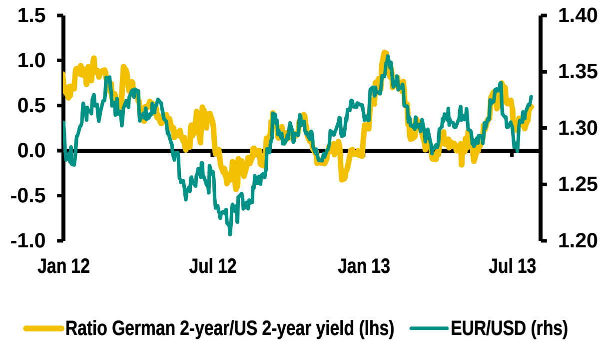
EUR/USD & other European FX

Georgette Boele, tel: +31 20 629 7789

EUR/USD

EUR/USD

Ratio Germany/US 2 yr yield level



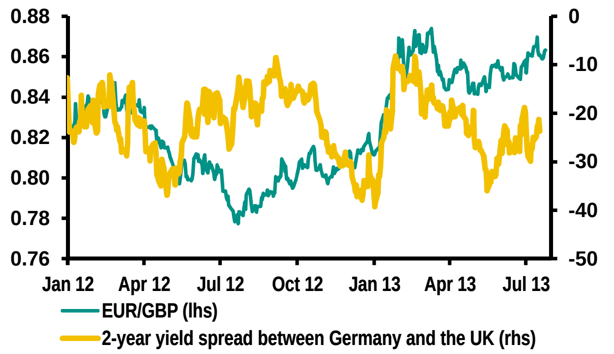
Source: Bloomberg

Last week, EUR/USD continued to move higher. Eurozone data such as the PMIs and German Ifo came in above expectations and pushed up German yields faster than US yields. The euro is very sensitive to interest rate expectations. So, if eurozone yields rise quicker than US yields, EUR/USD moves higher. Moreover, an article in the WSJ that the Fed may adjust its forward guidance was perceived by the market as dovish, and as a result the USD came under pressure. This week will be a very important week with the Fed and ECB both deciding on monetary policy. The market has already sharply adjusted its expectations on the Fed. So we believe that it is unlikely that the USD will face more headwinds, barring that the Fed will signal that a tapering will not be done this year. After the dovish remarks of the ECB at the previous meeting, it will unlikely live up to expectations this time in particular after the recent stronger eurozone data. Meanwhile, crucial US data such as the employment report will be released. Stronger US data are needed to start the USD rally, which we expect to see in H2

GBP

EUR/GBP, 2-year yield spread Germany-UK

Level 2-year yield spread, in bp



Source: Bloomberg

At the start of the week, positive momentum in the GBP versus the euro continued until eurozone data came in above market consensus. Then, EUR/GBP bottomed out around 0.8580 and started to move higher again. The rise in German yields (at a stronger pace than UK yields) was the main reason behind the euro strength. As a result, the euro rose modestly versus the pound during the week. This week manufacturing and housing data will be released. Better UK numbers should support sterling because of more signs that the UK economy is recovering. The Bank of England also decides on monetary policy this week. With the arrival of Mark Carney three things are clear. The MPC will be more aligned, there will be more emphasis on forward guidance, and a lower likelihood of further easing. This should be supportive for the GBP. In the end, we believe that a stronger UK economy will force the BoE to start hiking interest rates well in advance of what the market is currently anticipating, which explains why we expect the GBP to strengthen.

