

G10 FX Weekly

Ripples of China FX move

Group Economics
Macro & Financial Markets Research

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- **China FX move has weighed on the USD, but USD weakness will be temporary in our view**
- **Commodity currencies were sold off but recovered afterwards...**
- **...however we remain negative on Australian dollar and New Zealand dollar**
- **We expect more yen weakness ahead**

China FX move has weighed on the US dollar

China's FX regime shift (see our EM FX Weekly) has negatively impacted the US dollar. There are two reasons for this. First, as recent episodes of deterioration in investor sentiment have shown, the US dollar is negatively affected because it is mainly driven by cyclical forces such as the state of the US economy and Fed rate hike expectations. Second, financial markets have slightly scaled back expectations about a possible rate hike in September because of concerns about China. We do not share this view. Chinese authorities are working hard to support the economy, which is logical. We expect ongoing strength in the US labour market to trigger a Fed rate hike in September. Currently, money market futures have not even fully priced in one rate hike. We expect two rate hikes this year. This, and the upward adjustment in interest rate expectations for 2016 should give a strong boost to the US dollar this year. We expect EUR/USD to test parity in the coming months mainly because of the monetary policy divergence between the US and eurozone.

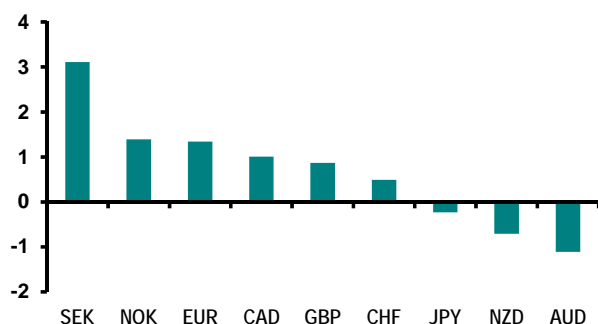
weaker yuan will also reduce China's purchasing power for commodities. However, sentiment improved and commodity currencies recovered as Chinese authorities seek to calm market volatility in the yuan. Furthermore, market speculation has increased that the Fed may delay raising interest rates if the US dollar strengthens further and worries on China's growth lingers. Separately the Reserve Bank of Australia (RBA) was more sanguine on the depreciation in the yuan. RBA deputy governor Lowe said that if the yuan depreciation reflects genuine reform and would support China's economy, Australia may benefit from a stronger China in the long term. We remain negative on the Australian dollar and New Zealand dollar going forward mainly because of growth and monetary policy divergence relative to the US.

Japan economy to contract in the second quarter

Next week, Japan's second quarter GDP preliminary estimate will be released. The economy is widely expected to contract 1.8% qoq s.a. after a 3.9% expansion in the first quarter. Indeed, this reinforces our view that the Bank of Japan's (BoJ) 2% inflation target by the first half of Fiscal year 2016 is too ambitious. We maintain our view that the BoJ is likely to step up monetary stimulus early 2016. We maintain our year end USD/JPY target of 128.

Performance this week

Performance in %, with USD as base



Source: Bloomberg

Commodity currencies sell off before recovery

The sharp decline in the Chinese yuan earlier this week triggered a selloff in commodity currencies. This is due to market fears that the devaluation in the yuan is a signal that the Chinese economy is weaker than economic data imply. A

ABN AMRO major currency forecasts

	13-Aug	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016
EUR/USD	1.1136	1.00	1.00	1.05	1.05	1.10	1.15
USD/JPY	124.48	125	128	130	135	135	135
EUR/JPY	138.62	125	128	137	142	149	155
GBP/USD	1.5629	1.47	1.49	1.52	1.50	1.51	1.51
EUR/GBP	0.7125	0.68	0.67	0.69	0.70	0.73	0.76
USD/CHF	0.9778	1.05	1.05	1.00	1.00	0.95	0.96
EUR/CHF	1.0889	1.05	1.05	1.05	1.05	1.05	1.10
AUD/USD	0.7370	0.72	0.70	0.69	0.67	0.65	0.64
NZD/USD	0.6614	0.65	0.63	0.62	0.60	0.59	0.58
USD/CAD	1.2979	1.34	1.36	1.38	1.41	1.43	1.45
EUR/SEK	9.5896	9.50	9.50	9.50	9.50	9.50	9.50
EUR/NOK	9.0937	9.00	8.50	8.50	8.25	8.00	8.00
EUR/DKK	7.4631	7.46	7.46	7.46	7.46	7.46	7.46

Source: ABN AMRO Group Economics

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