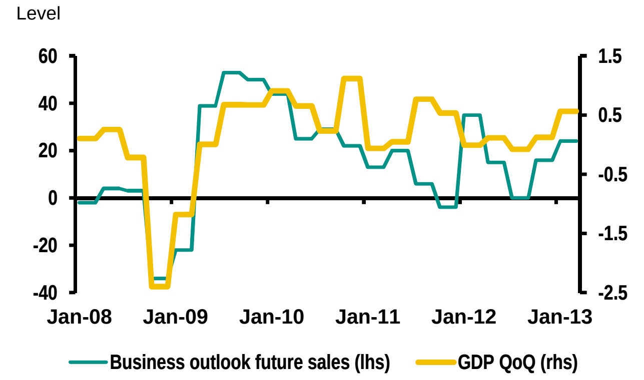


Source: Bloomberg, ABN AMRO

USD/CAD

Early last week, there was a lack of direction in USD/CAD, which traded around 1.05. The CAD received some support from higher oil prices and a narrower trade deficit. But the CAD fell under pressure versus the USD after the stronger-than-expected US employment report and weaker-than-expected Ivey purchasing manufacturing index. USD/CAD moved temporarily above 1.06. This week, the Bank of Canada's business outlook survey will give further insight on businesses' future sales growth outlook. As shown in the graph on the left, businesses have been increasingly more optimistic, which adds to the evidence that economic growth is likely to pick up later this year. The CAD should also do relatively well when US growth improves in the second half of this year, which is part of our main economic scenario. As a result, speculative short positions in the CAD are likely to be unwound and this should support the CAD's rise against the USD towards 1.0 later this year.

Business outlook future sales and GDP QoQ

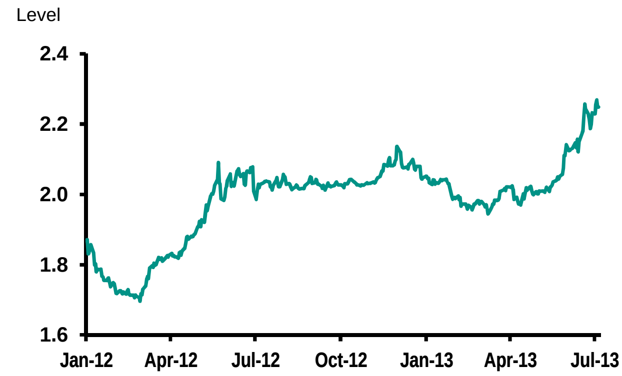


Source: Bloomberg

USD/BRL

Last week, the Brazilian real (BRL) remained under pressure. Weaker-than-expected industrial production data further eroded the already negative sentiment. The BRL was not able to recover on the back of some improvement in sentiment following the successful effort by central bankers around the globe to talk down interest rates. The central bank of Brazil intervened in currency markets last week to stem the fall of the BRL. They will probably return if the BRL were to remain under pressure. The fall in the BRL complicates the inflation outlook for the central bank, which will decide on monetary policy this week. Market consensus is for a 50bp rate hike to 8.5%. Inflation data and retail sales are also in focus. Higher inflation numbers and lower retail sales combined with strong US data will keep the uptrend in USD/BRL in place for now. But we expect some recovery of the BRL later this year, driven by an improvement of the growth/inflation mix and an improvement in sentiment.

USD/BRL



Source: Bloomberg