SEK/NOK

EUR/SEK

Level

Source: Bloomberg

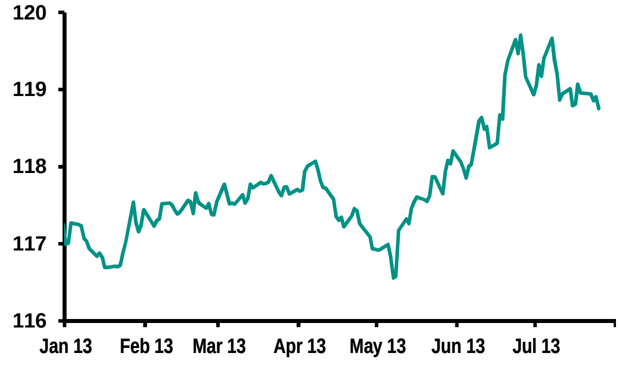
Last week, both EUR/SEK and EUR/NOK moved sideways, but there were some movements during the week. At the start of the week both Swedish krona (SEK) and Norwegian krone (NOK) strengthened versus the euro. But these moves reversed once eurozone data came in above expectations and German yields started to move higher. As a result, EUR/SEK and EUR/NOK rose to levels seen at the end of the previous week. This week Swedish retail sales, GDP and PMI manufacturing are due. Higher-than-expected numbers in an environment of positive investor sentiment should push EUR/SEK towards 8.5 again. This week, there is, however, a lack of Norwegian data. So, EUR/NOK is likely to be more driven by overall euro sentiment and movements in oil prices.

Asia - FX

Roy Wellington Teo, tel. +65 65 978 616

USD/Asia currency index

Level, higher level means Asian currencies depreciating vs the USD



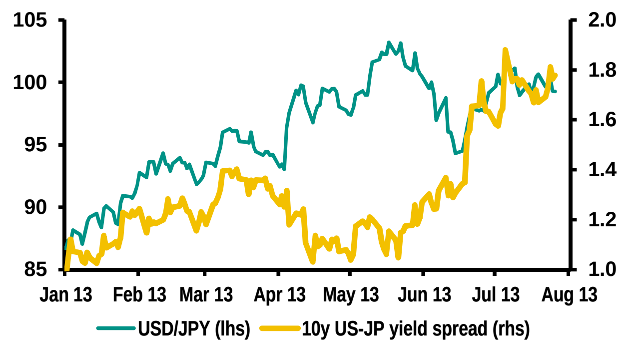
Source: ABN AMRO Group Economics

Asian currencies

Asian currencies edged higher last week due to a weaker USD and expectations that Chinese authorities will stabilise growth if economic data continue to deteriorate. The Chinese yuan (CNY) edged higher after the government announced measures to support growth and officials stated that they will try to keep the exchange rate stable at a reasonable and balanced level. The Indian rupee rose 1% due to measures by the central bank to reduce liquidity and curb speculation in the currency. The South Korean won also gained by more than 0.5% after economic growth in the second quarter came in better than expected. The central bank also retains an optimistic view on growth in the second half of this year. However, the Indonesian rupiah (IDR) extended its loss after the central bank said that the currency weakness is still in line with economic fundamentals. Looking ahead, we expect a pickup in global growth later this year to be supportive for Asian currencies.

USD/JPY and 10y US-JP interest rate differentials

USD/JPY   Interest rate differentials %



Source: Bloomberg

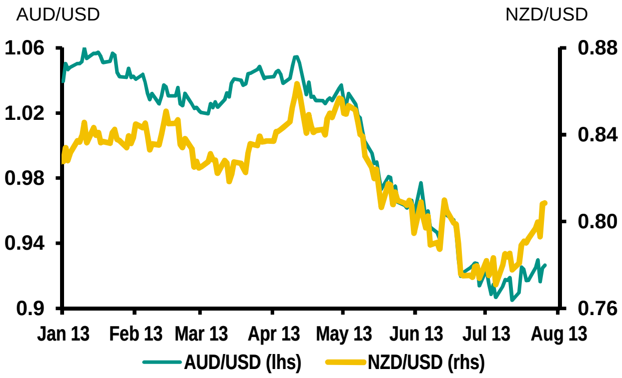
JPY

The yen strengthened during the week. In the beginning of the week, stronger US data resulted in a wider interest rate differential, which pushed USD/JPY above 100. However, an article in the Wall Street Journal led to market speculation that the Fed may adjust its forward guidance. This led to dollar weakness versus the yen, and as a result USD/JPY fell to 98.25 at the end of the week. This week, the FOMC rate decision and US data releases are likely to be the dominant drivers for USD/JPY. In the last two weeks, the options market has adjusted its expectations for USD/JPY, positioning for a lower likelihood of JPY strength. We remain comfortable with our view that the yen is likely to decline towards 110 against the USD as the BoJ will keep monetary policy ultra-accommodative for longer than the Fed, which should help to fuel carry trades. Indeed, Japanese investors were net buyers of foreign bonds for the third consecutive week ending 19 July.

Commodity exporters

Roy Wellington Teo, tel. +65 65 978 616
Georgette Boele, tel: +31 20 629 7789

AUD/USD and NZD/USD

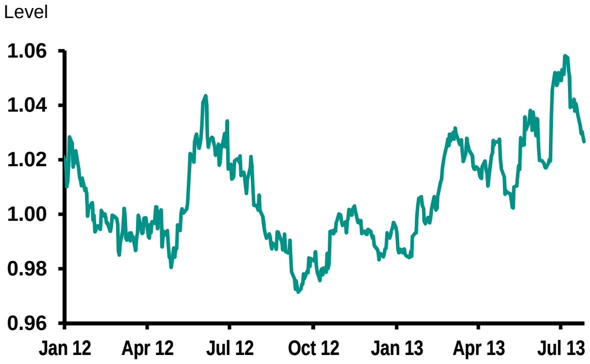


Source: Bloomberg

AUD/NZD

The RBA's preferred measure of inflation accelerated in Q2 from previous quarter. This triggered a short term rally in the AUD to above 0.93 against the USD as the market priced in a lower probability of a near-term rate cut. General weakness in the USD and easing fears of a hard landing in China also supported the AUD. We do not believe, though, that the inflation print is sufficient to delay a rate cut next month, as inflation remains in the lower half of the RBA's 2-3% target. In addition, economic data releases since the last monetary policy meeting continue to reflect a slower than desired rebound in the non-mining sectors. As a result, we stick to our 25bp rate cut view in August and expect the AUD to decline towards our Q3 target of 0.90. Meanwhile, the NZD was supported after the RBNZ was more positive on the economy and less concerned about the strength of the NZD. We believe that pressure on commodity prices and a higher USD will result in NZD/USD moving towards our Q3 forecast of 0.76.

USD/CAD



Source: Bloomberg

USD/CAD

The positive momentum in the CAD extended last week as the stronger-than-expected rebound in retail sales added to a string of positive data releases in the previous week. As a result, the risk has increased that economic growth in May might rebound at a stronger pace than market expectations of 0.2% mom rise. The strength in the CAD against the USD, however, stalled close to 1.0250 due to positive US data releases and a decline in WTI oil prices. Although volatility in the CAD declined after Fed Chairman Bernanke calmed markets' nerves two weeks ago, volatility expectations in the coming week have increased due to important data releases in the US. A stronger-than-expected US GDP and nonfarm payrolls is likely to support the USD against the CAD. However, given that Canadian exports to the US as a percentage of GDP is 20%, a stronger US economy is also beneficial to the Canadian economy and this should support the CAD later this year.

USD/BRL

Source: Bloomberg

USD/BRL

At the start of the week, the Brazilian real (BRL) recovered and USD/BRL moved towards 2.21. Since then the pair has moved higher, back above 2.25. This reflected that inflation data came in somewhat lower that expected, while the unemployment rate unexpectedly rose to 6.0% from 5.8%. In addition to data releases, higher US yields were another major driver that halted the recovery in most emerging market currencies, including the BRL. Markets expecting that the first rate hike of the Fed will even have to wait for longer and interventions in the FX market prevented the BRL from sliding much lower, though. Weaker domestic data this week and higher US yields will continue to keep the BRL under pressure in the near-term. However, later this year, we expect sentiment of the BRL to improve due to increased confidence about the COPOM's inflation fighting credentials and an improvement in the growth/inflation mix. We therefore keep our end of year forecast at 2.15.